

MECHANICAL TECHNOLOGY INC  
Form 10-Q  
August 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q  
\_\_\_\_\_

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2013

**OR**

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Mechanical Technology, Incorporated

(Exact name of registrant as specified in its charter)

\_\_\_\_\_

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New York  
(State or Other Jurisdiction  
of Incorporation)

0-6890  
(Commission File Number)

14-1462255  
(IRS Employer

Identification No.)

**325 Washington Avenue Extension, Albany, New York 12205**

(Address of registrant's principal executive office)

**(518) 218-2550**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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  No

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

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

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

The number of shares of common stock, par value of \$0.01 per share, outstanding as of August 1, 2013 was 5,256,883.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Mechanical Technology, Incorporated and Subsidiaries****Condensed Consolidated Balance Sheets as of June 30, 2013 (Unaudited) and December 31, 2012**

(Dollars in thousands, except per share)

	June 30, 2013	December 31, 2012
<b>Assets</b>		
<b>Current Assets:</b>		
Cash	\$ 835	\$ 289
Accounts receivable	1,092	1,674
Inventories	839	1,118
Deferred income taxes, net	16	16
Prepaid expenses and other current assets	90	100
Total Current Assets	2,872	3,197
<b>Deferred income taxes, net</b>	1,363	1,519
<b>Property, plant and equipment, net</b>	124	129
<b>Total Assets</b>	<b>\$ 4,359</b>	<b>\$ 4,845</b>
<b>Liabilities and Equity</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 246	\$ 208
Accrued liabilities	939	1,048
Deferred revenue		591
Total Current Liabilities	1,185	1,847
<b>Commitments and Contingencies (Note 11)</b>		
<b>Equity:</b>		
Common stock, par value \$0.01 per share, authorized 75,000,000; 6,261,975 issued in both 2013 and 2012	63	63
Additional paid-in capital	135,585	135,561
Accumulated deficit	(121,997 )	(122,183 )
	(13,754 )	(13,754 )

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Common stock in treasury, at cost, 1,005,092 shares  
in both 2013 and 2012

Total MTI stockholders' deficit	(103	)	(313	)
Non-controlling interest	3,277		3,311	
Total Equity	3,174		2,998	
<b>Total Liabilities and Equity</b>	\$	4,359	\$	4,845

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

## Mechanical Technology, Incorporated and Subsidiaries

## Condensed Consolidated Statements of Operations (Unaudited)

For the Three and Six Months Ended June 30, 2013 and 2012

(Dollars in thousands, except per share)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Product revenue	\$ 2,267	\$ 1,366	\$ 4,467	\$ 2,570
Operating costs and expenses:				
Cost of product revenue	801	740	1,776	1,318
Unfunded research and product development expenses	307	337	647	710
Selling, general and administrative expenses	927	978	1,746	2,070
Operating income (loss)	232	(689 )	298	(1,528 )
Other income, net	9	180	9	183
Income (loss) before income taxes and non-controlling interest	241	(509 )	307	(1,345 )
Income tax expense	(156 )		(155 )	
Net income (loss)	85	(509 )	152	(1,345 )
Plus: Net loss (income) attributed to non-controlling interest	15	(61 )	34	(46 )
Net income (loss) attributed to MTI	\$ 100	\$ (570 )	\$ 186	\$ (1,391 )
Income (loss) per share attributable to MTI (Basic)	\$ .02	\$ (.11 )	\$ .04	\$ (.26 )
Income (loss) per share attributable to MTI (Diluted)	\$ .02	\$ (.11 )	\$ .04	\$ (.26 )
Weighted average shares outstanding (Basic)	5,256,883	5,256,246	5,256,883	5,255,564
Weighted average shares outstanding (Diluted)	5,258,901	5,256,246	5,256,883	5,255,564

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





**MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES****Condensed Consolidated Statements of Changes in Equity****For the Year Ended December 31, 2012****and the Six Months Ended June 30, 2013 (Unaudited)**

	Common Stock			Treasury Stock		Non-Controlling Interest (NCI)		Total Equity	
	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Shares	Amount	Total MTI Stockholders Equity (Deficit)		
<b>January 1, 2012</b>	6,259,975	\$ 63	\$ 135,389	\$ (120,097 )	1,005,092	\$ (13,754 )	\$ 1,601	\$ 3,314	\$ 4,915
Net loss attributed to MTI	-	-	-	(2,086 )	-	-	(2,086 )	-	(2,086 )
Stock based compensation	-	-	171	-	-	-	171	-	171
Issuance of shares common stock	2,000	-	1	-	-	-	1	-	1
Net loss attributed to NCI	-	-	-	-	-	-	-	(3 )	(3 )
<b>December 31, 2012</b>	6,261,975	\$ 63	\$ 135,561	\$ (122,183 )	1,005,092	\$ (13,754 )	\$ (313 )	\$ 3,311	\$ 2,998
Net income attributed to MTI	-	-	-	186	-	-	186	-	186
Stock based compensation	-	-	24	-	-	-	24	-	24
Net loss attributed to NCI	-	-	-	-	-	-	-	(34 )	(34 )
<b>June 30, 2013</b>	6,261,975	\$ 63	\$ 135,585	\$ (121,997 )	1,005,092	\$ (13,754 )	\$ (103 )	\$ 3,277	\$ 3,174

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

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**MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited)****For the Six Months Ended June 30, 2013 and 2012**

(Dollars in thousands)

	<b>Six Months Ended June 30,</b>	
	2013	2012
<b>Operating Activities</b>		
Net income (loss)	\$ 152	\$(1,345)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	46	73
Gain on disposal of equipment	(9 )	(130 )
Deferred income taxes	156	
Stock based compensation	24	113
Provision for excess and obsolete inventories	(16 )	68
Changes in operating assets and liabilities:		
Accounts receivable	582	1,231
Inventories	295	(280 )
Prepaid expenses and other current assets	10	20
Accounts payable	38	116
Deferred revenue	(591)	
Accrued liabilities	(109)	(172 )
Net cash provided by (used in) operating activities	578	(306 )
<b>Investing Activities</b>		
Purchases of equipment	(41 )	(10 )
Proceeds from sale of equipment	9	91
Net cash (used in) provided by investing activities	(32 )	81
Increase (decrease) in cash	546	(225 )
Cash beginning of period	289	1,669
Cash end of period	\$ 835	\$ 1,444

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



**MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**1. Nature of Operations**

*Description of Business*

Mechanical Technology, Incorporated (MTI or the Company), a New York corporation, was incorporated in 1961. MTI operates in two segments, the Test and Measurement Instrumentation segment, which is conducted through MTI Instruments, Incorporated (MTI Instruments), a wholly-owned subsidiary, and the New Energy segment, which is conducted through MTI MicroFuel Cells Incorporated (MTI Micro), a variable interest entity (VIE) that is included in these condensed consolidated financial statements and described further below in Note 2.

MTI Instruments was incorporated in New York on March 8, 2000 and is a worldwide supplier of precision non-contact physical measurement solutions, portable vibration measurement and balancing systems, wafer inspection tools and precision contact measurement of material tensile strength. MTI Instruments uses a comprehensive array of technologies to solve complex, real world applications in numerous industries including industrial manufacturing, semiconductor, solar, commercial and military aviation, automotive and research and development centers. MTI Instruments' products consist of electronic gauging instruments for position, displacement, vibration applications within the research, design, test, manufacturing/production processes; wafer characterization of semi-insulating and semi-conducting wafers, both in the semiconductor and solar industries; tensile stage systems for materials testing at academic and industrial settings; and engine vibration analysis systems for both military and commercial aircraft as well as industrial power engines.

