

ULTRALIFE CORP
Form 10-K
March 15, 2013

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

FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2012

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 0-20852

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.)
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2000 Technology Parkway, Newark, New York (Address of principal executive offices)	14513 (Zip Code)
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Registrant's telephone number, including area code: (315) 332-7100

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.10 per share	The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes.... No..X...

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes.... No..X...

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to

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submit and post such files). Yes..X... No....

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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...

On July 1, 2012, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$45,000,000 (in whole dollars) based upon the closing price for such common stock as reported on the NASDAQ Global Market on July 1, 2012.

As of February 28, 2013, the registrant had 17,455,977 shares of common stock outstanding, net of 1,372,757 treasury shares.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive proxy statement relating to the June 4, 2013 Annual Meeting of Shareholders are specifically incorporated by reference in Part III, Items 10, 11, 12, 13 and 14 of this Annual Report on Form 10-K, except for the equity plan information required by Item 12 as set forth therein.

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PART I

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, 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, government and environmental regulations, business disruptions, including those caused by fires, 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 "Risk Factors" in Item 1A of this annual report.

As used in this annual report, unless otherwise indicated, the terms "we", "our" and "us" refer to Ultralife Corporation and include our wholly-owned subsidiaries, Ultralife Batteries (UK) Ltd., ABLE New Energy Co., Limited and its wholly-owned subsidiary ABLE New Energy Co., Ltd, and our majority-owned joint venture Ultralife Batteries India Private Limited.

Operations of RedBlack Communications, Inc. ("RedBlack"), our divested company, Ultralife Energy Services Corporation ("UES"), our wholly owned subsidiary, and certain components of UK operations are reported as discontinued operations.

Dollar amounts throughout this Form 10-K Annual Report are presented in thousands of dollars, except for per share amounts.

ITEM 1. BUSINESS

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 enjoy strong name recognition in our markets under our Ultralife® Batteries, McDowell Research®, AMTITM, and ABLETM brands. We have sales, operations and product development facilities in North America, Europe and Asia.

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: 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 10 in the Notes to Consolidated Financial Statements.)

Our website address is www.ultralifecorp.com. We make available free of charge via a hyperlink on our website (see Investor Relations link) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (“SEC”). We will provide copies of these reports upon written request to the attention of Peter F. Comerford, Secretary, Ultralife Corporation, 2000 Technology Parkway, Newark, New York, 14513. Our filings with the SEC are also available through the SEC website at www.sec.gov or at the SEC Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or by calling 1-800-SEC-0330.

Battery & Energy Products

We manufacture and/or market a family of lithium manganese dioxide (Li-MnO₂) and lithium manganese dioxide carbon monofluoride hybrid non-rechargeable batteries including 9-volt, HiRate® cylindrical, ThinCell®, and other form factors. We also manufacture and market a family of lithium thionyl chloride (Li-SOCl₂) non-rechargeable batteries produced at our Chinese operations. Applications for our 9-volt batteries include: smoke alarms, wireless security systems and intensive care monitors, among many other devices. Our HiRate® and ThinCell® lithium non-rechargeable batteries are sold primarily to the military and to OEMs in industrial markets for use in a variety of applications including radios, emergency radio beacons, search and rescue transponders, pipeline inspection gauges, portable medical devices and other specialty instruments and applications. Military applications for our non-rechargeable HiRate® batteries include: man-pack and survival radios, night vision devices, targeting devices, chemical agent monitors and thermal imaging equipment. Our lithium thionyl chloride batteries, sold under our ABLE and Ultralife brands as well as various private label brands, are used in a variety of applications including utility meters, wireless security devices, electronic meters, automotive electronics and geothermal devices. We believe that the chemistry of lithium batteries provides significant advantages over other currently available non-rechargeable battery technologies. These advantages include: higher energy density, lighter weight, longer operating time, longer shelf life and a wider operating temperature range. Our non-rechargeable batteries also have relatively flat voltage profiles, which provide stable power. Conventional non-rechargeable batteries, such as alkaline batteries, have sloping voltage profiles that result in decreasing power output during discharge. While the price for our lithium batteries is generally higher than alkaline batteries, the increased energy per unit of weight and volume of our lithium batteries allow for longer operating times and less frequent battery replacements for our targeted applications.

