

ULTRALIFE CORP  
Form 10-Q  
November 08, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2013

or

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

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

Commission File Number 000-20852

ULTRALIFE CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

16-1387013  
(I.R.S. Employer Identification No.)

2000 Technology Parkway, Newark, New York 14513  
(Address of principal executive offices)  
(Zip Code)

(315) 332-7100  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes..X... 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes..X... No.....

Edgar Filing: ULTRALIFE CORP - Form 10-Q

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ..... Accelerated filer ..... Non-accelerated filer ..... Smaller reporting company..X..

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Common stock, \$.10 par value – 17,474,249 shares of common stock outstanding, net of 1,372,757 treasury shares, as of November 1, 2013.

ULTRALIFE CORPORATION  
INDEX

PART I FINANCIAL INFORMATION	Page	
<u>Item 1.</u>	<u>Financial Statements</u>	
	<u>Condensed Consolidated Balance Sheets - September 29, 2013 (Unaudited) and December 31, 2012</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited) - Three month and nine month periods ended September 29, 2013 and September 30, 2012</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Cash Flows (Unaudited) - Nine month periods ended September 29, 2013 and September 30, 2012</u>	<u>5</u>
	<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>26</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>37</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>37</u>
PART II OTHER INFORMATION		
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>38</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>38</u>
<u>Signatures</u>		<u>39</u>
<u>Index to Exhibits</u>		<u>40</u>

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

ULTRALIFE CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollars in Thousands, Except Per Share Amounts)

ASSETS	(Unaudited) September 29, 2013	December 31, 2012
Current assets:		
Cash and cash equivalents	\$ 10,365	\$ 9,656
Restricted cash	420	422
Trade accounts receivable (less allowance for doubtful accounts of \$295 at September 29, 2013 and \$322 at December 31, 2012)	15,571	20,913
Inventories	27,829	30,370
Due from insurance company	427	723
Deferred tax asset - current	157	120
Income taxes receivable	120	28
Prepaid expenses and other current assets	1,251	1,590
<b>Total current assets</b>	<b>56,140</b>	<b>63,822</b>
Property, plant and equipment, net	10,836	12,415
Other assets:		
Goodwill	16,405	16,344
Intangible assets, net	4,745	5,039
Security deposits and other long-term assets	549	98
	21,699	21,481
<b>Total Assets</b>	<b>\$ 88,675</b>	<b>\$ 97,718</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of debt	\$ -	\$ -
Accounts payable	6,057	11,357
Income taxes payable	2	2
Deferred tax liability - current	75	-
Other current liabilities	4,949	8,533
<b>Total current liabilities</b>	<b>11,083</b>	<b>19,892</b>
Long-term liabilities:		
Deferred tax liability - long-term	4,298	4,160
Other long-term liabilities	59	210

Edgar Filing: ULTRALIFE CORP - Form 10-Q

Total long-term liabilities	4,357	4,370
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Ultralife equity:		
Preferred stock, par value \$0.10 per share, authorized 1,000,000 shares; none issued or outstanding	-	-
Common stock, par value \$0.10 per share, authorized 40,000,000 shares; issued - 18,847,006 at September 29, 2013 and 18,828,734 at December 31, 2012	1,888	1,886
Capital in excess of par value	174,541	173,791
Accumulated other comprehensive loss	(567 )	(620 )
Accumulated deficit	(94,873 )	(93,878 )
	80,989	81,179
Less --Treasury stock, at cost -- 1,372,757 shares at September 29, 2013 and 1,372,757 shares at December 31, 2012	7,658	7,658
Total Ultralife equity	73,331	73,521
Noncontrolling interest	(96 )	(65 )
Total shareholders' equity	73,235	73,456
Total Liabilities and Shareholders' Equity	\$ 88,675	\$ 97,718

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

ULTRALIFE CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(In Thousands, Except Per Share Amounts)  
(unaudited)

	Three Month Periods Ended		Nine Month Periods Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Revenues	\$ 20,361	\$ 26,181	\$ 58,659	\$ 72,388
Cost of products sold	14,234	17,962	41,631	53,109
Gross profit	6,127	8,219	17,028	19,279
Operating expenses:				
Research and development (including \$56, \$65, \$167 and \$195, respectively, of amortization of intangible assets)	1,418	1,596	4,456	5,706
Selling, general, and administrative (including \$46, \$57, \$134 and \$177, respectively, of amortization of intangible assets)	4,057	4,869	13,419	16,041
Total operating expenses	5,475	6,465	17,875	21,747
Operating income (loss)	652	1,754	(847 )	(2,468 )
Other income (expense):				
Interest income	13	1	27	4
Interest expense	(66 )	(97 )	(199 )	(316 )
Miscellaneous	(8 )	(15 )	(31 )	17
Income (loss) from continuing operations before income taxes	591	1,643	(1,050 )	(2,763 )
Income tax provision (benefit)-current	(19 )	120	42	387
Income tax provision-deferred	3	55	93	50
Total income tax provision (benefit)	(16 )	175	135	437
Net income (loss) from continuing operations	607	1,468	(1,185 )	(3,200 )
Discontinued operations:				
Income from discontinued operations, net of tax	15	200	159	178
Net income (loss)	622	1,668	(1,026 )	(3,022 )
Net loss attributable to noncontrolling interest	22	11	31	31
Net income (loss) attributable to Ultralife	\$ 644	\$ 1,679	\$ (995 )	\$ (2,991 )

Edgar Filing: ULTRALIFE CORP - Form 10-Q

Other comprehensive income (loss):				
Foreign currency translation adjustments	32	(204 )	53	(81 )
Comprehensive income (loss) loss attributable to Ultralife				
	\$ 676	\$ 1,475	\$ (942 )	\$ (3,072 )
Net income (loss) attributable to Ultralife common shareholders - basic				
Continuing operations	\$ 0.04	\$ 0.09	\$ (0.07 )	\$ (0.18 )
Discontinued operations	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01
Total	\$ 0.04	\$ 0.10	\$ (0.06 )	\$ (0.17 )
Net income (loss) attributable to Ultralife common shareholders - diluted				
Continuing operations	\$ 0.04	\$ 0.09	\$ (0.07 )	\$ (0.18 )
Discontinued operations	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01
Total	\$ 0.04	\$ 0.10	\$ (0.06 )	\$ (0.17 )
Weighted average shares outstanding - basic				
	17,467	17,418	17,461	17,390
Weighted average shares outstanding - diluted				
	17,532	17,418	17,461	17,390

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

ULTRALIFE CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in Thousands)  
(unaudited)

	Nine Month Periods Ended	
	September 29, 2013	September 30, 2012
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (1,026 )	\$ (3,022 )
Income from discontinued operations, net of tax	(159 )	(178 )
Adjustments to reconcile net loss from continuing operations to net cash provided from operating activities:		
Depreciation and amortization of financing fees	2,331	2,566
Amortization of intangible assets	301	372
Loss on long-lived asset impairment	56	13
Loss on long-lived asset disposal and write-offs	-	
Foreign exchange loss (gain)	33	(3 )
Non-cash stock-based compensation	740	1,001
Changes in deferred income taxes	170	74
Changes in operating assets and liabilities:		
Trade accounts receivable	5,380	3,265
Inventories	2,622	1,766
Due from insurance company	315	1,014
Income taxes receivable	(91 )	104
Prepaid expenses and other assets	(455 )	(39 )
Income taxes payable	-	(9 )
Accounts payable and other liabilities	(7,818 )	(5,020 )
Net cash provided from (used in) operating activities from continuing operations	2,399	1,904
Net cash used in operating activities from discontinued operations	(998 )	(2,133 )
Net cash provided from (used in) operating activities	1,401	(229 )
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(736 )	(2,011 )
Change in restricted cash	(2 )	(250 )
Net cash used in investing activities from continuing operations	(738 )	(2,261 )
Net cash provided from investing activities from discontinued operations	182	2,133
Net cash used in investing activities	(556 )	(128 )
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock	12	115
Net cash provided from financing activities from continuing operations	12	115
Net cash used in financing activities from discontinued operations	-	-
Net cash provided from financing activities	12	115
Effect of exchange rate changes on cash	(148 )	(119 )



Change in cash and cash equivalents	709	(361 )
Cash and cash equivalents at beginning of period	9,656	5,320
Cash and cash equivalents at end of period	\$ 10,365	\$ 4,959
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash paid for income taxes	\$ 77	\$ 291
Cash paid for interest	\$ 84	\$ 184

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

ULTRALIFE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar Amounts in Thousands – Except Share and Per Share Amounts)

(unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements of Ultralife Corporation and Subsidiaries have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the Condensed Consolidated Financial Statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the Consolidated Financial Statements and related notes thereto contained in our Form 10-K for the twelve month period ended December 31, 2012.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

Certain items previously reported in specific financial statement captions have been reclassified to conform to the current presentation.

Our monthly closing schedule is a 4/4/5 weekly-based cycle for each fiscal quarter, as opposed to a calendar month-based cycle for each fiscal quarter. While the actual dates for the quarter-ends will change slightly each year, we believe that there are not any material differences when making quarterly comparisons.

2. DISPOSITIONS AND EXIT ACTIVITIES

Ultralife Batteries UK, Ltd.

During the fourth quarter of 2012, we elected not to renew the lease for our U.K. manufacturing facility which expired on March 24, 2013 (the “U.K. Facility Lease”), and instead relocated our sales and services operations to a smaller facility. As a result of this decision, we were required to restore the facility back to its original condition pursuant to the terms of the U.K. Facility Lease.

The costs associated with the lease exit were not determinable until late in the fourth quarter of 2012. Accordingly, we recorded a liability as of the end of 2012 for our estimate of the costs to return the facility to its original condition as well as other related expenses. A total of \$228 was charged to selling, general, and administrative costs related to operations transferred to our facilities in Newark, NY, and an additional \$815 was recorded as discontinued operations for those operations that were not transferred to our facilities in Newark, NY. The termination of the U.K. Facility Lease did not result in any employee reductions or other termination costs, with the exception of the aforementioned restoration costs.

As a result, the results of presentation herein exclude the discontinued Ultralife Batteries UK, Ltd. operations from the results of continuing operations. The following amounts have been reported as discontinued operations for the three and nine month periods ending September 29, 2013 and September 30, 2012:



	Three Month Periods Ended		Nine Month Periods Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
	Net sales	\$ -	\$ -	\$ -
Gain from discontinued operations	-	-	241	-
Provision for income taxes	-	-	-	-
Gain from discontinued operations, net of tax	\$ -	\$ -	\$ 241	\$ -

The cost of returning our former UK facility back to its original condition was less than our estimate of the cost made during the fourth quarter of 2012. As a result, we recognized the difference as a gain from discontinued operations during the first quarter of 2013.

#### RedBlack Communications, Inc.

On February 16, 2012, we announced our intention to divest our RedBlack Communications, Inc. (“RedBlack”) business in 2012. RedBlack was a wholly-owned subsidiary of ours based in Hollywood, Maryland, that designed, integrated and fielded mobile, modular and fixed site communication and electronic systems. We determined that RedBlack offered limited opportunities to achieve the operating criteria thresholds of our business model.