MTI Micro was incorporated in Delaware on March 26, 2001, and, until its operations were suspended in late 2011, had been developing Mobion<sup>®</sup>, a handheld energy-generating device to replace current lithium-ion and similar rechargeable battery systems in many handheld electronic devices for the military and consumer markets. Although MTI Micro continues to believe in the potential of its Mobion<sup>®</sup> based power solutions, operations continue to remain suspended at MTI Micro until such time as market demand and other deciding factors, including obtaining additional external financing, the successful completion of customer trials, a new development program with a government agency, and/or a customer order, come to fruition. MTI Micro will continue to seek additional capital from external sources to resume operations and fund future development, as warranted. If MTI Micro is unable to secure additional financing, a new development program or customer order, the MTI Micro Board of Directors will assess other options for MTI Micro, including the sale of its intellectual property portfolio and/or remaining assets. As of June 30, 2013, the Company owned approximately 47.6% of MTI Micro's outstanding common stock.

*Liquidity*

The Company has incurred significant losses primarily due to its past efforts to fund MTI Micro's direct methanol fuel cell product development and commercialization programs, and has an accumulated deficit of approximately \$122.0 million and working capital of approximately \$1.7 million at June 30, 2013.

The Company restructured the operations of the Company during the second half of 2012, which included the departure of its then CEO, staffing adjustments to its MTI Instrument's sales force and reduction in MTI Instrument's production and development personnel. This restructuring is expected to yield cash flow savings of approximately \$1.0 million annually.

Based on the Company's projected cash requirements for operations and capital expenditures for 2013, its current available cash of \$784 thousand (excluding MTI Micro available cash), current cash flow requirements and revenue and expense projections, management believes it will have adequate resources to fund its active operations and capital expenditures for at least the next twelve months.

However, the Company may need to do one or more of the following to raise additional resources, or reduce its cash requirements:

- 1) Reduce its current expenditure run rate;
- 2) Defer its capital expenditures;
- 3) Defer its hiring plans; and
- 4) Secure additional debt or equity financing.

There is no guarantee that such resources will be available to the Company on terms acceptable to it, or at all, or that such resources will be received in a timely manner, if at all, or that the Company will be able to reduce its expenditure run-rate, defer its capital expenditures or hiring plans without materially and adversely effecting its business.

The Company suspended operations at MTI Micro in late 2011 and, as of June 30, 2013, MTI Micro's available cash is approximately \$51 thousand.

## **2. Basis of Presentation**

In the opinion of management, the Company's condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair statement of the results for the periods presented in accordance with United States of America Generally Accepted Accounting Principles (U.S. GAAP) and with the instructions to Form 10-Q in Article 10 of the Securities and Exchange Commission's (SEC) Regulation S-X. The results of operations for the interim periods presented are not necessarily indicative of results for the full year.

Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The information presented in the accompanying condensed consolidated balance sheet as of December 31, 2012 has been derived from the Company's audited consolidated financial statements. All other information has been derived from the Company's unaudited condensed consolidated financial statements for the three and six months ended June 30, 2013 and June 30, 2012.

### ***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, MTI Instruments and its VIE, MTI Micro. The Company is the primary beneficiary of the VIE. All inter-company balances and transactions are eliminated in consolidation. The Company reflects the impact of the equity securities issuances in its investment in a VIE and additional paid-in-capital accounts for the dilution or anti-dilution of its ownership interest in the VIE.

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The Company has performed an analysis under the VIE model and determined that MTI Micro is a VIE. One of the criteria for determining whether an entity is a VIE is determining if the entity, MTI Micro, has equity at risk. Management has concluded that MTI Micro does not have equity at risk to fund operations into its next phase of development. Further, the Company has determined that it is the primary beneficiary of MTI Micro, and therefore should include MTI Micro's results of operations in the Company's consolidated financial statements.

The Company's analysis to determine the primary beneficiary of MTI Micro focused primarily on determining which variable interest holder has the power to direct the activities that would have the most significant impact on the financial performance of MTI Micro. MTI Micro is governed by its own board of directors and significant decisions are determined by a majority vote of this board. MTI does not have control of the MTI Micro board of directors; however, at this time, the Company's board of directors and the MTI Micro board of directors consist of the same members. Under the Articles of Incorporation of MTI Micro, each share of MTI Micro stock is entitled to a vote, and further, holders of a majority of the shares of MTI Micro's common stock have the ability to reconstitute the board. As of June 30, 2013, MTI, Counter Point Ventures Fund II, LP (Counter Point) and Dr. Walter L. Robb, a member of the Company's and MTI Micro's board of directors own 47.6%, 45.2% and 5.1% of the common shares of MTI Micro, respectively. Counter Point is a venture capital fund sponsored and managed by Dr. Robb. Since no entity of the related parties has power but, as a group, the Company and its related parties have the power, then the party within the related party group that is most closely associated with the VIE, MTI Micro, is the primary beneficiary. Even though Dr. Robb and Counterpoint combined control a majority of the outstanding common stock, and they have the ability to elect the directors of MTI Micro and decide whether to continue to seek business opportunities for MTI Micro or instead seek opportunities to sell the intellectual property, they have not elected to do so. The Company continues to oversee the day to day operations, exercise management decision making, seek opportunities to sell intellectual property, and has a vested interest in the commercialization of MTI Micro's fuel cell technology. Since inception in 2001, the Company has made the largest investment and been the principal funder of MTI Micro. The Company has also been exposed to losses and has the ability to benefit from MTI Micro. Considering the facts and circumstances, management believes the Company is most closely associated with the VIE, MTI Micro, and therefore, it is the primary beneficiary.

Should there be a change in the facts and circumstances (such as undertaking additional activities, a change in governance or a change to the related party group) in the future, management will reassess whether the Company remains the primary beneficiary and should continue to consolidate MTI Micro in the Company's consolidated financial statements.



Non-controlling interests (NCI) are classified as equity in the consolidated financial statements. The consolidated statement of operations presents net income (loss) for both the Company and the non-controlling interests. The calculation of earnings per share is based on net income (loss) attributable to the Company.

### 3. Accounts Receivable

Accounts receivables consist of the following at:

(Dollars in thousands)	June 30, 2013	December 31, 2012
U.S. and State Government	\$ 203	\$ 874
Commercial	889	800
Total	\$ 1,092	\$ 1,674

For the six months ended June 30, 2013 and 2012, the largest commercial customer represented 8.4% and 9.6%, respectively, and a U.S. governmental agency represented 31.7% and 14.7%, respectively, of the Company's Test and Measurement Instrumentation segment product revenue. As of June 30, 2013 and December 31, 2012, the largest commercial customer represented 7.9% and 9.7%, respectively, and a U.S. governmental agency represented 15.8% and 51.3%, respectively, of the Company's Test and Measurement Instrumentation segment accounts receivable.

As of June 30, 2013 and December 31, 2012, there were no outstanding receivables for the New Energy segment.

As of June 30, 2013 and December 31, 2012, the Company had no allowance for doubtful trade accounts receivable.