We believe that our range of lithium ion rechargeable batteries and charging systems offer substantial benefits, including the ability to design and produce lightweight, high-energy batteries in a variety of custom sizes, shapes, and thickness. We market lithium ion rechargeable batteries comprising cells manufactured by qualified cell manufacturers. Our rechargeable products can be used in a wide variety of applications including communications, medical and other portable electronic devices. Our GenSet Eliminator provides energy storage capabilities to generators and renewable energy sources, thereby promoting optimum efficiencies through the continuous charging and discharging of our lithium ion batteries incorporated into the system. Our Multi-Kilowatt Module lithium ion battery system is a large format battery utilizable for energy storage, battery back-up, and remote power applications. We believe that the chemistry of our lithium ion batteries provides significant advantages over other currently available rechargeable batteries. These advantages include: higher energy density, lighter weight, longer operating time, longer time between charges and a wider operating temperature range. Conventional rechargeable batteries such as nickel metal hydride and nickel cadmium are heavier, have lower energy and require more frequent charging.

Within this segment, we also seek to fund the development of new products to advance our technologies through contracts with both government agencies and third parties. We have been successful in obtaining awards for such programs for power-system technologies.

We continue to obtain contracts that are in parallel with our efforts to ultimately commercialize products that we develop. Revenues in this segment that pertain to technology contracts may vary widely each year, depending upon the quantity and size of contracts obtained.

Revenues for this segment for the year ended December 31, 2012 were \$71,084 and segment contribution (gross profit) was \$17,562.

Communications Systems

Under our McDowell Research and AMTI brands, we design and manufacture a line of communications systems and accessories to support military communications systems, including RF amplifiers, power supplies, power cables, connector assemblies, amplified speakers, equipment mounts, case equipment, man-portable systems and integrated communication systems for fixed or vehicle applications such as tactical repeaters and SATCOM systems. All systems are packaged to meet specific customer needs in rugged enclosures to allow for their use in severe environments. We market these products to all branches of the U.S. military and approved foreign defense organizations, as well as, U.S. and international prime defense contractors.

Revenues for this segment for the year ended December 31, 2012 were \$30,573 and segment contribution (gross profit) was \$11,168.

Corporate

We allocate revenues and cost of sales across the above operating segments. The balance of income and expense, including but not limited to research and development expenses, and selling, general and administrative expenses, are reported as Corporate expenses.

There were no revenues for this category for the year ended December 31, 2012 and our corporate expenses were \$28,844.

See Management's Discussion and Analysis of Financial Condition and Results of Operations and the 2012 Consolidated Financial Statements and Notes thereto for additional information. For information relating to total assets by segment, revenues for the last two years by segment, and contribution by segment for the last two years, see Note 10 in the Notes to Consolidated Financial Statements.

History

We were formed as a Delaware corporation in December 1990. In March 1991, we acquired certain technology and assets from Eastman Kodak Company ("Kodak") relating to its 9-volt lithium manganese dioxide non-rechargeable battery. In December 1992, we completed our initial public offering and became listed on NASDAQ. In June 1994, we formed a subsidiary, Ultralife Batteries (UK) Ltd. ("Ultralife UK"), which acquired certain assets of Dowty Group PLC ("Dowty") and provided us with a presence in Europe. In 2012, certain of our Ultralife UK operations were discontinued. See Note 2 to our Consolidated Financial Statements for more information.

In May 2006, we acquired ABLE New Energy Co., Ltd. ("ABLE"), an established manufacturer of lithium batteries located in Shenzhen, China, which broadened our product offering and provided additional exposure to new markets.

In July 2006, we finalized the acquisition of substantially all the assets of McDowell Research, Ltd. ("McDowell"), a manufacturer of military communications accessories located originally in Waco, Texas, whose operations were relocated to our Newark, New York facility during the second half of 2007, which enhanced our channels into the military communications area and strengthened our presence in global defense markets. In January 2012, we relocated these operations to our Virginia Beach, Virginia facility in order to gain operational efficiencies.