On September 28, 2012 (the “Closing Date”), we entered into and closed a Stock Purchase Agreement (the “Agreement”) to sell 100% of our capital stock in RedBlack to BCF Solutions, Inc. In exchange for the sale of RedBlack, we received \$2,533 as a purchase price, comprised of cash at closing in the amount of \$2,133, funds held in escrow for up to one year in the amount of \$250, as well as \$150 to be available for RedBlack employee retention programs. In addition, there was a customary post-closing working capital adjustment to the purchase price of \$125, partially offset by other adjustments, that resulted in a loss of \$118 that was recorded in the second quarter of 2013.

The Agreement contains customary representations and warranties that will survive the Closing Date for a period of two or three years. The Agreement also contains customary indemnification for breaches of the representations and warranties contained in the Agreement.

The Agreement contains restrictive covenants that continue for two years from the Closing Date, under which we are prohibited from engaging or participating with any current customer of RedBlack in any business, directly or indirectly, that competes with the business conducted by RedBlack for two years. We are also prohibited from hiring, soliciting, or recruiting any current employee, independent contractor, or consultant of BCF Solutions, Inc. or RedBlack for two years.

Commencing with the first quarter of 2012, the results of the RedBlack operations and related divestiture costs have been reported as a discontinued operation.

As a result, the presentation of results herein excludes the RedBlack operations from the results of continuing operations. The following amounts have been reported as discontinued operations for the three and nine month periods ended September 29, 2013 and September 30, 2012:

	Three Month Periods		Nine Month Periods Ended	
	Ended September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net sales	\$ -	\$ 1,267	\$ -	\$ 3,404
Gain (loss) from discontinued operations	15	(59 )	(96 )	(3 )
Benefit from income taxes	-	(196 )	-	(174 )
Gain (loss) from discontinued operations, net of tax	\$ 15	\$ 137	\$ (96 )	\$ 171

### 3. INVENTORIES

Inventories are stated at the lower of cost or market with cost determined under the first-in, first-out (FIFO) method. The composition of inventories was:

	September 29, 2013	December 31, 2012
Raw materials	\$ 16,458	\$ 15,023
Work in process	3,353	4,863
Finished goods	8,018	10,484
	\$ 27,829	\$ 30,370

### 4. PROPERTY, PLANT AND EQUIPMENT

Major classes of property, plant and equipment consisted of the following:

	September 29, 2013	December 31, 2012
Land	\$ 123	\$ 123
Buildings and leasehold improvements	7,407	7,381
Machinery and equipment	47,018	46,606
Furniture and fixtures	1,947	1,810
Computer hardware and software	4,209	4,103
Construction in progress	1,389	1,275
	62,093	61,298
Less: Accumulated depreciation	51,257	48,883
	\$ 10,836	\$ 12,415

Depreciation expense for property, plant and equipment was \$720 and \$2,279 for the three and nine month periods ended September 29, 2013, respectively, and \$800 and \$2,460 for the three and nine month periods ended September 30, 2012, respectively.

In the second quarter of 2013, we received a termination notice from the New York State Energy Research and Development Authority (“NYSERDA”) regarding our collaborative agreement to develop and demonstrate a large hybrid grid-connected energy storage system. Pursuant to the terms of the agreement, NYSERDA will reimburse us for certain construction and project research and development costs incurred through the date of termination. Construction costs are reflected in the property, plant and equipment, net line on our Condensed Consolidated Balance Sheets as of September 29, 2013 and December 31, 2012. Project research and development costs are reflected in the research and development line on our Condensed Consolidated Statements of Comprehensive Income (Loss) the three

and nine month periods ended September 29, 2013 and September 30, 2012.

8

---

We plan to continue this project internally with smaller form batteries which provide greater opportunity and applicability in the markets we serve. However, due to the termination of the NYSERDA agreement and the resulting change in scope of the project, we performed a review of the details of costs capitalized in connection with this project to determine their future use. Those costs without an identifiable future use were written off in the second quarter of 2013 and totaled \$56. The remaining capitalized costs were subjected to an impairment test based upon forecasted future cash flows, in accordance with current accounting guidance. No impairment was taken on the remaining capitalized costs.

## 5. GOODWILL, INTANGIBLE ASSETS AND LONG TERM ASSETS

### a. Goodwill

The following table summarizes the goodwill activity by segment for the three month periods ended September 29, 2013 and September 30, 2012:

	Battery & Energy Products	Communications Systems	Discontinued Operations	Total
Balance at December 31, 2011	\$ 4,838	\$ 11,493	\$ 2,025	\$18,356
Sale of RedBlack Communications	-	-	(2,025 )	(2,025 )
Effect of foreign currency Translations	6	-	-	6
Balance at September 30, 2012	4,844	11,493	-	16,337
Effect of foreign currency Translations	7	-	-	7
Balance at December 31, 2012	4,851	11,493	-	16,344
Effect of foreign currency translations	61	-	-	61
Balance at September 29, 2013	\$ 4,912	\$ 11,493	\$ -	\$16,405

## b. Intangible Assets

The composition of intangible assets was:

	September 29, 2013		
	Gross Assets	Accumulated Amortization	Net
Trademarks	\$3,567	\$ -	\$3,567
Patents and technology	4,508	3,882	626
Customer relationships	4,027	3,515	512
Distributor relationships	390	350	40
Non-compete agreements	218	218	-
<b>Total intangible assets</b>	<b>\$12,710</b>	<b>\$ 7,965</b>	<b>\$4,745</b>

  

	December 31, 2012		
	Gross Assets	Accumulated Amortization	Net
Trademarks	\$3,564	\$ -	\$3,564
Patents and technology	4,495	3,702	793
Customer relationships	3,998	3,366	632
Distributor relationships	380	330	50
Non-compete agreements	217	217	-
<b>Total intangible assets</b>	<b>\$12,654</b>	<b>\$ 7,615</b>	<b>\$5,039</b>

Amortization expense for intangible assets was \$102 and \$301 for the three and nine month periods ended September 29, 2013, respectively, and \$122 and \$372 for the three and nine month periods ended September 30, 2012, respectively.

The change in the cost value of total intangible assets from December 31, 2012 to September 29, 2013 is a result of the effect of foreign currency translations.

In accordance with the Financial Accounting Standards Board's ("FASB") guidance for intangible assets other than goodwill, we do not amortize intangible assets with indefinite lives, but instead measure these assets for impairment at least annually, or when events indicate that impairment may exist. We amortize intangible assets that have definite lives so that the economic benefits of the intangible assets are being utilized over their weighted-average estimated useful life.

The impairment analysis of an indefinite-lived intangible asset consists first of a review of various qualitative factors of the identified indefinite-lived intangible asset to determine whether it is more likely than not that its fair value exceeds its carrying amount. This review includes, but is not limited to, an evaluation of the macroeconomic, industry or market, and cost factors relevant to the intangible asset as well as financial performance and entity or reporting unit events that may affect the value of the intangible asset. If this review leads to the determination that it is more likely than not that the fair value of the indefinite-lived intangible asset is greater than its carrying amount, further impairment testing is not required. However, if this review cannot support a conclusion that it is more likely than not that the fair value of the indefinite-lived intangible asset is greater than its carrying amount, or at our discretion, quantitative impairment steps are performed.





The impairment test for intangible assets with indefinite lives consists of a comparison of the fair value of the intangible assets with their carrying amounts. If the carrying value of the intangible assets exceeds the fair value, an impairment loss shall be recognized in an amount equal to that excess. We determine the fair value of our intangibles assets with indefinite lives (trademarks) through a royalty relief income valuation approach.

Due to the general slowdown in the timing of order processing resulting from the U.S. Government furloughs, shutdown and budget uncertainties, we accelerated our impairment test for our McDowell Communications Systems trademark from October 1, 2013 to September 29, 2013. Based upon the results of that review, we have determined that there is no impairment of the McDowell Communications Systems trademark. We will continue to monitor this trademark closely and will update our testing during the fourth quarter.

#### c. Long-Term Assets

In the first quarter of this year, we had a sale to a customer of our Communications Systems segment of which \$2,031, net of interest, had a payment term of greater than one year. This sale was in order to facilitate this customer's ability to support a soldier modernization initiative. We expect this receivable to be fully collected within two years. Currently \$267 is classified as long-term.

## 6. DEBT

On May 24, 2013, we entered into a Revolving Credit, Guaranty and Security Agreement (the "Credit Agreement") and related security agreements with PNC Bank, National Association ("PNC") to establish a \$20 million secured asset-based revolving credit facility that includes a \$1 million letter of credit subfacility (the "Credit Facility"). The Credit Agreement provides that the Credit Facility may be increased with the PNC's concurrence to \$35 million prior to the last six months of the term and expires on May 24, 2017. The Credit Facility replaces the prior credit facility with RBS Business Capital, a division of RBS Asset Finance, Inc., which expired in accordance with its terms on May 15, 2013, with no debt outstanding.

Our available borrowing limit under the Credit Facility fluctuates from time to time based on a borrowing base formula equal to the sum of up to 85% of eligible accounts receivable plus the least of (a) up to 65% of the eligible inventory and eligible foreign in-transit inventory, (b) up to 85% of the appraised net orderly liquidation value of eligible inventory and eligible foreign in-transit inventory, and (c) \$7.5 million, in each case subject to the definitions in the Credit Agreement and reserves required by PNC.

Interest is payable quarterly and will accrue on outstanding indebtedness under the Credit Agreement at the alternate base rate, as defined in the Credit Agreement, plus the applicable margin or at the one, two or three month LIBOR rate plus the applicable margin as selected by the Company and listed below.

Quarterly Average Undrawn Borrowing Availability	Applicable Margin for Alternate Base Rate Loans		Applicable Margin for LIBOR Rate Loans	
Greater than \$8,000,000	1.00	%	2.00	%
\$5,000,000 up to \$8,000,000	1.25	%	2.25	%
Less than \$5,000,000	1.50	%	2.50	%

We must pay a fee on its unused availability of 0.375% per annum and customary letter of credit fees in addition to various collateral monitoring and related fees and expenses.



In addition to customary affirmative and negative covenants, we must maintain a fixed charge coverage ratio as defined in the Credit Agreement of 1:15 to 1:00 tested quarterly for the four-quarters then ended. As of September 29, 2013 we were in compliance with all covenants. The Credit Facility is secured by substantially all our assets.

Any outstanding advances must be repaid upon expiration of the term of the Credit Facility. Payments must be made during the term to the extent outstanding advances exceed the maximum amount then permitted to be drawn as advances under the Credit Facility and from the proceeds of certain transactions. Upon the occurrence of an event of default, the outstanding obligations may be accelerated and PNC will have other customary remedies.

As of September 29, 2013, we had \$-0- outstanding under the Credit Facility, an applicable interest rate of 2.18%, approximately \$12,781 of borrowing capacity in addition to our unrestricted cash on hand of \$10,365, and no outstanding letters of credit related to the Credit Facility.

## 7. SHAREHOLDERS' EQUITY

### a. Common Stock

In August 2013, we issued 15,272 shares of common stock to our non-employee directors, valued at \$57.

In 2012, we issued to our non-employee directors 16,271 shares of common stock valued at \$76, 17,473 shares of common stock valued at \$77, and 24,311 shares of common stock valued at \$77, in February, May, and August, respectively.