### 4. Inventories

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Inventories consist of the following at:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Finished goods	\$ 265	\$ 265
Work in process	225	482
Raw materials	349	371
Total	\$ 839	\$ 1,118

**5. Property, Plant and Equipment**

Property, plant and equipment consist of the following at:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Leasehold improvements	\$954	\$ 954
Computers and related software	1,749	1,709
Machinery and equipment	1,383	1,390
Office furniture and fixtures	270	271
	4,356	4,324
Less: Accumulated depreciation	4,232	4,195
	\$124	\$ 129

Depreciation expense was \$46 thousand and \$129 thousand for the six months ended June 30, 2013 and the year ended December 31, 2012, respectively. In conjunction with the suspension of MTI Micro operations in late 2011, sales of certain surplus equipment on hand were made during 2013 and 2012. This resulted in a net gain on sale of \$9 thousand and \$130 thousand for the six months ended June 30, 2013 and 2012. As of June 30, 2013 and December 31, 2012, all \$9 thousand and \$143 thousand, respectively in sales proceeds have been received.

## 6. Income Taxes

During the three months ended June 30, 2013, the Company's effective income tax rate was 64.7%. The projected annual effective tax rate is more than the Federal statutory rate of 35%, primarily due to permanent differences, the change in the valuation allowance and changes to estimated taxable income for 2013. For the three months ended June 30, 2012, the Company's effective income tax rate was 0%.

During the six months ended June 30, 2013, the Company's effective income tax rate was 50.6%. The projected annual effective tax rate is more than the Federal statutory rate of 35%, primarily due to permanent differences and the change in the valuation allowance. For the six months ended June 30, 2012, the Company's effective income tax rate was 0%.

The Company provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur in accordance with accounting standards that address income taxes. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. The Company has considered all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income amongst other items, in determining our valuation allowance. In addition, the Company's assessment requires us to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance which further requires the exercise of significant management judgment.

The Company released a portion of our valuation allowance against its deferred tax assets causing an incremental tax benefit of \$1.5 million that was recognized in the fourth quarter of 2011. The release of a portion of the valuation allowance was based upon a recent cumulative income history for MTI and its subsidiary exclusive of MTI Micro (MTI Micro files separate federal and state tax returns) causing the Company to evaluate what portion of the Company's deferred tax assets it believes are more likely than not to be realized. The Company has recognized a deferred tax expense of \$156 thousand for the second quarter of 2013, which represents the anticipated use of net operating losses to offset current tax liabilities due to the Company being in a net earnings position. The Company has determined that it continues to expect to generate sufficient levels of pre-tax earnings in the future to realize the remaining net deferred tax assets recorded on the balance sheet at June 30, 2013. The Company has projected such pre-tax earnings utilizing a combination of historical and projected results, taking into consideration existing levels of permanent differences, non-deductible expense and the reversal of significant temporary differences. The Company needs to generate approximately \$225 thousand of taxable income in each year over the next twenty years to ensure the realizability of the approximately \$1.4 million of deferred tax assets recorded on the condensed consolidated balance sheet at June 30, 2013.

The Company believes that the accounting estimate for the valuation of deferred tax assets is a critical accounting estimate, because judgment is required in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns. The Company based the estimate of deferred tax assets and liabilities on current tax laws and rates and, in certain cases, business plans and other expectations about future outcomes. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to adjust the recorded valuation allowance, which could materially impact our financial position and results of operations. The valuation allowance was \$17.8 million at June 30, 2013 and December 31, 2012. The Company will continue to evaluate the ability to realize its deferred tax assets and related valuation allowances on a quarterly basis.

## 7. Stockholders' Equity

### *Common Stock*

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The Company has one class of common stock, par value \$.01. Each share of the Company's common stock is entitled to one vote on all matters submitted to stockholders. As of June 30, 2013 and December 31, 2012, there were 5,256,883 shares of common stock issued and outstanding.

Changes in common shares issued and treasury stock outstanding are as follows:

	Six Months Ended	Year Ended
	June 30, 2013	December 31, 2012
<b>Common Shares</b>		
Balance, beginning	6,261,975	6,259,975
Issuance of shares for common stock grants		2,000
Balance, ending	6,261,975	6,261,975
<b>Treasury Stock</b>		
Balance, beginning	1,005,092	1,005,092
Balance, ending	1,005,092	1,005,092

***Reservation of Shares***

The Company had reserved common shares for future issuance as follows as of June 30, 2013:

Stock options outstanding	464,256
Common stock available for future equity awards or issuance of options	262,500
Number of common shares reserved	726,756

***Earnings (Loss) per Share***

The Company computes basic income (loss) per common share by dividing net income (loss) by the weighted average number of common shares outstanding during the reporting period. Diluted income (loss) per share reflects the potential dilution, if any, computed by dividing income (loss) by the combination of dilutive common share equivalents, comprised of shares issuable under outstanding investment rights, warrants and the Company's share-based compensation plans, and the weighted average number of common shares outstanding during the reporting period. Dilutive common share equivalents include the dilutive effect of in-the-money stock options, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of a stock option, the amount of compensation cost, if any, for future service that the Company has not yet recognized, and the amount of windfall tax benefits that would be recorded in additional paid-in capital, if any, when the stock option is exercised are assumed to be used to repurchase shares in the current period.

Not included in the computation of earnings per share, assuming dilution, for the three and six months ended June 30, 2013, were options to purchase 454,256 and 464,256 shares, respectively of the Company's common stock. These potentially dilutive items were excluded even though the average market price of the common stock exceeded the exercise prices for a portion of the options because the calculation of incremental shares resulted in an anti-dilutive effect.

Not included in the computation of loss per share, assuming dilution, for the three and six months ended June 30, 2012, were options to purchase 412,555 shares of the Company's common stock. These potentially dilutive items were excluded because the Company incurred a loss for this period and their inclusion would be anti-dilutive.

**8. Issuance of Common Stock, Warrants and Stock Options by MTI Micro**

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As of June 30, 2013, the Company owned approximately 47.6% of MTI Micro's outstanding common stock, or 75,049,937 shares, and 53.3% of common stock and warrants issued, which includes 32,904,136 outstanding warrants. The number of shares of MTI Micro common stock authorized for issuance is 240,000,000 as of June 30, 2013.

### *Common Stock MTI Micro*

The following table represents changes in ownership between the Company and non-controlling interests (NCI) in common shares of MTI Micro:

	<b>Average</b>	<b>MTI</b>	<b>Ownership</b>	<b>Non Controlling Interest (NCI)</b>	<b>Ownership</b>	<b>Total</b>
	<b>Price</b>	<b>Shares</b>	<b>%</b>	<b>Shares</b>	<b>%</b>	<b>Shares</b>
Balance at 12/31/12	\$0.07	75,049,937	47.61	82,573,107	52.39	157,623,044
Balance at 6/30/13	\$0.07	75,049,937	47.61	82,573,107	52.39	157,623,044

### *Warrants Issued MTI Micro*

On December 9, 2009, MTI Micro issued warrants to the then current shareholders of MTI Micro, including the Company, without consideration, to purchase 32,779,310 shares of MTI Micro Common Stock at an exercise price of \$0.07 per share. The warrants became exercisable on December 9, 2010 and expire on December 8, 2017. The warrants have been accounted for as an equity distribution of \$2.0 million, including warrants to the Company with a value of \$2.0 million, which were eliminated in consolidation.