In September 2007, we acquired RedBlack Communications, Inc. ("RedBlack"), located in Hollywood, Maryland, an engineering and technical services firm specializing in the design, integration, and fielding of mobile, modular and fixed-site communication and electronic systems. 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. See Note 2 to our Consolidated Financial Statements for more information.

In November 2007, we acquired Stationary Power Services, Inc. ("Stationary Power") and RPS Power Systems, Inc. ("RPS"), affiliated companies both located in Clearwater, Florida. Stationary Power was an infrastructure power management services firm specializing in the engineering, installation and preventive maintenance of standby power systems, uninterruptible power supply systems, DC power systems and switchgear/control systems for the telecommunications, aerospace, banking and information services industries. RPS supplied lead acid batteries for use in the design and installation of standby power systems. The Stationary Power acquisition furthered our transformation to a value-added power solutions, accessories and engineering services company serving a broad spectrum of government, defense and commercial markets. As described in greater detail below, we have ceased our Stationary Power business.

In March 2008, we formed a joint venture, named Ultralife Batteries India Private Limited (“India JV”), with our distributor partner in India. The India JV assembles Ultralife power solution products and manages local sales and marketing activities, serving commercial, government and defense customers throughout India. We have invested cash into the India JV, as consideration for our 51% ownership stake in the India JV.

In November 2008, we acquired certain assets of U.S. Energy Systems, Inc. and its services affiliate, U.S. Power Services, Inc. (“USE” collectively), a nationally recognized standby power installation and power management services business located in Riverside, California. The acquisition was made to advance our goal of becoming the leading provider of engineering, installation, integration and maintenance services to the growing standby power industry. As described in greater detail below, we have ceased our USE business.

In March 2009, we acquired the tactical communications products business of Science Applications International Corporation. The tactical communications products business (“AMTI”) designs, develops and manufactures tactical communications products including: amplifiers, man-portable systems, cables, power solutions and ancillary communications equipment, which are sold by Ultralife under the brand name AMTI. The acquisition strengthened our communications systems business and provided us with direct entry into the handheld radio/amplifier market, complementing Ultralife’s communications systems offerings.

In January 2010, Stationary Power and RPS formally merged, with Stationary Power being the surviving corporation. Subsequent to the merger, we changed the name of Stationary Power to Ultralife Energy Services Corporation (“UES”).

On March 8, 2011, we decided to exit our Energy Services business. We completed all exit activities with respect to our Energy Services segment by the end of the second quarter of 2011, and have reclassified our Energy Services segment as a discontinued operation.

Products, Services and Technology

Battery & Energy Products

A non-rechargeable battery is used until discharged and then discarded. The principal competing non-rechargeable battery technologies are carbon zinc, alkaline and lithium. We manufacture a range of non-rechargeable battery products based on lithium manganese dioxide, lithium manganese carbon mono-fluoride hybrid, and lithium thionyl chloride technologies.

We believe that the chemistry of lithium batteries provides significant advantages over currently available non-rechargeable battery technologies, which include: lighter weight, longer operating time, longer shelf life, and a wider operating temperature range. Our non-rechargeable batteries also have relatively flat voltage profiles, which provide stable power. Conventional non-rechargeable batteries, such as alkaline batteries, have sloping voltage profiles that result in decreasing power during discharge. While the prices for our lithium batteries are generally higher than commercially available alkaline batteries produced by others, we believe that the increased energy per unit of weight and volume of our batteries will allow longer operating time and less frequent battery replacements for our targeted applications. As a result, we believe that our non-rechargeable batteries are price competitive with other battery technologies on a price per unit of energy or volume basis.

Our non-rechargeable products include the following product configurations:

9-Volt Lithium Battery. Our 9-volt lithium battery delivers a unique combination of high energy and stable voltage, which results in a longer operating life for the battery and, accordingly, fewer battery replacements. While our 9-volt battery price is generally higher than conventional 9-volt carbon zinc and alkaline batteries, we believe the enhanced operating performance and decreased costs associated with battery replacement make our 9-volt battery more cost effective than conventional batteries on a cost per unit of energy or volume basis when used in a variety of applications.