### b. Treasury Stock

At September 29, 2013 and December 31, 2012, we had 1,372,757 shares of treasury stock valued at \$7,658.

### c. Stock Options

We have various stock-based employee compensation plans, for which we follow the provisions of the Financial Accounting Standards Board's ("FASB") guidance on share-based payments, which requires that compensation cost relating to share-based payment transactions be recognized in the financial statements. The cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award).

Our shareholders have approved various equity-based plans that permit the grant of stock options, restricted stock and other equity-based awards. In addition, our shareholders have approved certain grants of stock options outside of these plans.

In June 2004, shareholders adopted the 2004 Long-Term Incentive Plan ("LTIP") pursuant to which we were authorized to issue up to 750,000 shares of common stock and grant stock options, restricted stock awards, stock appreciation rights and other stock-based awards. Through shareholder approved amendments to the LTIP in 2006, 2008 and 2011, the total number of authorized shares under the LTIP increased to 2,900,000.

Stock options granted under the LTIP are either Incentive Stock Options ("ISOs") or Non-Qualified Stock Options ("NQSOs"). Key employees are eligible to receive ISOs and NQSOs; however, directors and consultants are eligible to receive only NQSOs. Most ISOs vest over a three- or five-year period and expire on the sixth or seventh anniversary of the grant date. All NQSOs issued to non-employee directors vest immediately and expire on either the sixth or seventh anniversary of the grant date. Some NQSOs issued to non-employees vest immediately and expire within three years; others have the same vesting characteristics as options issued to employees. As of September 29, 2013,

there were 2,096,422 stock options outstanding under the LTIP.

On December 19, 2005, we granted our former President and Chief Executive Officer, John D. Kavazanjian, an option to purchase 48,000 shares of common stock at \$12.96 per share outside of any of our equity-based compensation plans, subject to shareholder approval. Shareholder approval was obtained on June 8, 2006. The stock option is fully vested and expired on June 8, 2013.

On March 7, 2008, in connection with his becoming employed by us, we granted our Chief Financial Officer and Treasurer, Philip A. Fain, an option to purchase 50,000 shares of common stock at \$12.74 per share outside of any of our equity-based compensation plans. The stock option is fully vested and expires on March 7, 2015.

On December 30, 2010, pursuant to the terms of his employment agreement, we granted our President and Chief Executive Officer, Michael D. Popielec, options to purchase shares of common stock under the LTIP as follows: (i) 50,000 shares at \$6.42, vesting in annual increments of 12,500 shares over a four-year period commencing December 30, 2011; (ii) 250,000 shares at \$6.42, vesting in annual increments of 62,500 shares over a four-year period commencing December 30, 2011; (iii) 200,000 shares at \$10.00, with vesting to begin on the date the stock reaches a closing price of \$10.00 per share for 15 trading days within a 30-day trading period, with such vesting in annual increments of 50,000 shares over the four anniversary dates of that date; and (iv) 200,000 shares at \$15.00, with vesting to begin on the date the stock reaches a closing price of \$15.00 per share for 15 trading days within a 30-day trading period, with such vesting in annual increments of 50,000 shares over the four anniversary dates of that date. All such options in items (i) and (ii) shall expire on December 30, 2017. All such options in items (iii) and (iv) shall expire as of the later of December 30, 2017 or five years after the initial vesting commences, but in no event later than December 30, 2020. The options set forth in items (ii), (iii) and (iv) were subject to shareholder approval of an amendment to the LTIP, which approval was obtained on June 7, 2011.

On January 3, 2011, pursuant to the terms of his employment agreement, we granted our President and Chief Executive Officer, Michael D. Popielec, an option to purchase 50,000 shares of common stock at \$6.58 under the LTIP. The option vests in annual increments of 12,500 shares over a four-year period commencing December 30, 2011. The option expires on December 30, 2017.

In conjunction with FASB's guidance for share-based payments, we recorded compensation cost related to stock options of \$131 and \$521 for the three and nine month periods ended September 29, 2013 and \$254 and \$770 for the three and nine month periods ended September 30, 2012, respectively. As of September 29, 2013, there was \$833 of total unrecognized compensation cost related to outstanding stock options, which is expected to be recognized over a weighted average period of 1.50 years.

We use the Black-Scholes option-pricing model to estimate the fair value of non-market performance stock-based awards. The following weighted average assumptions were used to value non-market performance stock options granted during the nine month periods ended September 29, 2013 and September 30, 2012.

	Nine Month Periods Ended			
	September 29, 2013		September 30, 2012	
Risk-free interest rate	0.78	%	0.56	%
Volatility factor	61.94	%	63.53	%
Dividends	0.00	%	0.00	%
Weighted average expected life (years)	4.06		3.91	

We use a Monte Carlo simulation option-pricing model to estimate the fair value of market performance stock-based awards. There were no market performance stock options granted during the nine months ended September 29, 2013 and September 29, 2012.

We calculate expected volatility for stock options by taking an average of historical volatility over the past five years and a computation of implied volatility. The computation of expected term was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards and vesting schedules. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield in effect at the time of grant.

Stock option activity for the first nine months of 2013 is summarized as:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Shares under option at January 1, 2013	2,211,488	\$ 7.47		
Options granted	228,000	3.60		
Options exercised	(3,000 )	3.91		
Options forfeited	(114,348 )	3.51		
Options expired	(175,718 )	10.80		
Shares under option at September 29, 2013	2,146,422	\$ 7.00	4.57	\$ 134
Vested and expected to vest as of September 29, 2013	1,944,424	\$ 7.22	4.50	\$ 109
Options exercisable at September 29, 2013	991,953	\$ 6.52	3.48	\$ 44

The total intrinsic value of stock options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the nine month period ended September 29, 2013 was \$1.

FASB's guidance for share-based payments requires cash flows from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised stock options in excess of the deferred tax asset attributable to stock compensation costs for such stock options. We did not record any excess tax benefits in the first nine months of 2013 and 2012. Cash received from stock option exercises under our stock-based compensation plans for the nine month periods ended September 29, 2013 and September 30, 2012 was \$12 and \$115, respectively.





## d. Restricted Stock Units

On January 29, 2013, we granted 120,000 contingent restricted stock units to our President and Chief Executive Officer, Michael D. Popielec, subject to shareholder approval, which was obtained on June 4, 2013, which vest as follows: (i) 30,000 shares of our common stock will vest on the later of January 1, 2014 or the date when our common stock first reaches a closing price of \$4.00 per share for 15 trading days in a 30 trading day period; (ii) 30,000 shares of our common stock will vest on the later of January 1, 2014 or the date when our common stock first reaches a closing price of \$5.00 per share for 15 trading days in a 30 trading day period; (iii) 30,000 shares of our common stock will vest on the later of January 1, 2015 or the date when our common stock first reaches a closing price of \$4.00 per share for 15 trading days in a 30 trading day period; and (iv) 30,000 shares of our common stock will vest on the later of January 1, 2015 or the date when our common stock first reaches a closing price of \$5.00 per share for 15 trading days in a 30 trading day period.

The restricted stock units described in (i) and (iii) had achieved their closing price condition prior to shareholder approval and were valued at the closing price on the date of grant. The restricted stock units described in (ii) and (iv) had not yet achieved their closing price conditions and were valued utilizing a Monte Carlo simulation to determine fair value and the derived service period. The weighted average inputs utilized were:

	Nine Month Period Ended September 29, 2013	
Risk-free interest rate	0.21	%
Volatility factor	59.08	%
Dividends	0.00	%

The restricted stock units had the following values:

	Nine Month Period Ended September 29, 2013	
Number of shares award	120,000	
Weighted average fair value per share	\$	3.62
Aggregate total value	\$	434

The activity of restricted stock units for the first nine months of 2013 is summarized below:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2013	0	\$ 0
Granted	120,000	\$ 3.62
Vested	0	0
Forfeited	0	0
Unvested at September 29, 2013	120,000	\$ 3.62

No restricted stock was awarded during the nine month period ended September 30, 2012.

Compensation cost recorded in our financial statements related to our restricted stock units and restricted stock awards was \$122 and \$162 during the three and nine month periods ended September 29, 2013, respectively, and \$0 and \$1 during the three and nine month periods ended September 30, 2012, respectively. There is \$278 of unrecognized compensation cost related to restricted stock units as of September 29, 2013.

## 8. INCOME TAXES

The asset and liability method, prescribed by FASB's guidance on the accounting for income taxes, is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

For the three and nine month periods ended September 29, 2013, we recorded a benefit of \$16 and an expense of \$135, respectively. For the three and nine month periods ended September 30, 2012, we recorded a benefit of \$21 and an expense of \$264, respectively, including the amounts attributable to our discontinued operations. The expense is primarily due to the recognition of deferred tax liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. The remaining expense in 2013 was primarily due to the income reported for our China operations during the period.

Our effective consolidated tax rates for the three and nine month periods ended September 29, 2013 and September 30, 2012 were:

	Three Month Periods		Nine Month Periods Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Income (Loss) from continuing operations before Incomes Taxes (a)	\$ 591	\$ 1,643	\$ (1,050 )	\$ (2,763 )
Total Income Tax Provision (Benefit) (b)	\$ (16 )	\$ 175	\$ 135	\$ 437
Effective Tax Rate (b/a)	2.7 %	10.7 %	12.9 %	15.8 %

The overall effective tax rate is the result of the combination of income and losses in each of our tax jurisdictions, which is particularly influenced by the fact that we have not recognized a deferred tax asset pertaining to cumulative historical losses for our U.S. operations and our U.K. subsidiary, as management does not believe, at this time, it is more likely than not that we will realize the benefit of these losses. We have substantial net operating loss carryforwards which offset taxable income in the United States. However, we remain subject to the alternative minimum tax in the United States. The alternative minimum tax limits the amount of net operating loss available to offset taxable income to 90% of the current year income. We incurred \$0 and \$12 in alternative minimum tax for the three and nine months ended September 29, 2013, respectively. The alternative minimum tax did not have an impact on income taxes determined for the three and nine month periods ended September 30, 2012. The payment of the alternative minimum tax normally results in the establishment of a deferred tax asset; however, we have established a valuation allowance for our net U.S. deferred tax asset. Therefore, the expected payment of the alternative minimum tax does not result in a net deferred tax asset.

As of December 31, 2012, we had foreign and domestic net operating loss carryforwards totaling approximately \$60,494 available to reduce future taxable income. Foreign loss carryforwards of approximately \$12,390 can be

carried forward indefinitely. The domestic net operating loss carryforwards of \$48,104 expire from 2019 through 2032. The domestic net operating loss carryforwards include approximately \$2,949 for which a benefit will be recorded in capital in excess of par value when realized.