On December 9, 2009, MTI Micro issued warrants to the Bridge Investors of MTI Micro, including the Company, to purchase 5,081,237 shares of MTI Micro Common Stock at an exercise price of \$0.07 per share. The MTI Micro Warrants became exercisable on December 9, 2009 and will expire on the earlier of: (i) April 15, 2014; (ii) immediately prior to a change in control; or (iii) immediately prior to an initial public offering of MTI Micro. The MTI Micro Warrants were issued without consideration and were accounted for as equity and a loss on extinguishment of debt was recorded in the amount of \$289 thousand, including warrants to the Company with a value of \$57 thousand, which were eliminated in consolidation.

Under the Purchase Agreement entered into on January 11, 2010, MTI Micro issued 5,714,286 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of \$0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

Under Amendment No. 1 entered into on February 9, 2011, MTI Micro issued 1,285,715 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of \$0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

Under Amendment No. 2 entered into on September 23, 2011, MTI Micro issued 240,000 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of \$0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

***Reservation of Shares MTI Micro***

MTI Micro has reserved common shares for future issuance, broken down between the Company and NCI, as follows as of June 30, 2013:

	<b>MTI</b>	<b>NCI</b>	<b>Total</b>
Stock options outstanding		1,140,240	1,140,240
Warrants outstanding	32,904,136	12,196,411	45,100,547
Number of shares reserved for outstanding options and warrants	32,904,136	13,336,651	46,240,787

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During the six months ended June 30, 2013, there were 389,800 option cancellations. MTI Micro has 36,861,760 stock options available for issuance as of June 30, 2013.

As of June 30, 2013, the Company owned an aggregate of approximately 47.6% of the outstanding shares of MTI Micro or 53.3% of the outstanding common stock and warrants issued of MTI Micro, and Counter Point and Dr. Robb owned approximately 45.2% and 5.1%, respectively of the outstanding shares of MTI Micro or 40.3% and 4.3%, respectively of the outstanding common stock and warrants issued of MTI Micro.

### **9. Fair Value Measurement**

The Company performs a detailed analysis of financial assets and liabilities in determining the appropriate levels of classification. At each reporting period, all assets and liabilities for which the fair value measurements are based upon significant unobservable inputs are classified as Level 3. The Company had no Level 1, Level 2 or Level 3 assets and liabilities as of June 30, 2013 and December 31, 2012.

### **10. Segment Information**

The Company operates in two business segments, Test and Measurement Instrumentation and New Energy. The Test and Measurement Instrumentation segment designs, manufactures, markets and services high performance test and measurement instruments and systems, wafer characterization tools for the semiconductor and solar industries, tensile stage systems for materials testing at academic and industrial settings, and computer-based balancing systems for aircraft and industrial power engines. The New Energy segment is focused on commercializing direct methanol fuel cells. The Company's principal operations are located in North America.

The accounting policies of the Test and Measurement Instrumentation and New Energy segments are similar to those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K (Note 2). The Company evaluates performance based on profit or loss from operations before income taxes. Inter-segment sales and expenses are not significant.



Summarized financial information concerning the Company's reportable segments is shown in the following tables. The Other column includes corporate related items and items such as income taxes or unusual items, which are not allocated to reportable segments. The Reconciling Items column includes non-controlling interests in a consolidated entity. In addition, segments' non-cash items include any depreciation in reported profit or loss. The New Energy segment figures include the Company's direct micro fuel cell operations. As a result of the suspension of the MTI Micro operations in late 2011, the New Energy segment will continue to be included in these tables as long as they remain in our consolidated operations.

(Dollars in thousands)

	Test and Measurement Instrumentation	New Energy	Other	Reconciling Items	Condensed Consolidated Totals
<u>Three Months Ended June 30, 2013</u>					
Product revenue	\$ 2,267	\$	\$	\$	\$ 2,267
Unfunded research and product development expenses	307				307
Selling, general and administrative expenses	501	17	409		927
Segment profit (loss) from operations before non-controlling interest	499	(28 )	(386 )		85
Segment profit (loss)	499	(28 )	(386 )	15	100
Total assets	1,985	53	2,321		4,359
Capital expenditures					
Depreciation	20	1	1		22

(Dollars in thousands)

	Test and Measurement Instrumentation	New Energy	Other	Reconciling Items	Condensed Consolidated Totals
<u>Three Months Ended June 30, 2012</u>					
Product revenue	\$ 1,366	\$	\$	\$	\$ 1,366
Unfunded research and product development expenses	337				337
Selling, general and administrative expenses	433	60	485		978
Segment (loss) profit from operations before non-controlling interest	(345 )	116	(280 )		(509 )
Segment (loss) profit	(345 )	116	(280 )	(61 )	(570 )
Total assets	1,984	199	2,931		5,114
Capital expenditures	7				7
Depreciation	24	10			34

(Dollars in thousands)

New Other

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	Test and Measurement Instrumentation	Energy	Reconciling Items	Condensed Consolidated Totals
<u>Six Months Ended June 30, 2013</u>				
Product revenue	\$ 4,467	\$	\$	\$ 4,467
Unfunded research and product development expenses	647			647
Selling, general and administrative expenses	1,010	41	695	1,746
Segment profit (loss) from operations before non-controlling interest	753	(66 )	(535 )	152
Segment profit (loss)	753	(66 )	(535 )	186
Total assets	1,985	53	2,321	4,359
Capital expenditures	41			41
Depreciation	41	4	1	46

(Dollars in thousands)

	Test and Measurement Instrumentation	New Energy	Other	Reconciling Items	Condensed Consolidated Totals
<b><u>Six Months Ended June 30, 2012</u></b>					
Product revenue	\$ 2,570	\$	\$	\$	\$ 2,570
Unfunded research and product development expenses (income)	711	(1 )			710
Selling, general and administrative expenses	951	96	1,023		2,070
Segment (loss) profit from operations before non-controlling interest	(823 )	88	(610 )		(1,345 )
Segment (loss) profit	(823 )	88	(610 )	(46 )	(1,391 )
Total assets	1,984	199	2,931		5,114
Capital expenditures	10				10
Depreciation	49	24			73

The following table presents the details of Other segment loss:

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Corporate and other (expenses) income:				
Salaries and benefits	\$ (189 )	\$ (260 )	\$ (267 )	\$ (612 )
Income tax expense	(156 )		(155 )	
Other (expense) income, net	(41 )	(20 )	(113 )	2
Total Other segment loss	\$ (386 )	\$ (280 )	\$ (535 )	\$ (610 )

## 11. Commitments and Contingencies

### Commitments:

**Leases**

The Company and its subsidiary lease certain manufacturing, laboratory and office facilities. The leases generally provide for the Company to pay either an increase over a base year level for taxes, maintenance, insurance and other costs of the leased properties or the Company's allocated share of insurance, taxes, maintenance and other costs of leased properties. The leases contain renewal provisions.

Future minimum rental payments required under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) are (dollars in thousands): \$141 thousand remaining in 2013 and \$263 thousand in 2014.

**Warranties**

Product warranty liabilities are included in *Accrued liabilities* in the Condensed Consolidated Balance Sheets. Below is a reconciliation of changes in product warranty liabilities:

(Dollars in thousands)	Six Months Ended	
	June 30, 2013	2012
Balance, January 1	\$ 20	\$ 26
Accruals for warranties issued	14	6
Settlements made (in cash or in kind)	(9 )	(4 )
Balance, end of period	\$ 25	\$ 28

**Licenses**

MTI Micro has residual royalty agreements with NYSERDA in conjunction with two contracts from 2002 and 2010. With operations currently suspended at MTI Micro, these licensing agreements are currently immaterial, and there are no amounts accrued in the condensed consolidated balance sheets as of June 30, 2013 and December 31, 2012 related to these royalty provisions.