We market our 9-volt lithium batteries to OEM, distributor and retail markets including industrial electronics, safety and security and medical. Typical applications include: smoke alarms, wireless alarm systems, bone growth stimulators, telemetry devices, blood analyzers, ambulatory infusion pumps and parking meters. A significant portion of the sales of our 9-volt battery is to major U.S. and international smoke alarm OEMs for use in their long-life smoke alarms. We also manufacture our 9-volt lithium battery under private label for a variety of companies. Additionally, we sell our 9-volt battery to the broader consumer market through national and regional retail chains and Internet retailers.

We believe that we manufacture the only standard size 9-volt battery designed to last 10 years when used in ionization-type smoke alarms. Although designs exist using other battery configurations, such as three 2/3 A or 1/2 AA-type battery cells, we believe that our 9-volt solution is superior to these alternatives. Our current 9-volt battery manufacturing capacity is adequate to meet forecasted customer demand over the next three years.

Cylindrical Batteries. Featuring high energy, wide temperature range, long shelf life and operating life, our cylindrical cells and batteries, based on both lithium manganese dioxide and lithium thionyl chloride technologies, represent some of the most advanced lithium power sources currently available. We market a wide range of cylindrical non-rechargeable lithium cells and batteries in various sizes under both the Ultralife HiRate and ABLE brands. These include: D, C, 5/4 C, 1/2 AA, 2/3 A and other sizes, which are sold individually as well as packaged into multi-cell battery packs, including our leading BA-5390 military battery, an alternative to the competing Li-SO₂ BA-5590 battery, and one of the most widely used battery types in the U.S. armed forces for portable applications. Our BA-5390 battery provides 50% to 100% more energy (mission time) than the BA-5590, and it is used in approximately 60 military applications.

We market our line of lithium cells and batteries to the OEM market for commercial, defense, medical, asset tracking and search and rescue applications, among others. Significant commercial applications include pipeline inspection equipment, automatic reclosers and oceanographic devices. Asset tracking applications include RFID (Radio Frequency Identification) systems. Among the defense uses are manpack radios, night vision goggles, chemical agent monitors and thermal imaging equipment. Medical applications include: AED's (Automated External Defibrillators), infusion pumps and telemetry systems. Search and rescue applications include: ELT's (Emergency Locator Transmitters) for aircraft and EPIRB's (Emergency Position Indicating Radio Beacons) for ships.

Thin Cell Batteries. We manufacture a range of thin lithium manganese dioxide batteries under the Thin Cell® brand. Thin Cell batteries are flat, lightweight batteries providing a unique combination of high energy, long shelf life, wide operating temperature range and very low profile. With their thin prismatic form and a high ratio of active materials to packaging, Thin Cell batteries can efficiently fill most battery cavities. We are currently marketing these batteries to OEMs for applications such as displays, wearable medical devices, theft detection systems, and RFID devices.

In contrast to non-rechargeable batteries, after a rechargeable battery is discharged, it can be recharged and reused many times. Generally, discharge and recharge cycles can be repeated hundreds of times in rechargeable batteries, but the achievable number of cycles (cycle life) varies among technologies and is an important competitive factor. All rechargeable batteries experience a small, but measurable, loss in energy with each cycle. The industry commonly reports cycle life in the number of cycles a battery can achieve until 80% of the battery's initial energy capacity remains. In the rechargeable battery market, the principal competing technologies are nickel cadmium, nickel metal hydride and lithium ion (including lithium polymer) batteries. Rechargeable batteries are used in many applications, such as military radios, laptop computers, mobile telephones, portable medical devices, wearable devices and many other commercial, defense and consumer products.

Three important performance characteristics of a rechargeable battery are design flexibility, energy density and cycle life. Design flexibility refers to the ability of rechargeable batteries to be designed to fit a variety of shapes and sizes of battery compartments. Thin profile batteries with prismatic geometry provide the design flexibility to fit the battery compartments of today's electronic devices. Energy density refers to the total amount of electrical energy stored in a battery divided by the battery's weight and volume as measured in watt-hours per kilogram and watt-hours per liter, respectively. High energy density batteries generally are longer lasting power sources providing longer operating time and necessitating fewer battery recharges. High energy density and long achievable cycle life are important characteristics for comparing rechargeable battery technologies. Greater energy density will permit the use of batteries of a given weight or volume for a longer time period. Accordingly, greater energy density will enable the use of smaller and lighter batteries with energy comparable to those currently marketed. Lithium ion batteries, by the nature of their electrochemical properties, are capable of providing higher energy density than comparably sized batteries that utilize other chemistries and, therefore, tend to consume less volume and weight for a given energy content. Long achievable cycle life, particularly in combination with high energy density, is suitable for applications requiring frequent battery recharges, such as cellular telephones and laptop computers, and allows the user to charge and recharge many times before noticing a difference in performance. We believe that our lithium ion batteries generally have some of the highest energy density and longest cycle life available.