Our unrecognized tax benefits related to uncertain tax positions at September 29, 2013 relate to Federal and various state jurisdictions. The following table summarizes the activity related to our unrecognized tax benefits:

	Nine Month Periods Ended	
	September 29, 2013	September 30, 2012
Balance at beginning of the period	\$ 7,508	\$ 6,779
Increases related to current year tax positions	-	-
Increases related to prior year tax positions	-	-
Decreases related to prior year tax positions	-	-
Expiration of statute of limitations for assessment of taxes	-	-
Settlements	-	-
Balance at end of the period	\$ 7,508	\$ 6,779

The total unrecognized tax benefit balance at September 29, 2013 is comprised of tax benefits that, if recognized, would result in a deferred tax asset and a corresponding increase in our valuation allowance. As a result, because the benefit would be offset by an increase in the valuation allowance, there would be no effect on the effective tax rate.

We are not required to accrue interest and penalties as the unrecognized tax benefits have been recorded as a decrease in our net operating loss carryforward. Interest and penalties would begin to accrue in the period in which the net operating loss carryforwards related to the uncertain tax positions are utilized. We do not expect our unrecognized tax benefits to change significantly over the next twelve months.

As a result of our operations, we file income tax returns in various jurisdictions including U.S. federal, U.S. state and foreign jurisdictions. We are routinely subject to examination by taxing authorities in these various jurisdictions. Our U.S. tax matters for the years 2000 through 2012 remain subject to examination by the Internal Revenue Service (“IRS”) due to our net operating loss carryforwards. Our U.S. tax matters for the years 2000 through 2012 remain subject to examination by various state and local tax jurisdictions due to our net operating loss carryforwards. Our tax matters for the years 2007 through 2012 remain subject to examination by the respective foreign tax jurisdiction authorities. The IRS has completed the examination of our 2009 U.S. federal income tax return, with no resulting material effect to our financial position or results of operations.

The use of our U.K. net operating loss carryforwards may be limited due to the change in our U.K. operation during 2008 from a manufacturing and assembly center to primarily a distribution and service center.

## 9. EARNINGS PER SHARE

We have adopted the provisions of FASB's guidance for determining whether instruments granted in share-based payment transactions are participating securities. The guidance requires that all outstanding unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (such as restricted stock awards granted by us) be considered participating securities. Because restricted stock awards are participating securities, we are required to apply the two-class method of computing basic and diluted earnings per share (the "Two-Class Method").

Basic earnings per share ("EPS") is determined using the Two-Class Method and is computed by dividing earnings attributable to Ultralife common shareholders by the weighted-average shares outstanding during the period. The Two-Class Method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Diluted EPS includes the dilutive effect of securities, if any, and reflects the more dilutive EPS amount calculated using the treasury stock method or the Two-Class Method. For the three and nine month periods ended September 29, 2013 and September 30, 2012, both the Two-Class Method and the treasury stock method calculations for diluted EPS yielded the same result.

The computation of basic and diluted earnings per share is summarized as follows:

	Three Month Period Ended		Nine Month Period Ended	
	September	September	September	September
	29,	30,	29,	30,
	2013	2012	2013	2012
Net Income (Loss) from continuing operations attributable to Ultralife common shareholders (a)	\$629	\$ 1,479	\$(1,154 )	\$(3,169 )
Effect of Dilutive Securities	-	-	-	-
Net Income (Loss) from continuing operations attributable to Ultralife common shareholders - Adjusted (b)	\$629	\$ 1,479	\$(1,154 )	\$(3,169 )
Net Income from discontinued operations attributable to Ultralife common shareholders (c)	\$15	\$ 200	\$159	\$ 178
Effect of Dilutive Securities	-	-	-	-
Net Income from discontinued operations attributable to Ultralife common shareholders - Adjusted (d)	\$15	\$ 200	\$159	\$ 178
Average Common Shares Outstanding – Basic (e)	17,467,000	17,418,000	17,461,000	17,390,000
Effect of Dilutive Securities:				
Stock Options / Warrants	65,000	-	-	-
Average Common Shares Outstanding – Diluted (f)	17,532,000	17,418,000	17,461,000	17,390,000

EPS – Basic (a/e) - continuing operations	\$0.04	\$0.09	\$(0.07 )	\$(0.18 )
EPS – Basic (c/e) - discontinued operations	\$0.00	\$0.01	\$0.01	\$0.01
EPS – Diluted (b/f) - continuing operations	\$0.04	\$0.09	\$(0.07 )	\$(0.18 )
EPS – Diluted (d/f) - discontinued operations	\$0.00	\$0.01	\$0.01	\$0.01

There were 2,020,588 and 2,342,722 outstanding stock options and awards at September 29, 2013 and September 30, 2012, respectively, that were not included in the three month EPS calculation as the effect would be anti-dilutive. The dilutive effect of 245,834 and -0- outstanding stock options and awards were included in the computation for the three month periods September 29, 2013 and September 30, 2012, respectively.

There were 2,266,422 and 2,342,722 outstanding stock options and awards at September 29, 2013 and September 30, 2012, respectively, that were not included in the nine month EPS calculation as the effect would be anti-dilutive.

## 10. COMMITMENTS AND CONTINGENCIES

### a. Purchase Commitments

As of September 29, 2013, we have made commitments to purchase approximately \$453 of production machinery and equipment.

### b. Product Warranties

We estimate future costs associated with expected product failure rates, material usage and service costs in the development of our warranty obligations. Warranty reserves are based on historical experience of warranty claims and generally will be estimated as a percentage of sales over the warranty period. In the event the actual results of these items differ from the estimates, an adjustment to the warranty obligation would be recorded. Changes in our product warranty liability during the first three months of 2013 were as follows:

Balance at December 31, 2012	\$607
Accruals for warranties issued	174
Settlements made	(68 )
Balance at September 29, 2013	\$713

### c. Contingencies and Legal Matters

We are subject to legal proceedings and claims that arise from time to time in the normal course of business. We believe that the final disposition of such matters, other than the matters described below, will not have a material adverse effect on our financial position, results of operations or cash flows.

### Government Grants/Loans

In conjunction with the City of West Point, Mississippi, we applied for a Community Development Block Grant (“CDBG”) from the State of Mississippi for infrastructure improvements to our leased facility that is owned by the City of West Point, Mississippi. The CDBG was awarded and as of December 31, 2011, approximately \$480 has been distributed under the grant. Under an agreement with the City of West Point, we agreed to employ at least 30 full-time employees at the facility, of which 51% of the jobs had to be filled or made available to low or moderate income families, within three years of completion of the CDBG improvement activities. In addition, we agreed to invest at least \$1,000 in equipment and working capital into the facility within the first three years of operation of the facility. While we have yet to receive formal notice from the applicable government agency confirming the closure of the grant, we believe that both of these commitments were satisfied as of March 2011 and, therefore, have not

recorded an accrual with respect to any potential liability for the grant amounts received under the CDBG.



In conjunction with Clay County, Mississippi, we applied for a Mississippi Rural Impact Fund Grant (“RIFG”) from the State of Mississippi for infrastructure improvements to our leased facility that is owned by the City of West Point, Mississippi. The RIFG was awarded and as of December 31, 2011, approximately \$150 has been distributed under the grant. Under an agreement with Clay County, we agreed to employ at least 30 full-time employees at the facility, of which 51% of the jobs had to be filled or made available to low or moderate income families, within two years of completion of the RIFG improvement activities. In September 2010, we received an extension for this commitment to March 31, 2011. In addition, we agreed to invest at least \$1,000 in equipment and working capital into the facility within the first three years of operation of the facility. While we have yet to receive formal notice from the applicable government agency confirming the closure of the grant, we believe that both of these commitments were satisfied as of March 2011 and, therefore, have not recorded an accrual with respect to any potential liability for the grant amounts received under the RIFG.

#### Post Audits of Government Contracts

We had certain “exigent”, non-bid contracts with the U.S. government, which were subject to audit and final price adjustment, which resulted in decreased margins compared with the original terms of the contracts. As of December 31, 2012, there were no outstanding exigent contracts with the U.S. government. As part of its due diligence, the U.S. government has conducted post-audits of the completed exigent contracts to ensure that information used in supporting the pricing of exigent contracts did not differ materially from actual results. In September 2005, the Defense Contracting Audit Agency (“DCAA”) presented its findings related to the audits of three of the exigent contracts, suggesting a potential pricing adjustment of approximately \$1,400 related to reductions in the cost of materials that occurred prior to the final negotiation of these contracts. In addition, in June 2007, we received a request from the Office of Inspector General of the Department of Defense (“DoD IG”) seeking certain information and documents relating to our business with the Department of Defense. We cooperated with the DCAA audit and DoD IG inquiry by making available to government auditors and investigators our personnel and furnishing the requested information and documents. The DCAA Audit and DoD IG inquiry were consolidated and the US Attorney’s Office represented the government in connection with these matters. Under applicable federal law, we may have been subject up to treble damages and penalties associated with the potential pricing adjustment. In light of the uncertainty, we decided to enter into discussions with the U.S. Attorney’s Office in April 2011 to negotiate a settlement that would be in the best interests of our customers, employees and shareholders. On April 21, 2011, we were advised by the government that there was a \$2,730 settlement-in-principle to resolve all claims related to the contracts, subject to final approval by the Department of Justice. As a result, we recorded a \$2,730 charge as a reduction in revenues for the first quarter of 2011. On June 1, 2011, we entered into a Settlement Agreement with the United States of America, acting through the United States Department of Justice and on behalf of the Department of Defense that required us to pay a total of \$2,700 plus accrued interest thereon at the rate of 2.625% per annum. Under the Settlement Agreement, we were required to make principal payments of \$1,000, \$567, \$567 and \$566 being due on June 8, 2011, December 1, 2011, June 1, 2012 and December 1, 2012, respectively. Each principal payment was accompanied by a payment of accrued interest. As of December 31, 2012, we have made all required payments.

### 9-Volt Battery Litigation

In July 2010, we were served with a summons and complaint filed in Japan by one of our 9-volt battery customers. The complaint alleged damages associated with claims of breach of warranty in an amount of approximately \$1,100. A trial was held on May 25, 2012, in Japan before a panel of three judges, after which the parties agreed to settle the matter for approximately \$125, which has been reflected in our cost of products sold in the second quarter of 2012. The terms of the settlement agreement include no legal liability on our part and the plaintiff abandoning all other claims against us.

### Arista Power Litigation

On September 23, 2011, we initiated an action against Arista Power, Inc. (“Arista”) and our former senior sales and engineering employee, David Modeen (“Modeen”) in the State of New York Supreme Court, County of Wayne (Index No. 73379). In our Complaint, we allege that Arista recruited all but one of the members of its executive team from us, subsequently changed and redirected its business to compete directly with us by using our confidential information, and during the summer of 2011, recruited Modeen to become an Arista employee. We allege that, as a result of actions by Arista and Modeen: (i) Modeen has breached the terms of his Employee Confidentiality, Non-Disclosure, Non-Compete, Non-Disparagement and Assignment Agreement with us; (ii) Modeen has breached certain agreements, duties and obligations he owed us, including to protect and refrain from disclosing our trade secrets and confidential and proprietary information; (iii) Arista’s employment of Modeen will inevitably lead to the disclosure and use of our trade secrets by Arista, in violation of Modeen’s duties and obligations to us; (iv) Arista unlawfully induced Modeen to breach his agreements with and duties and obligations to us; and (v) Arista’s recruitment and employment of Modeen has breached a subcontract between Arista and us. We seek damages as determined at trial and preliminary and permanent injunctive relief. The defendants have answered the allegations set forth in the Complaint, without asserting any counterclaims.