### ***Employment Agreement***

The Company has an employment agreement with one employee that provides certain payments upon termination of employment under certain circumstances, as defined in the applicable agreement. As of June 30, 2013, the Company's potential minimum obligation to this employee was approximately \$65 thousand.

### **Contingencies:**

### ***Legal***

We are subject to legal proceedings, claims and liabilities which arise in the ordinary course of business. We accrue for losses associated with legal claims when such losses are probable and can be reasonably estimated. These accruals are adjusted as additional information becomes available or circumstances change. Legal fees are charged to expense as they are incurred.

## **12. Line of Credit**

On September 20, 2011, MTI Instruments entered into a working capital line of credit with First Niagara Bank, N.A. Pursuant to the Demand Grid Note, MTI Instruments may borrow from time to time up to \$400 thousand to support its working capital needs. The note is payable upon demand, and the interest rate on the note is equal to the prime rate with a floor of 4.0% per annum. The note is secured by a lien on all of the assets of MTI Instruments and is guaranteed by the Company. The line of credit is subject to a review date of August 31, 2013. Under the line of credit, MTI Instruments is required to hold a line balance of \$0 for 30 consecutive days out during each consecutive year. As of June 30, 2013 and December 31, 2012, there were no amounts outstanding under the line of credit.

## **13. Stock Based Compensation**

The Mechanical Technology Incorporated 2012 Equity Incentive Plan (the 2012 Plan) was adopted by the Company's Board of Directors on April 14, 2012 and approved by stockholders on June 14, 2012. The 2012 Plan provides an initial aggregate number of 600,000 shares of common stock which may be awarded or issued. The number of shares which may be awarded under the 2012 Plan and awards outstanding can be subject to adjustment on account of any recapitalization, reclassification, stock split, reverse stock split and other dilutive changes in Common Stock. Under the 2012 Plan, the Board of Directors is authorized to issue stock options (incentive and nonqualified), stock appreciation rights, restricted stock, restricted stock units and other stock-based awards to employees, officers, directors, consultants and advisors of the Company and its subsidiaries. Incentive stock options may only be granted to employees of the Company and its subsidiaries.

During 2013, the Company granted 175,000 options to purchase the Company's common stock from the 2012 Plan, which generally vest 25% on each of the first four anniversaries of the date of the award. The exercise price of these grants was from \$0.46 to \$0.52 per share and was based on the closing market price of the Company's common stock on the dates of grant. Using a Black-Scholes Option Pricing Model, the weighted average fair value of these options was \$0.47 per share and was estimated at the date of grant.

During 2012, the Company granted 2,000 shares of the Company's common stock from the 2006 Plan, which immediately vested and the stock was issued to the holder. The shares were granted from the 2006 Plan before the 2012 Plan was approved by the shareholders. The fair value of this grant was \$0.31 per share and was based on the closing market price of the Company's common stock on the date of grant.

During 2012, the Company granted 224,500 options to purchase the Company's common stock from the 2012 Plan, which generally vest 25% on each of the first four anniversaries of the date of the award. The exercise price of these grants was \$0.29 per share and was based on the closing market price of the Company's common stock on the dates of grant. Using a Black-Scholes Option Pricing Model, the weighted average fair value of these options was \$0.27 per share and was estimated at the date of grant. During 2012, 62,000 options of the 2012 grants were cancelled before vesting occurred.

#### **14. New Accounting Pronouncements**

There are no recently issued accounting standards or standards with pending adoptions that the Company's management currently anticipates will have any material impact upon its financial statements.

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

*Unless the context requires otherwise, the terms we, us, and our refer to Mechanical Technology, Incorporated, a New York Corporation, MTI Instruments refers to MTI Instruments, Incorporated, a New York corporation and our wholly owned subsidiary, and MTI Micro refers to MTI MicroFuel Cells Incorporated, a Delaware corporation and variable interest entity that is included in these consolidated results. MTI Micro has a registered trademark in the United States for Mobion. Other trademarks, trade names, and service marks used in this Quarterly Report on Form 10-Q are the property of their respective owners.*

*The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2012 contained in our 2012 Annual Report on Form 10-K.*

*In addition to historical information, the following discussion contains forward-looking statements, which involve risk and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements. Important factors that could cause actual results to differ include those set forth in Part I Item 1A-Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed on March 21, 2013 and elsewhere in this Quarterly Report on Form 10-Q. Readers should not place undue reliance on our forward-looking statements. These forward-looking statements speak only as of the date on which the statements were made and are not guarantees of future performance. Except as may be required by applicable law, we do not undertake or intend to update any forward-looking statements after the date of this Quarterly Report on Form 10-Q.*

### **Overview**

MTI operates in two segments: the Test and Measurement Instrumentation segment, which is conducted through MTI Instruments, Incorporated (MTI Instruments), a wholly-owned subsidiary, and the New Energy segment, which is conducted through MTI MicroFuel Cells, Incorporated (MTI Micro), a variable interest entity (VIE) as of June 30, 2013. MTI and MTI Micro currently share the same board of directors, while MTI also continues to oversee the day to day operations, exercise management decision making, seek opportunities to sell intellectual property, and have a vested interest in the commercialization of MTI Micro's fuel cell technology. Since inception in 2001, MTI has made the largest investment and been the principal funder of MTI Micro. MTI has also been exposed to losses and has the ability to benefit from MTI Micro. Considering the facts and circumstances, management believes MTI is most closely associated with the VIE, MTI Micro, and therefore, it is the primary beneficiary. Should there be a change in the facts and circumstances (such as a change in governance or a change to the related party group) management will reassess whether MTI remains the primary beneficiary and should continue to consolidate MTI Micro in MTI's condensed consolidated financial statements.

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*Test and Measurement Segment* MTI Instruments is a worldwide supplier of precision non-contact physical measurement solutions, portable vibration measurement and balancing systems, wafer inspection tools and precision contact measurement of material tensile strength. MTI Instruments uses a comprehensive array of technologies to solve complex, real world applications in numerous industries including industrial manufacturing, semiconductor, solar, commercial and military aviation, automotive and research & development centers. We are continuously working on ways to expand our sales reach, including expanded sales coverage throughout Europe and Asia, as well as a focus on internet marketing.

Our test and measurement segment has three product groups: Precision Instruments, Semiconductor and Solar Metrology Systems, and Balancing Systems. Our products consist of electronic gauging instruments for position, displacement, and vibration applications within the research, design, test, manufacturing/production processes; wafer characterization of semi-insulating and semi-conducting wafers, both in the semiconductor and solar industries; tensile stage systems for materials testing at academic and industrial settings; and engine vibration analysis systems for both military and commercial aircraft as well as industrial power engines.

*New Energy Segment* Until its operations were suspended in late 2011, MTI Micro had been developing an off-the-grid power solutions for various portable electronic devices. Our patented proprietary direct methanol fuel cell (DMFC) technology platform, called Mobion<sup>®</sup>, converts methanol fuel to usable electricity capable of providing continuous power as long as necessary fuel flows are maintained. Our proprietary fuel cell power solution consists of two primary components integrated into an easily manufactured device: the DMFC power engine, which we refer to as our Mobion<sup>®</sup> Chip, and methanol fuel cartridges.