Lithium Ion Cells and Batteries. We market a variety of lithium ion cells and rechargeable batteries comprising cells manufactured by qualified cell manufacturers. These products are used in a wide variety of applications including communications, medical and other portable electronic devices.

Battery Charging Systems and Accessories. To provide our customers with complete power system solutions, we offer a wide range of rugged military and commercial battery charging systems and accessories including smart chargers, multi-bay charging systems and a variety of cables.

GenSet Eliminator. Our GenSet Eliminator provides energy storage capabilities to generators and renewable energy sources, thereby promoting optimum efficiencies through the continuous charging and discharging of our lithium ion batteries incorporated into the system. The system is mobile, flexible and scalable from 10 to 50 kWh of battery storage and will significantly reduce fuel consumption while enabling the primary generator or power source to be operated at 85% - 95% of its rated load capacity. The switch between the primary energy source and battery power is seamless to the user and allows for silent and clean (zero emission) operation when the batteries are in use. Our lithium ion batteries allow for continuous monitoring, reduce battery weight by a factor of four to five if comparable lead acid batteries are used, and allow much higher operating temperatures of up to 140°F (60°C) without degradation. The resulting benefits of lower fuel consumption, extended life expectancy, less maintenance to the primary power source, and silent watch capability make the GenSet Eliminator ideal for military bases that generate their own electricity.

Multi-Kilowatt Module. Our Multi-Kilowatt Module lithium ion battery system is a large format battery utilizable for energy storage, battery back-up, and remote power applications. This product is a direct replacement of 2.5 kWh and greater lead acid batteries in 24V or 48V applications. It can be connected in multiples to obtain higher-voltages and is capable of over 3,000 cycles while maintaining 80% of its capacity.

Technology Contracts. Our technology contract activities involve the development of new products or the advancement of existing products through contracts with both government agencies and third parties.

Communications Systems

Under our McDowell Research and AMTI brands, we design and manufacture a line of communications systems and accessories to support military communications systems, including RF amplifiers, power supplies, power cables, connector assemblies, amplified speakers, equipment mounts, case equipment, man-portable systems and integrated communication systems for fixed or vehicle applications such as tactical repeaters and SATCOM systems. We package all systems to meet specific customer needs in rugged enclosures to allow their use in severe environments.

We offer a wide range of military communications systems and accessories designed to enhance and extend the operation of communications equipment such as vehicle-mounted, manpack and handheld transceivers. Our communications products include the following product configurations:

RF Amplifiers. Our RF amplifiers include: 20, 50 and 75-watt amplifiers and 20-watt accessories and kits. These amplifiers are used to extend the range of manpack and handheld tactical transceivers and can be used on mobile or fixed site applications.

Integrated Systems. Our integrated systems include: SATCOM systems; rugged, deployable case systems; multiband transceiver kits; briefcase power systems; dual transceiver cases; enroute communications cases; radio cases; and tactical repeater systems. These systems give communications operators everything that is needed to provide reliable links to support C4I (Command, Control, Communications, Computers and Information systems).

Power Systems. Our power systems include: universal AC/DC power supplies with battery backup for tactical manpack and handheld transceivers; Rover power supplies; interoperable power adapters and chargers; portable power systems; tactical combat and AC to DC power supplies for encryption units, among many others. We can provide power supplies for virtually all tactical communications devices.

Communications and Electronics. Our communications and electronics services include the design, integration, fielding and life cycle management of portable, mobile and fixed-site communications systems. Capabilities include engineering, rapid prototyping, systems integration and logistics support.