On December 5, 2011, Arista served us with a Complaint it filed on November 29, 2011 in the State of New York Supreme Court, County of Monroe (Index No. 11-13896) against us, our officers, several of our directors, and an employee. In its Complaint, Arista alleges that we and our named defendants have violated the terms of a Confidentiality Agreement with Arista and have unfairly competed against Arista by unlawfully appropriating Arista’s trade secrets and that as a result of such activity, Arista has incurred damages in excess of \$60,000. Arista seeks damages, an accounting, and preliminary and permanent injunctive relief.

On December 21, 2011, we and our officers, directors and employee named in Arista’s Complaint filed a motion to dismiss Arista’s Complaint against our officers, directors and employee as Arista’s Complaint fails to state any cause of action against any of them and to dismiss the claim of fraud against our officers, directors and employee. Subsequently, Arista filed an Amended Complaint alleging essentially the same causes of action but adding additional factual allegations against us and our officers, directors and employee. In addition, Arista filed a motion to disqualify our outside legal counsel representing us and our officers, directors and employee in both Arista’s Complaint and our Complaint against Arista. In response, we and our officers, directors and employee filed a new motion to dismiss Arista’s Complaint against us in its entirety and seeking dismissal of the fraud claim against us. Arista’s motion to disqualify our outside legal counsel was denied on February 10, 2012. On March 9, 2012, the Court issued its decision on our motion to dismiss, granting the motion to the extent of dismissing some claims against us, but denying the motion to dismiss the individuals from the lawsuit at this preliminary stage. On April 19, 2012, an Answer was filed on behalf of us, our officers, directors and employee. On September 10, 2013, Arista filed a Second Amended Complaint deleting all individual defendants except our named employee, to which an Answer was filed on our behalf on September 30, 2013. Discovery has commenced with respect to the Arista litigation and is ongoing.



We initiated the September 23, 2011 Complaint against Arista Power to protect our customers, employees and shareholders from the unauthorized use and theft of our investments in intellectual property, trade secrets and confidential information by Arista and its employees. Protecting our collective intellectual property and know-how, developed at great cost to us to form our competitive position in the marketplace and create value for our shareholders, is a fundamental responsibility of all our employees.

We believe the November 29, 2011 Arista Complaint is retaliatory and without merit. Our development of the foundation for the new product concept for which Arista claims we allegedly used its trade secrets commenced in 2008, long prior to the departure of those individuals who now constitute the executive team of Arista. Furthermore, we believe the purported damage of \$60,000 being claimed by Arista is based solely on the reduction in its market capitalization between November 2009 and the filing date of the Complaint. This market value loss is totally unrelated to any actions on account of us, and claims for recovery of this or any other amount are legally and factually baseless.

Accordingly, we will vigorously pursue our complaint against Arista and defend what we believe to be a meritless action on the part of Arista Power.

## 11. BUSINESS SEGMENT INFORMATION

On February 16, 2012, our senior management, as authorized by our Board of Directors, decided to divest our RedBlack Communications business, which previously was reported in the Communications Systems segment. See Note 2 in these Notes to Condensed Consolidated Financial Statements for additional information.

During the fourth quarter of 2012, we elected not to renew the lease for our U.K. manufacturing facility which expired on March 24, 2013, and to relocate our sales and services operations to a smaller facility. As a result of this decision, we were required to restore the facility back to its original condition per a previous contractual commitment. This facility previously served our Battery and Energy Segments business. A portion of these costs were classified as a discontinued operation in the fourth quarter of 2012. See Note 2 in these Notes to Condensed Consolidated Financial Statements for additional information.

We report our results in two operating segments: Battery & Energy Products and Communications Systems. The Battery & Energy Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries, in addition to rechargeable batteries, uninterruptable power supplies, charging systems and accessories, such as cables. The Communications Systems segment includes: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment, integrated communication system kits and communications and electronics systems design. We believe that reporting performance at the gross profit level is the best indicator of segment performance. As such, we report segment performance at the gross profit level and operating expenses as Corporate charges.

Edgar Filing: ULTRALIFE CORP - Form 10-Q

The components of segment performance were as follows:

Three Month Period Ended September 29, 2013

	Battery & Energy Products	Communications Systems	Discontinued Operations	Corporate	Total
Revenues	\$ 13,507	\$ 6,854	\$ -	\$ -	\$20,361
Segment contribution	3,601	2,526	-	(5,475 )	652
Interest expense, net				(53 )	(53 )
Miscellaneous				(8 )	(8 )
Income taxes-current				19	19
Income taxes-deferred				(3 )	(3 )
Income from discontinued operations			15		15
Noncontrolling interest				22	22
Net income attributable to Ultralife					\$644
Total assets	\$ 42,679	\$ 32,268	\$ -	\$ 13,728	\$88,675

Three Month Period Ended September 30, 2012

	Battery & Energy Products	Communications Systems	Discontinued Operations	Corporate	Total
Revenues	\$ 16,633	\$ 9,548	\$ -	\$ -	\$26,181
Segment contribution	4,770	3,449	-	(6,465 )	1,754
Interest expense, net				(96 )	(96 )
Miscellaneous				(15 )	(15 )
Income taxes-current				(120 )	(120 )
Income taxes-deferred				(55 )	(55 )
Income from discontinued operations			200		200
Noncontrolling interest				11	11
Net income attributable to Ultralife					\$1,679
Total assets	\$ 54,031	\$ 32,290	\$ 11	\$ 8,997	\$95,329

Nine Month Period Ended September 29, 2013

	Battery & Energy Products	Communications Systems	Discontinued Operations	Corporate	Total
Revenues	\$ 41,216	\$ 17,443	\$ -	\$ -	\$58,659
Segment contribution	10,191	6,837	-	(17,875 )	(847 )
Interest expense, net				(172 )	(172 )
Miscellaneous				(31 )	(31 )
Income taxes-current				(42 )	(42 )
Income taxes-deferred				(93 )	(93 )
Income from discontinued operations			159		159
Noncontrolling interest				31	31
Net loss attributable to Ultralife					\$(995 )
Total assets	\$ 42,679	\$ 32,268	\$ -	\$ 13,728	\$88,675



Nine Month Period Ended September 30, 2012

	Battery & Energy Products	Communications Systems	Discontinued Operations	Corporate	Total
Revenues	\$ 52,238	\$ 20,150	\$ -	\$-	\$72,388
Segment contribution	12,476	6,803	-	(21,747 )	(2,468 )
Interest expense, net				(312 )	(312 )
Miscellaneous				17	17
Income taxes-current				(387 )	(387 )
Income taxes-deferred				(50 )	(50 )
Loss from discontinued operations			178		178
Noncontrolling interest				31	31
Net loss attributable to Ultralife					\$(2,991 )
Total assets	\$ 54,031	\$ 32,290	\$ 11	\$ 8,997	\$95,329

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB's guidance for the disclosure regarding fair value of financial instruments requires disclosure of an estimate of the fair value of certain financial instruments. The fair value of financial instruments pursuant to FASB's guidance for the disclosure regarding fair value of financial instruments approximated their carrying values at September 29, 2013 and December 31, 2012. The fair value of cash, trade accounts receivable, trade accounts payable, accrued liabilities, and our revolving credit facility approximates carrying value due to the short-term nature of these instruments.

## 13. FIRE AT MANUFACTURING FACILITY

In June 2011, we experienced a fire that damaged certain inventory and machinery and equipment at our facility in China. The fire occurred after business hours and was extinguished quickly with no injuries, and the plant was back in full operation shortly thereafter with no significant disruption in supply or service to customers.

The total amount of the loss pertaining to assets and the related expenses was approximately \$1,589. The majority of our insurance claim is related to the recovery of damaged inventory. In June 2012, we received approximately \$1,017 as a partial payment on our insurance claim, which resulted in no gain or loss being recognized. In April 2013, we have received \$269 as a further payment on this claim, with no gain or loss recognized. As of September 29, 2013, we reflect a net receivable from the insurance company relating to this claim of \$184, which is net of our deductible of approximately \$132, and represents additional proceeds to be received. The deductible charge was expensed in the second quarter of 2011.

## 14. RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

In March 2013, the FASB issued ASU 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." ASU 2013-05 provides that the cumulative translation adjustment is released into net income when a reporting entity ceases to have a controlling interest in a subsidiary that is controlled by a consolidated foreign entity. Further, this update states that the sale of an investment in a foreign entity includes both events that result in the loss of a controlling financial interest in a foreign entity, regardless of any retained investment, and events that result in an acquirer obtaining control through a step acquisition. ASU 2013-05 is effective prospectively for fiscal years beginning after December 15, 2013, with early adoption permitted. We do not believe that adoption of this standard will have a material impact on our consolidated results of operations and financial condition.





In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income." ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component as well as presentation, either on the face of the financial statement or in the notes, of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. ASU 2013-02 is effective for fiscal years beginning after December 15, 2012. Adoption of this standard did not have a material impact on our consolidated results of operations and financial condition.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. This report contains certain forward-looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to management. The statements contained in this report relating to matters that are not historical facts are forward-looking statements that involve risks and uncertainties, including, but not limited to, our reliance on certain key customers, reduced U.S. defense spending, including the uncertainty with government budget approvals, timing delays in receiving orders relating to funded government projects, general domestic and global economic conditions, future demand for our products and services, the successful commercialization of our products, our resources being overwhelmed by our growth prospects, residual effects of negative news related to our industries and industry products, government and environmental regulations, business disruptions, including those caused by fires, product liability risks, the impairment of our intangible assets, the unique risks associated with our Chinese operations, loss of top management, the process of U.S. defense procurement, finalization of non-bid government contracts, raw material supplies, competition and customer strategies, technological innovations in the non-rechargeable and rechargeable battery industries, changes in our business strategy or development plans, capital deployment, and other risks and uncertainties, certain of which are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those forward-looking statements described herein. When used in this report, the words "anticipate", "believe", "estimate" or "expect" or words of similar import are intended to identify forward-looking statements. For further discussion of certain of the matters described above and other risks and uncertainties, see Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012.

Undue reliance should not be placed on our forward-looking statements. Except as required by law, we disclaim any obligation to update any factors or to publicly announce the results of any revisions to any of the forward-looking statements contained in this Quarterly Report on Form 10-Q to reflect new information, future events or other developments.

The following discussion and analysis should be read in conjunction with the accompanying Condensed Consolidated Financial Statements and Notes thereto appearing elsewhere in this Form 10-Q and our Consolidated Financial Statements and Notes thereto contained in our Form 10-K for the year ended December 31, 2012.

The financial information in this Management's Discussion and Analysis of Financial Condition and Results of Operations is presented in thousands of dollars, except for share and per share amounts. All figures presented below represent results from continuing operations, unless otherwise specified.

### General

We offer products and services ranging from portable power solutions to communications and electronics systems. Through our engineering and collaborative approach to problem solving, we serve government, defense and commercial customers across the globe. We design, manufacture, install and maintain power and communications systems including: rechargeable and non-rechargeable batteries, charging systems, communications and electronics systems and accessories and custom engineered systems. We continually evaluate ways to grow, including the design, development and sale of new products, expansion of our sales force to penetrate new markets and geographies, as well as seeking opportunities to expand through acquisitions. We sell our products worldwide through a variety of trade channels, including original equipment manufacturers ("OEMs"), industrial and defense supply distributors and directly to U.S. and international defense departments.