Although MTI Micro continues to believe in the potential of its Mobion® based power solutions, operations have been suspended since late 2011 at MTI Micro until such time as market demand and other deciding factors, including obtaining additional external financing, the successful completion of customer trials, a new development program with a government agency, and/or a customer order come to fruition. MTI Micro will continue to seek additional capital from external sources to resume operations and fund future development, as warranted. If MTI Micro is unable to secure additional financing, a new development program or customer order, the MTI Micro board of directors will assess other options for MTI Micro, including the sale of its intellectual property portfolio and/or remaining assets.

## Recent Developments

The Company appointed Kevin G. Lynch as the Chief Executive Officer of the Company, effective May 1, 2013. Mr. Lynch had served as the Acting Chief Executive Officer, in an advisory role, since September 12, 2012. In connection with his permanent appointment, Mr. Lynch will receive an annual base salary of \$260 thousand and will be eligible for annual bonus of up to \$200 thousand based upon achieving milestones as established by the Board of Directors. Mr. Lynch also received options to purchase 100,000 shares of the Company's common stock with an exercise price based on the closing market price of \$0.46 per share on the date of grant.

## Results of Operations

*Results of Operations for the Three and Six Months Ended June 30, 2013 Compared to the Three and Six Months Ended June 30, 2012.*

## Test and Measurement Instrumentation Segment

**Product Revenue.** Product revenue in our Test and Measurement Instrumentation segment for the three months ended June 30, 2013 increased by \$901 thousand, or 65.9%, to \$2.3 million in 2013 from \$1.4 million for the same period in 2012. This increase in product revenue was primarily attributed to a combination of improvements including a 110.2% increase in military and commercial aviation balancing systems and accessory kits. Also contributing to the overall increase was a 45% rise in general instrumentation revenue which was driven by higher capacitance and tensile stage product shipments. For the three months ended June 30, 2013, the largest commercial customer for the segment was an Asian distributor, which accounted for \$196 thousand, or 8.7%, of the second quarter revenue. In 2012, the largest commercial customer for the segment was a European distributor, which accounted for \$152 thousand, or 11.1%, of the second quarter revenue. The U.S. Air Force was the largest government customer for the three months ended June 30, 2013 and accounted for \$740 thousand, or 32.6%, of the second

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quarter revenue. The U.S. Air Force was also the largest government customer for the quarter ended June 30, 2012 and accounted for \$239 thousand, or 17.5%, of the second quarter revenue.

Product revenue in our Test and Measurement Instrumentation segment for the six months ended June 30, 2013 increased by \$1.9 million, or 73.8%, to \$4.5 million in 2013 from \$2.6 million for the same period in 2012. This increase in product revenue was primarily attributed to a combination of improvements including a 113.4% increase in military and commercial aviation balancing systems and accessory kits. Also contributing to the overall increase was a 51% rise in general instrumentation revenue which was driven by higher tensile stage and laser product shipments. For the six months ended June 30, 2013, the largest commercial customer for the segment was an Asian distributor, which accounted for \$374 thousand, or 8.4%, of the year-to-date revenue. For the six months ended June 30, 2012, the largest commercial customer for the segment was an Asian distributor, which accounted for \$246 thousand, or 9.6%, of the year-to-date revenue. The U.S. Air Force was the largest government customer for the six months ended June 30, 2013 and accounted for \$1.4 million, or 31.7%, of the year-to-date revenue. The U.S. Air Force was also the largest government customer for the six months ended June 30, 2012 and accounted for \$378 thousand, or 14.7%, of the year-to-date revenue.

Information regarding government contracts included in product revenue is as follows:

(Dollars in thousands)		Revenues for the				Revenues for the				Contract		Total	
		Three Months Ended				Six Months Ended				Revenues to		Contract	
		June 30,				June 30,				Date		Orders	
Contract <sup>(1)</sup>	Expiration	2013	2012	2013	2012	2013	2012	2013	2013	2013	2013	2013	2013
Aviation Balancing Systems													
\$6.5 million U.S. Air Force Maintenance	09/27/2014 <sup>(2)</sup>	\$ 133	\$ 49	\$ 177	\$ 112	\$ 3,585	\$ 3,585	\$ 3,585	\$ 3,585	\$ 3,585	\$ 3,585	\$ 3,585	\$ 3,585
\$4.1 million U.S. Air Force Systems	08/29/2015 <sup>(2)</sup>	\$ 342	\$ 171	\$ 342	\$ 171	\$ 1,197	\$ 1,197	\$ 1,197	\$ 1,197	\$ 1,197	\$ 1,197	\$ 1,197	\$ 1,197
\$917 thousand U.S. Air Force Kit	09/30/2014 <sup>(3)</sup>	\$ 73	\$	\$ 585	\$	\$ 769	\$ 769	\$ 769	\$ 769	\$ 769	\$ 769	\$ 769	\$ 769

(1) Contract values represent maximum potential values and may not be representative of actual results.

(2) Date represents expiration of contract, which includes the exercise of all four option extensions.

(3) Date represents expiration of contract, which includes the exercise of two option extensions.



**Cost of Product Revenue.** Cost of product revenue in our Test and Measurement Instrumentation segment for the three months ended June 30, 2013 increased by \$60 thousand, or 8.2%, to \$800 thousand in 2013 from \$740 thousand for the same period in 2012 due to the 65.9% increase in product revenue. Gross profit, as a percentage of product revenue, increased to 64.7%, compared to 45.8% for the same period in 2012 due to reduced production overhead and lower product material costs.

Cost of product revenue in our Test and Measurement Instrumentation segment for the six months ended June 30, 2013 increased by \$458 thousand, or 34.7%, to \$1.8 million in 2013 from \$1.3 million for the same period in 2012 due to the 73.8% increase in product revenue. Gross profit, as a percentage of product revenue, increased to 60.2%, compared to 48.7% for the same period in 2012 due to reduced production overhead and lower product material costs.

**Unfunded Research and Product Development Expenses.** Unfunded research and product development expenses in our Test and Measurement Instrumentation segment for the three months ended June 30, 2013 decreased by \$31 thousand, or 9.1%, to \$307 thousand in 2013 from \$338 thousand for the same period in 2012. This decrease was due to lower personnel costs.

Unfunded research and product development expenses in our Test and Measurement Instrumentation segment for the six months ended June 30, 2013 decreased by \$64 thousand, or 9.0%, to \$647 thousand in 2013 from \$711 thousand for the same period in 2012. This decrease was due to lower personnel costs and reduced external development spending.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses in our Test and Measurement Instrumentation segment for the three months ended June 30, 2013 increased by \$68 thousand, or 15.8%, to \$501 thousand in 2013 from \$433 thousand for the same period in 2012. This increase is the result of additional staffing in the sales department.

Selling, general and administrative expenses in our Test and Measurement Instrumentation segment for the six months ended June 30, 2013 increased by \$59 thousand, or 6.2%, to \$1.0 million in 2013 from \$951 thousand for the same period in 2012. This increase is the result of additional staffing in the sales department and increased international

travel.

## **New Energy Segment**

***Selling, General and Administrative Expenses.*** Selling, general and administrative expenses in our New Energy segment decreased by \$43 thousand to \$17 thousand for the three months ended June 30, 2013, compared to \$60 thousand for the same period in 2012.

Selling, general and administrative expenses in our New Energy segment decreased by \$54 thousand to \$42 thousand for the six months ended June 30, 2013, compared to \$96 thousand for the same period in 2012. Currently, MTI Micro has no employees and projects to spend between \$5 and \$10 thousand per month for operating activities including rent, limited sales efforts, patent fees to keep the patent portfolio current and minimal consultant costs to perform these initiatives.

## **Results of Consolidated Operations**

***Operating Income (Loss).*** Operating income for the three months ended June 30, 2013 was \$232 thousand compared to an operating loss of \$689 thousand for the same period in 2012. Operating income for the six months ended June 30, 2013 was \$298 thousand compared to an operating loss of \$1.5 million for the same period in 2012. These decreases in operating loss were a result of the factors noted above as well as savings achieved from the cost reductions implemented in the second half of 2012.

***Income Tax Benefit (Expense).*** Income tax expense for the three and six months ended June 30, 2013 was \$156 thousand and \$155 thousand, respectively. There was no income tax benefit (expense) for the three and six months ended June 30, 2012. During the six months ended June 30, 2013, the Company's effective income tax rate was 50.6%. The projected annual effective tax rate is more than the Federal statutory rate of 35%, primarily due to permanent differences and the change in the valuation allowance. For the six months ended June 30, 2012, the Company's effective income tax rate was 0%. The valuation allowance against our deferred tax assets was approximately \$17.8 million at June 30, 2013 and December 31, 2012. We will continue to evaluate the ability to realize our deferred tax assets and related valuation allowances on a quarterly basis.

***Net Loss (Income) Attributed to Non-Controlling Interests (of MTI Micro).*** The net loss attributed to non-controlling interests for the three and six months ended June 30, 2013 was \$15 thousand and \$34 thousand, respectively. This is the result of the net loss of MTI Micro of \$28 thousand and \$66 thousand for the three and six months ended June 30, 2013. The net income attributed to non-controlling interests for the three and six months ended June 30, 2012 was \$61 thousand and \$46 thousand, respectively. This is the result of the net income of MTI Micro of \$116 thousand and \$88 thousand for the three and six months ended June 30, 2012, respectively.



**Net Income (Loss) Attributed to MTI.** Net income attributed to MTI for the three months ended June 30, 2013 was \$100 thousand compared to a net loss attributed to MTI of \$570 thousand for the same period in 2012. The increase in net income attributed to MTI of \$670 thousand is primarily attributed to an increase of MTI Instruments net income of \$844 thousand, which is a result of the factors discussed above.

Net income attributed to MTI for the six months ended June 30, 2013 was \$186 thousand compared to a net loss attributed to MTI of \$1.4 million for the same period in 2012. The increase in net income attributed to MTI of \$1.6 million is primarily attributed to an increase of MTI Instruments net income of \$1.6 million, which is a result of the factors discussed above.

#### Liquidity and Capital Resources

Several key indicators of our liquidity are summarized in the following table:

(Dollars in thousands)	<b>Six Months Ended June 30, 2013</b>	<b>Six Months Ended June 30, 2012</b>	<b>Year Ended Dec 31, 2012</b>
Cash	\$ 835	\$ 1,444	\$ 289
Working capital	1,687	1,985	1,350
Net income (loss) attributed to MTI	186	(1,391 )	(2,086 )
Net cash provided by (used in) operating activities	578	(306 )	(1,506 )
Purchase of property, plant and equipment	(41 )	(10 )	(17 )

The Company has historically incurred significant losses, until 2012 the majority stemming from the direct methanol fuel cell product development and commercialization programs of MTI Micro, and had a consolidated accumulated deficit of \$122.0 million as of June 30, 2013. During the six months ended June 30, 2013, the Company generated net income attributed to MTI of \$186 thousand, had cash provided by operating activities totaling \$578 thousand and had working capital of \$1.7 million, a \$337 thousand increase from December 31, 2012. This increase was the result of the cost saving initiatives that were implemented in the second half 2012. These reductions, on an annualized basis, are expected to equate to approximately \$1.0 million in cost savings and are expected to be realized during 2013 and beyond. As such, management believes that the reorganized Company currently has adequate resources to avoid any other cost cutting measures which could adversely affect the business. As of June 30, 2013, we had no debt, no outstanding commitments for capital expenditures and approximately \$784 thousand (excluding MTI Micro available cash) of cash available to fund our active operations.

If production levels rise at MTI Instruments, additional capital equipment may be required in the foreseeable future. We expect to spend approximately \$125 thousand on capital equipment and \$1.5 million in research and development on MTI Instruments products during 2013. We expect to finance any future expenditures and continue funding our active operations from our current cash position and our projected 2013 cash

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flow pursuant to management's current plan. We may also seek to supplement our resources through sales of stock or assets, including our investment in MTI Micro. Besides the line of credit at MTI Instruments, we have no other commitments for funding future needs of the organization at this time and such additional financing during 2013 may not be available to us on acceptable terms, if at all.

While it cannot be assured, the new management team believes that, due in part to our current working capital, the aforementioned cost reductions implemented in the second half of 2012, recent replacements in sales staff and projected inventory reductions, the Company expects to continue the positive cash flows it began in the first half of 2013 to fund the Company's active operations for the foreseeable future. However, if near-term revenue estimates are delayed or missed, the Company will need to implement additional steps to ensure liquidity including, but not limited to, the deferral of planned capital spending, postponing anticipated new hires and/or delaying existing or pending product development initiatives. Such steps, if required, could potentially have a material and adverse effect on the business.

Although MTI Micro continues to believe in the potential of its Mobion® based power solutions, operations have been suspended since late 2011 at MTI Micro until such time as market demand and other deciding factors, including obtaining additional external financing, the successful completion of customer trials, a new development program with a government agency, and/or a customer order, come to fruition. MTI Micro will continue to seek additional capital from external sources to resume operations and fund future development, as warranted. If MTI Micro is unable to secure additional financing, a new development program or customer order, the MTI Micro Board of Directors will assess other options for MTI Micro, including the sale of its intellectual property portfolio and/or remaining assets. As of June 30, 2013, MTI Micro's available cash is approximately \$51 thousand.



***Line of Credit***

On September 20, 2011, MTI Instruments entered into a working capital line of credit with First Niagara Bank, N.A. Pursuant to the Demand Grid Note, MTI Instruments may borrow from time to time up to \$400 thousand to support its working capital needs. The note is payable upon demand, and the interest rate on the note is equal to the prime rate with a floor of 4.0% per annum. The note is secured by a lien on all of the assets of MTI Instruments and is guaranteed by the Company. The line of credit is subject to a review date of August 31, 2013. Under the line of credit, MTI Instruments is required to hold a line balance of \$0 for 30 consecutive days out during each consecutive year. As of June 30, 2013 and December 31, 2012 there were no amounts outstanding under the line of credit.

***Backlog, Inventory and Accounts Receivable***

At June 30, 2013, our order backlog was \$667 thousand compared to \$1.1 million at June 30, 2012 and \$1.6 million at December 31, 2012. The decrease in backlog from December 2012 was due to lower bookings under existing contracts during the first half of the year.

Our inventory turnover ratios and accounts receivable days outstanding for the trailing twelve month periods and their changes at June 30, 2013 and 2012 are as follows:

	<b>2013</b>	<b>2012</b>	<b>Change</b>
Inventory turnover	2.8	3.0	(0.2 )
Average accounts receivable days outstanding	40	44	(4 )

The decrease in inventory turns is due to a 6% increase in average inventory balances, driven by production based on forecasted sales schedules, combining with 5% lower sales volume during the comparable periods.