We report our results in two operating segments: Battery & Energy Products and Communications Systems. The Battery & Energy Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries, in addition to rechargeable batteries, uninterruptable power supplies, charging systems and accessories. The Communications Systems segment includes: radio frequency (“RF”) amplifiers, power supplies, cable and connector assemblies, amplified speakers, equipment mounts, case equipment, man-portable systems, integrated communication systems for fixed or vehicle applications and communications and electronics systems design. We believe that reporting performance at the gross profit level is the best indicator of segment performance. As such we report segment performance at the gross profit level and operating expenses as Corporate charges. (See Note 11 in the Notes to Consolidated Financial Statements)

On February 16, 2012, we announced our intention to divest our RedBlack Communications, Inc. (“RedBlack”) business in 2012. As a result of management’s ongoing review of our business portfolio, management had determined that RedBlack offered limited opportunities to achieve the operating criteria thresholds of our new business model. On September 28, 2012, we entered into and closed a Stock Purchase Agreement to sell 100% of our capital stock in RedBlack to BCF Solutions, Inc (the “Agreement”). In exchange for the sale of RedBlack, we received \$2,533 as a purchase price, comprised of cash at closing in the amount of \$2,133, funds held in escrow for up to one year in the amount of \$250, as well as \$150 to be available for RedBlack employee retention programs. In addition, in the second quarter of 2013 we recorded \$125 for a customary post-closing working capital adjustment, which is reflected as a loss from discontinued operations. The Agreement contains customary representations and warranties that will survive for a period of two or three years. The Agreement also contains customary indemnification for breaches of the representations and warranties identified in the Agreement. Pursuant to the Agreement, we are prohibited from engaging or participating with any current customer of RedBlack in any business, directly or indirectly, that competes with the business conducted by RedBlack for two years. We are also prohibited from hiring, soliciting, or recruiting any current employee, independent contractor, or consultant of BCF Solutions, Inc. or RedBlack for two years. Commencing with the first quarter of 2012, the results of the RedBlack operations and related divestiture costs have been reported as a discontinued operation.

During the fourth quarter of 2012, we elected not to renew the lease for our U.K. manufacturing facility which expired on March 24, 2013, and relocated our sales and services operations to a smaller facility. As a result of this decision, we were required to restore the facility back to its original condition pursuant to the terms of the U.K. Facility Lease. In the fourth quarter of 2012, we recorded approximately \$950 related to this requirement of which \$200 was recorded as general & administrative expenses and \$750 was recorded as discontinued operations. This liability was settled in the first quarter of 2013 resulting in a gain from discontinued operations of \$241. We expect to realize net savings of approximately \$500 on an annualized basis beginning in the second quarter of 2013 due to this election.

We continually evaluate ways to grow, including opportunities to expand through mergers, acquisitions and joint ventures, which can broaden the scope of our products and services, expand operating and market opportunities and provide the ability to enter new lines of business synergistic with our portfolio of offerings.

In the second quarter of 2013, we received a termination notice from the New York State Energy Research and Development Authority (“NYSERDA”) regarding our collaborative agreement to develop and demonstrate a large hybrid grid-connected energy storage system. Pursuant to the terms of the agreement, NYSERDA will reimburse us for certain construction and project research and development costs incurred through the date of termination. We plan to continue this project internally with smaller form batteries which provide greater opportunity and applicability in the markets we serve. However, due to the termination letter and the change in scope of the project, we performed a review of the details of costs capitalized in connection with this project to determine their future use. Those costs without an identifiable future use were written off in the second quarter of 2013 and totaled \$56. The remaining capitalized costs were subjected to an impairment test based upon forecasted future cash flows, in accordance with current accounting guidance. No impairment was taken on the remaining capitalized costs.



## Overview

Consolidated revenues of \$20,361 for the three month period ended September 29, 2013, decreased by \$5,820, or 22.2%, from \$26,181 during the three month period ended September 30, 2012. This decrease is primarily attributable to the continued slowdown in the US government and defense order rate for rechargeable and non-rechargeable batteries and charger systems, as well as the effect of two large orders for our M-1 primary battery products and SATCOM systems units shipped in the third quarter of 2012.

Gross profit for the three month period ended September 29, 2013 was \$6,127, or 30.1% of revenues, compared to \$8,219, or 31.4% of revenues for the three month period ended September 30, 2012. The decrease in gross margin as a percentage of revenue is primarily due to lower overhead absorption as a consequence of strict inventory controls in the Battery & Energy Products business segment, partially offset by favorable product mix in the Communications Systems business segment.

Operating expenses decreased to \$5,475 or 15.3% during the three month period ended September 29, 2013, from \$6,465 during the three month period ended September 30, 2012, resulting primarily from continued actions to reduce general and administrative expenses and more focused spending in the development of new products.

Operating profit was \$652 for the three month period ended September 29, 2013, compared to \$1,754 for the three month period ended September 30, 2012 reflecting lower gross profit resulting from the impact of the SATCOM system units' shipment in the prior period, partially offset by reductions in operating expenses year over year.

Net income from continuing operations was \$607, or \$0.04 per share, for the three month period ended September 29, 2013, compared to net income of \$1,468, or \$0.09 per share, for the three month period ended September 30, 2012. Net income from discontinued operations was \$15, or \$0.00 per share, for the three month period ended September 29, 2013 versus net income of \$200, or \$0.01 per share, for the three month period ended September 30, 2012. The income in the third quarter of 2012 reflects the operating results, sale, and related divestiture costs and tax benefits for RedBlack.

Adjusted EBITDA from continuing operations, defined as net income (loss) attributable to Ultralife before net interest expense, provision (benefit) for income taxes, depreciation and amortization, plus/minus expenses/income that we do not consider reflective of our ongoing continuing operations, amounted to \$1,798 in the third quarter of 2013 compared to \$3,003 for the third quarter of 2012. See the section "Adjusted EBITDA from continuing operations" beginning on page 32 for a reconciliation of Adjusted EBITDA from continuing operations to net income (loss) attributable to Ultralife.

As a result of careful working capital management and cash generated from operations, our liquidity remains solid with no debt, and cash and cash equivalents, including restricted cash, of \$10,785, a \$5,414 improvement over the cash position of \$5,371 as of the third quarter of 2012 and a \$707 improvement over the cash position of \$10,078 as of year-end. The increase in cash and cash equivalents is primarily attributable to our operating cost reductions and cash generated from our Lean initiatives, including reductions in inventory.

## Outlook

For 2013, although the Company's pending project pipelines are growing, the continuing U.S. Government budget challenges have muddled our predictability of converting Communication Systems' sales opportunities in the timeframe originally forecasted. Primarily for this reason, management now expects that an overall year-over-year revenue decline could be approximately 20%, with Communications Systems revenues down in a comparable range for the year versus our prior expectations. Given the potential for reduced revenue, management now expects to report operating results in the range of breakeven to a modest operating loss for the year.



## Results of Operations

Three month periods ended September 29, 2013 and September 30, 2012

**Revenues.** Consolidated revenues for the three month period ended September 29, 2013 amounted to \$20,361, a decrease of \$5,850, or 22.2%, from the \$26,181 reported for the three month period ended September 30, 2012.

Battery & Energy Products revenues decreased \$3,126, or 18.8%, from \$16,633 for the three month period ended September 30, 2012 to \$13,507 for the three month period ended September 29, 2013. This decrease is primarily attributable to a large order for our M-1 primary battery products shipped in the third quarter of 2012 to service an allied country's department of defense. The decrease also reflects the continued slowdown in the US government and defense order rate for rechargeable and non-rechargeable batteries and charger systems.

Communications Systems revenues decreased \$2,694, or 28.2%, from \$9,548 during the three month period ended September 30, 2012 to \$6,854 for the three month period ended September 29, 2013. The decrease is attributable to shipments of SATCOM units in the amount of approximately \$3,400 to a large prime contractor which services the US Department of Defense during the third quarter of 2012.

**Cost of Products Sold.** Cost of products sold totaled \$14,234 for the quarter ended September 29, 2013, a decrease of \$3,728, or 20.8%, from the \$17,962 reported for the same three month period a year ago. Consolidated cost of products sold as a percentage of total revenue increased from 68.6% for the three month period ended September 30, 2012 to 69.9% for the three month period ended September 29, 2013. Correspondingly, consolidated gross margin was 30.1% for the three month period ended September 29, 2013, compared with 31.4% for the three month period ended September 30, 2012, primarily reflecting lower overhead absorption, partially offset by favorable product mix.

In our Battery & Energy Products segment, the cost of products sold decreased \$1,957, from \$11,863 during the three month period ended September 30, 2012 to \$9,906 during the three month period ended September 29, 2013. Battery & Energy Products' gross profit for the third quarter of 2013 was \$3,601, or 26.7% of revenues, a decrease of \$1,169 from gross profit of \$4,770, or 28.7% of revenues, for the third quarter of 2012. Battery & Energy Products' gross margin as a percentage of revenues decreased by 200 basis points for the three month period ended September 29, 2013, primarily reflecting lower overhead absorption in our Newark facility driven by better balancing of production and inventory levels with demand, which resulted in consolidated inventory reductions of over \$3,100 from the second quarter of 2013.

In our Communications Systems segment, the cost of products sold decreased by \$1,771 from \$6,099 during the three month period ended September 30, 2012 to \$4,328 during the three month period ended September 29, 2013. Communications Systems' gross profit for the third quarter of 2013 was \$2,526, or 36.9% of revenues, a decrease of \$923 from gross profit of \$3,449, or 36.1% of revenues, for the third quarter of 2012. The increase in gross margin as a percentage of revenue during the third quarter of 2013 is primarily due to strong product mix and continued productivity improvements.



**Operating Expenses.** Total operating expenses for the three month period ended September 29, 2013 totaled \$5,475, a decrease of \$990 or 15.3% from \$6,465 recorded during the three month period ended September 30, 2012, resulting primarily from continued actions to reduce general and administrative expenses and more focused spending in the development of new products.

Operating expenses as a percentage of revenues were 26.9% during the three month period ended September 29, 2013 as compared to 24.7% in the three month period ended September 30, 2012. Amortization expense associated with intangible assets related to our acquisitions was \$102 for the third quarter of 2013 (\$46 in selling, general and administrative expenses and \$56 in research and development costs), compared with \$122 for the third quarter of 2012 (\$57 in selling, general, and administrative expenses and \$65 in research and development costs). Research and development costs were \$1,418 for the three month period ended September 29, 2013, a decrease of \$178, or 11.2%, from \$1,596 for the three month ended September 30, 2012, as we focused our spending on the development of new products with the highest estimated return on investment. Selling, general, and administrative expenses decreased \$812, or 16.7%, to \$4,057 during the three month period ending September 29, 2013 from \$4,869 during the three month period ended September 30, 2012, reflecting continued actions to reduce discretionary general and administrative expenses to help fund additional revenue producing resources.

**Other Income (Expense).** Other income (expense) totaled \$(61) for the three month period ended September 29, 2013 compared to \$(111) for the three month period ended September 30, 2012. Interest expense, net of interest income, decreased \$43, to \$53 for the third quarter of 2013 from \$96 for the comparable period in 2012, as a result of a lower unused line rate associated with our new asset based lending facility with PNC Bank. Miscellaneous expense amounted to \$8 for the third quarter of 2013 compared with expense of \$15 for the third quarter of 2012, primarily due to transactions impacted by changes in foreign currencies relative to the U.S. dollar.

**Income Taxes.** We recorded a tax benefit of \$16 for the three month period ended September 29, 2013 compared with a tax provision of \$175 for the three month period ended September 30, 2012. The tax benefit in the third quarter of 2013 was primarily due to the timing of tax expense for our China operations related to a change in the statutory tax rate and the timing of temporary differences related to deferred tax liabilities generated from goodwill and certain intangible assets in our US operations. The effective consolidated tax rates for the three month periods ended September 29, 2013 and September 30, 2012 were:

	Three Month Periods Ended			
	September 29, 2013		September 30, 2012	
Income before Incomes Taxes (a)	\$	591	\$	1,643
Total Income Tax Provision (Benefit) (b)	\$	(16 )	\$	175
Effective Tax Rate (b/a)		2.7 %		10.7 %

See Note 8 in the Notes to Condensed Consolidated Financial Statements for additional information regarding our income taxes.

Certain of our NOL carryforwards are subject to U.S. alternative minimum tax such that carryforwards can offset only 90% of alternative minimum taxable income. This limitation did not have an impact on income taxes determined for the third quarter of 2013 and 2012. The use of our U.K. NOL carryforwards may be limited due to the change in the U.K. operation during 2008 from a manufacturing and assembly center to primarily a distribution and service center.



**Discontinued Operations.** Income from discontinued operations, net of tax was \$15 for the three month period ended September 29, 2013, compared to income of \$200 for the three month period ended September 30, 2012. The income in the three month period ended September 30, 2012 reflects the operating results, sale, and related divestiture costs and tax benefits for the RedBlack Communication business. For more information, see Note 2 to the Condensed Consolidated Financial Statements.

**Net Income Attributable to Ultralife.** Net income attributable to Ultralife and income attributable to Ultralife common shareholders per diluted share was \$644 and \$0.04, respectively, for the three months ended September 29, 2013, compared to a net income attributable to Ultralife and income attributable to Ultralife common shareholders per diluted share of \$1,679 and \$0.10, respectively, for the three months ended September 30, 2012. Average common shares outstanding used to compute diluted earnings per share increased from 17,418,000 in the third quarter of 2012 to 17,532,000 in the third quarter of 2013, mainly due to stock option exercises and shares of common stock issued to our non-employee directors.

Nine month periods ended September 29, 2013 and September 30, 2012

**Revenues.** Consolidated revenues for the nine month period ended September 29, 2013 amounted to \$58,659, a decrease of \$13,729, or 19.0%, from \$72,388 for the nine month period ended September 30, 2012.

**Battery & Energy Products** sales decreased \$11,022, or 21.1%, from \$52,238 during the nine month period ended September 30, 2012 to \$41,216 for the nine month period ended September 29, 2013. Revenues for Battery & Energy Products decreased primarily due to the continued slowdown in U.S. government and defense order rate for rechargeable and non-rechargeable batteries and charger systems, lower sales of 9 Volt batteries resulting from the sell-off of the remaining legacy products in the first quarter of 2012 with the introduction of the new battery design, as well as a large order for our M-1 primary battery products that took place in the third quarter of 2012.

**Communications Systems** revenues decreased \$2,707, or 13.4%, from \$20,150 during the nine month period ended September 30, 2012 to \$17,443 during the nine month period ended September 29, 2013. The year-over-year comparison reflects timing delays due to the government furloughs and shutdown, which has heightened the uncertainty of converting Communication Systems' sales opportunities as planned, as well as shipments of SATCOM units in the amount of approximately \$3,400 to a large prime contractor which services the US Department of Defense during the third quarter of 2012.

**Cost of Products Sold.** Cost of products sold totaled \$41,631 for the nine month period ended September 29, 2013, a decrease of \$11,478, or 21.6%, from the \$53,109 reported for the same nine month period a year ago. Consolidated cost of products sold as a percentage of total revenue decreased from 73.4% for the nine month period ended September 30, 2012 to 71.0% for the nine month period ended September 29, 2013. Correspondingly, consolidated gross margin was 29.0% for the nine month period ended September 29, 2013, compared with 26.6% for the nine month period ended September 30, 2012, primarily reflecting productivity gains in both businesses, favorable product mix and certain property tax credits related to prior years.

In our Battery & Energy Products segment, the cost of products sold decreased \$8,737, or 22.0%, from \$39,762 during the nine month period ended September 30, 2012 to \$31,025 during the nine month period ended September 29, 2013. Battery & Energy Products' gross profit for the first nine months of 2013 was \$10,191, or 24.7% of revenues, as compared to gross profit of \$12,476, or 23.9% of revenues, for the first nine months of 2012. Battery & Energy Products' gross margin increased by 80 basis points for the nine month period ended September 29, 2013, reflecting significant improvements in the overall productivity resulting from the reductions in labor and overhead spending, and, to a lesser extent, the receipt of certain property tax refunds relating to prior years.



In our Communications Systems segment, the cost of products sold decreased \$2,741, or 20.5%, from \$13,347 during the nine month period ended September 30, 2012 to \$10,606 during the nine month period ended September 29, 2013. Communications Systems' gross profit for the first nine months of 2013 was \$6,837, or 39.2% of revenues, an increase of \$34 from gross profit of \$6,803, or 33.8% of revenues, for the first nine months of 2012. The 540 basis points increase in gross margin as a percentage of revenue during 2013 is the result of stronger product mix, continued productivity improvements in line with our Lean initiatives, and the impact in the second quarter of 2012 of a reserve for approximately \$200 related to the request by a strategically important customer to upgrade certain products.

**Operating Expenses.** Total operating expenses for the nine month period ended September 29, 2013 totaled \$17,875, a decrease of \$3,872 or 17.8%, from \$21,747 for the nine month period ended September 30, 2012, resulting from continued actions to reduce general and administrative expenses, lower sales commissions and focused spending in the development of new products.

Overall, operating expenses as a percentage of revenues increased slightly to 30.5% during the first nine months of 2013 from 30.0% reported in the first nine months of 2012. Amortization expense associated with intangible assets related to our acquisitions was \$301 for the first nine months of 2013 (\$134 in selling, general and administrative expenses and \$167 in research and development costs), compared with \$372 for the first nine months of 2012 (\$177 in selling, general, and administrative expenses and \$195 in research and development costs). Research and development costs were \$4,456 in the first nine months of 2013, a decrease of \$1,250 or 21.9%, from \$5,706 reported in the first nine months of 2012, as we focused our spending on the development of new products with the highest estimated return on investment. Selling, general, and administrative expenses decreased \$2,622, or 16.3%, to \$13,419 during the nine month period ended September 29, 2013 from \$16,041 reported during the nine month period ended September 30, 2012, primarily reflecting on-going actions to reduce discretionary general and administrative expenses and lower sales commissions.

**Other Income (Expense).** Other income (expense) totaled \$(203) for the first nine months of 2013, compared to \$(295) for the first nine months of 2012. Interest expense, net of interest income, decreased \$140, to \$172 for the first nine months of 2013 from \$312 for the comparable period in 2012, as a result of a lower unused line rate associated with our new asset based lending facility with PNC Bank. Miscellaneous income/expense amounted to expense of \$31 for the first nine months of 2013 compared with income of \$17 for the first nine months of 2012, primarily driven by transactions impacted by changes in foreign currencies relative to the U.S. dollar.

**Income Taxes.** We reflected a tax provision of \$135 for the nine month period ended September 29, 2013 compared with a tax provision of \$437 for the nine month period ended September 30, 2012. The expense is primarily due to (a) the recognition of deferred tax liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods, and (b) the income reported for our China operations during the periods. The effective consolidated tax rate for the nine month periods ended September 29, 2013 and September 30, 2012 was:

	Nine month Periods Ended	
	September 29, 2013	September 30, 2012
Loss before Incomes Taxes (a)	\$ (1,050 )	\$ (2,763 )
Total Income Tax Provision (b)	\$ 135	\$ 437
Effective Tax Rate (b/a)	12.9 %	15.8 %

See Note 8 in the Notes to Condensed Consolidated Financial Statements for additional information regarding our income taxes.

Certain of our NOL carryforwards are subject to U.S. alternative minimum tax such that carryforwards can offset only 90% of alternative minimum taxable income. This limitation did not have an impact on income taxes determined for the first nine months of 2013 and 2012. The use of our U.K. NOL carryforwards may be limited due to the change in the U.K. operation during 2008 from a manufacturing and assembly center to primarily a distribution and service center.

**Discontinued Operations.** Income from discontinued operations, net of tax, totaled \$159 for the nine month period ended September 29, 2013, as compared to income of \$178 for the nine month period ended September 30, 2012. The income realized in the nine month period ended September 29, 2013 was primarily related to the final settlement of the obligation to return the company's former UK facility to its original condition per a previous contractual commitment, partially offset by the final post-closing working capital adjustment to the RedBlack Communications business purchase price. The income in the nine month period ended September 30, 2012 reflects the operating results, sale, and related divestiture costs and tax benefits for the RedBlack Communication business. For more information, see Note 2 to the Condensed Consolidated Financial Statements.

**Net Loss Attributable to Ultralife.** Net loss attributable to Ultralife and loss attributable to Ultralife common shareholders per diluted share was \$995 and \$0.06, respectively, for the nine month period ended September 29, 2013, compared to a net loss attributable to Ultralife and loss attributable to Ultralife common shareholders per diluted share of \$2,991 and \$0.17, respectively, for the nine month period ended September 30, 2012. Average common shares outstanding used to compute diluted earnings per share increased from 17,390,000 in the first nine months of 2012 to 17,461,000 in the first nine months of 2013, mainly due to stock option exercises and shares of common stock issued to our non-employee directors.

#### Adjusted EBITDA from Continuing Operations

In evaluating our business, we consider and use Adjusted EBITDA from continuing operations, a non-GAAP financial measure, as a supplemental measure of our operating performance. We define Adjusted EBITDA from continuing operations as net income (loss) attributable to Ultralife before net interest expense, provision (benefit) for income taxes, depreciation and amortization, plus/minus expenses/income that we do not consider reflective of our ongoing continuing operations. We use Adjusted EBITDA from continuing operations as a supplemental measure to review and assess our operating performance and to enhance comparability between periods. We also believe the use of Adjusted EBITDA from continuing operations facilitates investors' use of operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in such items as capital structures (affecting relative interest expense and stock-based compensation expense), the book amortization of intangible assets (affecting relative amortization expense), the age and book value of facilities and equipment (affecting relative depreciation expense) and other significant non-operating expenses or income. We also present Adjusted EBITDA from continuing operations because we believe it is frequently used by securities analysts, investors and other interested parties as a measure of financial performance. We reconcile Adjusted EBITDA from continuing operations to net income (loss) attributable to Ultralife, the most comparable financial measure under U.S. generally accepted accounting principles ("U.S. GAAP").