The average accounts receivable days outstanding for the last twelve months has been reduced four days due to higher government sales, which on average pay in less than thirty days.

**Off-Balance Sheet Arrangements**

There were no off balance sheet arrangements.

### **Contractual Payment Obligations**

Contractual Payment Obligations are not required for a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and in Item 10 (f)(1) of Regulation S-K. As such, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information required under this Item.

### **Market Risk**

Market risk is the risk that changes in market conditions will adversely affect earnings or cashflow. We categorize our market risks as interest rate risk and credit risk. Immediately below are detailed descriptions of the market risks and explanations as to how each of these risks are managed.

**Interest Rate Risk.** Interest rate risk is the risk that changes in interest rates could adversely affect earnings or cashflows. The Company's cash equivalents are sensitive to changes in interest rates. Interest rate changes would result in a change in interest income due to the difference between the current interest rates on cash. Interest rate risk sensitivity analysis is used to measure interest rate risk by computing estimated changes in cashflow as a result of assumed changes in market interest rates. A 10% decrease in 2013 interest rates would be immaterial to the Company's consolidated financial statements.

**Credit Risk.** Credit risk is the risk of loss we would incur if counterparties fail to perform their contractual obligations. Financial instruments that subject the Company to concentrations of credit risk principally consist of cash equivalents, trade accounts receivable and unbilled contract costs.

Our trade accounts receivable and fees are primarily from sales to commercial customers, the U.S. government and state agencies. We do not require collateral and have not historically experienced significant credit losses related to receivables or fees from individual customers or groups of customers in any particular industry or geographic area.

Our deposits are primarily in cash and deposited in commercial banks and investment companies. The Company has cash deposits in excess of federally insured limits. The amount of such deposits is essentially all cash at June 30, 2013.

### **Critical Accounting Policies and Significant Judgments and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Note 2, Accounting Policies, to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 includes a summary of our most significant accounting policies. There have been no material changes to the critical accounting policies previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, inventories, income taxes, stock-based compensation and derivatives. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Periodically, we review our critical accounting estimates with the Audit Committee of our Board of Directors.

### **Recent Accounting Pronouncements**

A discussion of recent accounting pronouncements is included in Note 14, New Accounting Pronouncements, of the unaudited condensed consolidated financial statements in Part I, Item 1 of this Form 10-Q.

### ***Statement Concerning Forward-Looking Statements***

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Any statements contained, or incorporated by reference, in this Form 10-Q that are not

statements of historical fact may be forward-looking statements. When we use the words anticipate, estimate, plans, projects, continuing, ongoing, expects, management believes, we believe, we intend, should, could, similar words or phrases, we are identifying forward-looking statements. Forward-looking statements involve risks, uncertainties, estimates and assumptions which may cause our actual results, performance or achievements to be materially different from those expressed or implied by forward-looking statements. Important factors that could cause these differences include the following:

- our inability to achieve profitability and improve liquidity;
- sales revenue growth of our test and measurement instrumentation business may not be achieved or maintained;
  
- the dependence of our test and measurement instrumentation business on a small number of customers and potential loss of government contracts particularly in light of expected defense department spending reductions resulting from the sequestration;
- our lack of long-term purchase commitments from our customers and the ability of our customers to cancel, reduce, or delay orders for our products;
  
- our inability to build and maintain relationships with our customers;
- our inability to develop and utilize new technologies that address the needs of our customers;
- intense competition in the instrumentation business;
- the cyclical nature of the electronics industry;
- significant periodic and seasonal quarterly fluctuations in our results of operations;
- the uncertainty of the U.S. and global economy;
- the impact of future exchange rate fluctuations;
- failure of our strategic alliances to achieve their objectives or perform as contemplated and the risk of cancellation or early termination of such alliance by either party;
- the loss of services of one or more of our key employees or the inability to hire, train, and retain key personnel;
- the historical volatility of our stock price;
  
- risks related to protection and infringement of intellectual property;
- product liability or defects;
- our dependence on sole suppliers or a limited group of suppliers for both business segments;
  
- our history of recurring net losses and the risk of continued net losses;
  
- our ability to generate income to realize our net operating losses
  
- risks related to the limitation of the use of our net operating losses in the event of certain ownership changes;
- our ownership position in MTI Micro may be reduced further as a result of our need to seek external financing for MTI Micro's operations;

- MTI Micro s need to raise additional financing; and
- other factors discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Forward-looking statements speak only as of the date they are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

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

The certifications of our Chief Executive Officer and Chief Financial Officer attached as Exhibits 31.1 and 31.2 to this Quarterly Report on Form 10-Q include, in paragraph 4 of such certifications, information concerning our disclosure controls and procedures and internal control over financial reporting. Such certifications should be read in conjunction with the information contained in this Item 4 for a more complete understanding of the matters covered by such certifications.

##### *(a) Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of MTI s disclosure controls and procedures as of June 30, 2013. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. We recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and we necessarily apply our judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2013, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

*(b) Changes in Internal Control Over Financial Reporting*

There have been no changes in our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during our fiscal quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

At any point in time, we may be involved in various lawsuits or other legal proceedings. Such lawsuits could arise from the sale of products or services or from other matters relating to our regular business activities, compliance with various governmental regulations and requirements, or other transactions or circumstances. We do not believe there are any such proceedings presently pending that could have a material adverse effect on our financial condition. See Note 11, Commitments and Contingencies, to our condensed consolidated financial statements for further information.

**Item 1A. Risk Factors**

Part II, Item 1A (Risk Factors) of our most recently filed Annual Report on Form 10-K with the Securities and Exchange Commission (SEC), filed on March 21, 2013, sets forth information relating to important risks and uncertainties that could materially adversely affect our business, financial condition and operating results. Except to the extent that information disclosed elsewhere in this Quarterly Report on Form 10-Q relates to such risk factors (including, without limitation, the matters described in Part I, Item 2 (Management's Discussion and Analysis of Financial Condition and Results of Operations - Statement Concerning Forward Looking Statements), there have been no material changes to our risk factors disclosed in our most recently filed Annual Report on Form 10-K. However, those risk factors continue to be relevant to an understanding of our business, financial condition and operating results and, accordingly, you should review and consider such risk factors in making any investment decision with respect to our securities.

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

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
10.1	Supplemental Lease Extension and Modification Agreement IV dated June 14, 2013, between Kingfisher, LLC and MTI MicroFuel Cells, Inc.
31.1	Rule 13a-14(a)/15d-14(a) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Kevin G. Lynch
31.2	Rule 13a-14(a)/15d-14(a) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Frederick W. Jones
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Kevin G. Lynch
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Frederick W. Jones
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

All other exhibits for which no other filing information is given are filed herewith.

\* Submitted electronically herewith. Attached as Exhibit 101 are the following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in eXtensible Business Reporting Language (XBRL) and tagged as blocks of text: (i) Condensed Consolidated Balance Sheets at June 30, 2013 and December 31, 2012; (ii) Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2013 and 2012; (iii) Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2013 and 2012; and (iv) related notes, tagged as blocks of text. Pursuant to Rule 406T of Regulation S-T this data is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is 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.

Mechanical Technology, Incorporated

Date: August 8, 2013

By: /S/ KEVIN G. LYNCH  
Kevin G. Lynch  
Chief Executive Officer

By: /S/ FREDERICK W. JONES  
Frederick W. Jones  
Chief Financial Officer

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