We use Adjusted EBITDA from continuing operations in our decision-making processes relating to the operation of our business together with U.S. GAAP financial measures such as income (loss) from operations. We believe that Adjusted EBITDA from continuing operations permits a comparative assessment of our operating performance, relative to our performance based on our U.S. GAAP results, while isolating the effects of depreciation and amortization, which may vary from period to period without any correlation to underlying operating performance, and of non-cash stock-based compensation, which is a non-cash expense that varies widely among companies. We believe that by limiting Adjusted EBITDA to continuing operations, we assist investors in gaining a better understanding of our business on a going forward basis. We provide information relating to our Adjusted EBITDA from continuing operations so that securities analysts, investors and other interested parties have the same data that we employ in

assessing our overall operations. We believe that trends in our Adjusted EBITDA from continuing operations are a valuable indicator of our operating performance on a consolidated basis and of our ability to produce operating cash flows to fund working capital needs, to service debt obligations and to fund capital expenditures.



The term Adjusted EBITDA from continuing operations is not defined under U.S. GAAP, and is not a measure of operating income, operating performance or liquidity presented in accordance with U.S. GAAP. Our Adjusted EBITDA from continuing operations has limitations as an analytical tool, and when assessing our operating performance, Adjusted EBITDA from continuing operations should not be considered in isolation or as a substitute for net income (loss) attributable to Ultralife or other consolidated statement of operations data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to, the following:

- Adjusted EBITDA from continuing operations does not reflect (1) our cash expenditures or future requirements for capital expenditures or contractual commitments; (2) changes in, or cash requirements for, our working capital needs; (3) the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt; (4) income taxes or the cash requirements for any tax payments; and (5) all of the costs associated with operating our business;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and Adjusted EBITDA from continuing operations does not reflect any cash requirements for such replacements;
- while stock-based compensation is a component of cost of products sold and operating expenses, the impact on our consolidated financial statements compared to other companies can vary significantly due to such factors as assumed life of the stock-based awards and assumed volatility of our common stock;
- although discontinued operations does not reflect our current business operations, discontinued operations includes the costs we incurred by exiting our Energy Services and certain of our UK businesses and divesting our RedBlack Communications business; and
- other companies may calculate Adjusted EBITDA from continuing operations differently than we do, limiting its usefulness as a comparative measure.

We compensate for these limitations by relying primarily on our U.S. GAAP results and using Adjusted EBITDA from continuing operations only supplementally. Adjusted EBITDA from continuing operations is calculated as follows for the periods presented:

Edgar Filing: ULTRALIFE CORP - Form 10-Q

	Three Month Periods Ended		Nine Month Periods Ended	
	September 29, 2013	September 30, 2012	September 29, 2013	September 30, 2012
Net income (loss) attributable to Ultralife	\$ 644	\$ 1,679	\$ (995 )	\$ (2,991 )
Add: interest expense, net	53	96	172	312
Add (Less): income tax provision (benefit)	(16 )	175	135	437
Add: depreciation expense	720	800	2,279	2,460
Add: amortization of intangible assets	102	122	301	372
Add: stock-based compensation expense	310	331	740	1,001
Less: gain from discontinued operations	(15 )	(200 )	(159 )	(178 )
<b>Adjusted EBITDA</b>	<b>\$ 1,798</b>	<b>\$ 3,003</b>	<b>\$ 2,473</b>	<b>\$ 1,413</b>

### Liquidity and Capital Resources

The following cash flow information is being presented net of continuing and discontinued operations.

As of September 29, 2013, cash and cash equivalents totaled \$10,365, an increase of \$709 from the beginning of the year. During the nine month period ended September 29, 2013, we generated \$1,401 of cash from operating activities as compared to using \$229 of cash for the nine month period ended September 30, 2012. The generation of cash in 2013 resulted primarily from our net loss from continuing operations of \$1,185 adjusted for the non-cash expenses of depreciation, amortization, and stock compensation.

We used \$556 in cash for investing activities during the first nine months of 2013 compared with \$128 in cash used for investing activities in the same period in 2012. The use of cash in 2013 is predominately for capital expenditures to improve our operations partially offset by the partial receipt of our working capital adjustment related to the sale of our RedBlack Communications business of \$182. The use of cash in 2012 is the result of \$2,011 used towards capital improvements, including the significant investment to automate certain production lines in China, an event that did not recur in 2013, and an increase of \$250 for restricted cash relating to our sale of our RedBlack Communications business. These two items were offset by \$2,133 cash received at closing from our sale of our RedBlack Communications business.

During the nine month period ended September 29, 2013, we generated \$12 in funds from financing activities compared to the generation of \$115 in funds in the same period of 2012. The financing activities in the first nine months of 2013 included a \$12 inflow from stock option exercises. The financing activities in the first nine months of 2012 included a \$115 inflow from stock option exercises.

Inventory turnover for the first nine months of 2013 was an annualized rate of approximately 2.0 turns per year as compared with 2.3 turns for the first nine months of 2012. The decrease in this metric is due mainly to lower sales period over period resulting primarily from delays in government spending.

As of September 29, 2013, we had made commitments to purchase approximately \$453 of production machinery and equipment, which we expect to fund through operating cash flows.

### Debt Commitments

On May 24, 2013, we entered into a Revolving Credit, Guaranty and Security Agreement (the "Credit Agreement") and related security agreements with PNC Bank, National Association ("PNC") to establish a \$20 million secured

asset-based revolving credit facility that includes a \$1 million letter of credit subfacility (the “Credit Facility”). The Credit Agreement provides that the Credit Facility may be increased with the PNC’s concurrence to \$35 million prior to the last six months of the term and expires on May 24, 2017. The Credit Facility replaces the prior credit facility with RBS Business Capital, a division of RBS Asset Finance, Inc., which expired in accordance with its terms on May 15, 2013, with no debt outstanding.

Our available borrowing limit under the Credit Facility fluctuates from time to time based on a borrowing base formula equal to the sum of up to 85% of eligible accounts receivable plus the least of (a) up to 65% of the eligible inventory and eligible foreign in-transit inventory, (b) up to 85% of the appraised net orderly liquidation value of eligible inventory and eligible foreign in-transit inventory, and (c) \$7.5 million, in each case subject to the definitions in the Credit Agreement and reserves required by PNC.

Interest is payable quarterly and will accrue on outstanding indebtedness under the Credit Agreement at the alternate base rate, as defined in the Credit Agreement, plus the applicable margin or at the one, two or three month LIBOR rate plus the applicable margin as selected by the Company and listed below.

Quarterly Average Undrawn Borrowing Availability	Applicable Margin for Alternate Base Rate Loans		Applicable Margin for LIBOR Rate Loans	
Greater than \$8,000,000	1.00	%	2.00	%
\$5,000,000 up to \$8,000,000	1.25	%	2.25	%
Less than \$5,000,000	1.50	%	2.50	%

We must pay a fee on its unused availability of 0.375% per annum and customary letter of credit fees in addition to various collateral monitoring and related fees and expenses.

In addition to customary affirmative and negative covenants, we must maintain a fixed charge coverage ratio as defined in the Credit Agreement of 1:15 to 1:00 tested quarterly for the four-quarters then ended. As of September 29, 2013 we were in compliance with all covenants. The Credit Facility is secured by substantially all our assets.

Any outstanding advances must be repaid upon expiration of the term of the Credit Facility. Payments must be made during the term to the extent outstanding advances exceed the maximum amount then permitted to be drawn as advances under the Credit Facility and from the proceeds of certain transactions. Upon the occurrence of an event of default, the outstanding obligations may be accelerated and PNC will have other customary remedies.

As of September 29, 2013, we had \$-0- outstanding under the Credit Facility, an applicable interest rate of 2.18%, approximately \$12,781 of borrowing capacity in addition to our unrestricted cash on hand of \$10,365, and no outstanding letters of credit related to the Credit Facility.

#### Warranty

With respect to our battery products, we typically offer warranties against any defects due to product malfunction or workmanship for a period up to one year from the date of purchase. With respect to our communications accessory products, we typically offer a three-year warranty. We provide for a reserve for these potential warranty expenses, which is based on an analysis of historical warranty issues. There is no assurance that future warranty claims will be consistent with past history, and in the event we experience a significant increase in warranty claims, there is no assurance that our reserves would be sufficient. This could have a material adverse effect on our business, financial condition and results of operations.

## Other Matters

We are currently participating in and providing technical assistance in support of an investigation conducted by a downstream customer and regulatory authorities with regard to a recent fire in an unoccupied and parked Boeing 787 Dreamliner aircraft.

## Critical Accounting Policies

Management exercises judgment in making important decisions pertaining to choosing and applying accounting policies and methodologies in many areas. Not only are these decisions necessary to comply with U.S. generally accepted accounting principles, but they also reflect management's view of the most appropriate manner in which to record and report our overall financial performance. All accounting policies are important, and all policies described in Note 1 ("Summary of Operations and Significant Accounting Policies") to our Consolidated Financial Statements in our 2012 Annual Report on Form 10-K should be reviewed for a greater understanding of how our financial performance is recorded and reported.

During the first nine months of 2013, there were no significant changes in the manner in which our significant accounting policies were applied or in which related assumptions and estimates were developed.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

As a Smaller Reporting Company, we are not required to provide this information.

## Item 4. CONTROLS AND PROCEDURES

### Evaluation Of Disclosure Controls And Procedures

Our president and chief executive officer (principal executive officer) and our chief financial officer and treasurer (principal financial officer) have evaluated our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e)) as of the end of the period covered by this quarterly report. Based on this evaluation, our president and chief executive officer and chief financial officer and treasurer concluded that our disclosure controls and procedures were effective as of such date.

### Changes In Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) that occurred during the fiscal quarter covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 6. Exhibits

Exhibit Index	Description of Document	Filed or Incorporated By Reference from:
31.1	Rule 13a-14(a) / 15d-14(a) CEO Certifications	Filed herewith
31.2	Rule 13a-14(a) / 15d-14(a) CFO Certifications	Filed herewith
32	Section 1350 Certifications	Filed herewith
*101.INS	XBRL Instance Document	
*101.SCH	XBRL Taxonomy Extension Schema Document	
*101.CAL	XBRL Taxonomy Calculation Linkbase Document	
*101.LAB	XBRL Taxonomy Label Linkbase Document	
*101.PRE	XBRL Taxonomy Presentation Linkbase Document	
*101.DEF	XBRL Taxonomy Definition Document	

\*Pursuant to Rule 406T of Regulation S-T, the information in this exhibit is deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is otherwise not subject to liability under these sections.

SIGNATURES

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

ULTRALIFE CORPORATION  
(Registrant)

Date: November 8, 2013

By: /s/ Michael D. Popielec  
Michael D. Popielec  
President and Chief Executive  
Officer  
(Principal Executive Officer)

Date: November 8, 2013

By: /s/ Philip A. Fain  
Philip A. Fain  
Chief Financial Officer and  
Treasurer  
(Principal Financial Officer and  
Principal Accounting Officer)

Index to Exhibits

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
101.DEF	XBRL Taxonomy Definition Document