Sales and Marketing

We employ a staff of sales and marketing personnel in North America, Europe and Asia. We sell our products and services directly to commercial customers, including OEMs, as well as government and defense agencies in the U.S. and abroad and have contractual arrangements with sales agents who market our products on a commission basis in particular areas. While OEM agreements and contracts contain volume-based pricing based on expected volumes, industry practices dictate that pricing is rarely adjusted retroactively when contract volumes are not achieved. Every effort is made to adjust future prices accordingly, but the ability to adjust prices is generally based on market conditions.

We also distribute some of our products through domestic and international distributors and retailers. Our sales are generated primarily from customer purchase orders. We have several long-term contracts with the U.S. government

and other customers. These contracts do not commit the customers to specific purchase volumes, nor to specific timing of purchase order releases, and they include fixed price agreements over various periods of time. In general we do not believe our sales are seasonal, although we may sometimes experience seasonality for some of our military products based on the timing of government fiscal budget expenditures.

A significant portion of our business comes from sales of products and services to the U.S. and foreign governments through various contracts. These contracts are subject to procurement laws and regulations that lay out policies and procedures for acquiring goods and services. The regulations also contain guidelines for managing contracts after they are awarded, including conditions under which contracts may be terminated, in whole or in part, at the government's convenience or for default. Failure to comply with the procurement laws or regulations can result in civil, criminal or administrative proceedings involving fines, penalties, suspension of payments, or suspension or disbarment from government contracting or subcontracting for a period of time.

During the years ended December 31, 2012 and 2011, we had one major customer, a large defense prime, which comprised 21% of our revenues in each year. There were no other customers that comprised greater than 10% of our total revenues during these years.

In 2012, sales to U.S. and non-U.S. customers were approximately \$59,486 and \$42,171, respectively. For information relating to revenues by country for the last two fiscal years and long-lived assets for the last two fiscal years by country of origin, see Note 10 in the Notes to Consolidated Financial Statements.

Battery & Energy Products

We target sales of our non-rechargeable products to manufacturers of security and safety equipment, medical devices, search and rescue equipment, specialty instruments, point of sale equipment and metering applications, as well as users of military equipment. Our strategy is to develop sales and marketing alliances with OEMs and governmental agencies that utilize our batteries in their products, commit to cooperative research and development or marketing programs, and recommend our products for design-in or replacement use in their products. We are addressing these markets through direct contact by our sales and technical personnel, use of sales agents and stocking distributors, manufacturing under private label and promotional activities.

We seek to capture a significant market share for our products within our targeted OEM markets, which we believe, if successful will result in increased product awareness and sales at the end-user or consumer level. We are also selling our 9-volt battery to the consumer market through limited retail distribution through a number of national retailers. Most military procurements are done directly by the specific government organizations requiring products, based on a competitive bidding process. For those military procurements that are not bid, the procurements are typically subject to an audit of the product's underlying cost structure and associated profitability. Additionally, we are typically required to successfully meet contractual specifications and to pass various qualification testing for the products under contract by the military. An inability by us to pass these tests in a timely fashion could have a material adverse effect on our business, financial condition and results of operations. When a government contract is awarded, there is a government procedure that allows for unsuccessful companies to formally protest the award if they believe they were unjustly treated in the government's bid evaluation process. A prolonged delay in the resolution of a protest, or a reversal of an award resulting from such a protest could have a material adverse effect on our business, financial condition and results of operations.

We market our products to defense organizations in the U.S. and other countries. These efforts have resulted in us winning significant contracts. In September 2010, we were awarded a production contract by the Defense Logistics Agency for up to five years, with a maximum total potential of \$42,100, to provide our BA-5390 non-rechargeable lithium manganese dioxide batteries to the U.S. military. Production deliveries began in the first quarter of 2011. Through December 31, 2012, we have received orders for deliveries under this contract totaling \$6,500. This contract is set to expire in 2015.

We target sales of our lithium ion rechargeable batteries and charging systems to OEM customers, as well as distributors and resellers focused on our target markets. We seek design wins with OEMs, and believe that our design capabilities, product characteristics and solution integration will drive OEMs to incorporate our batteries into their

product offerings, resulting in revenue growth opportunities for us.

We continue to expand our marketing activities as part of our strategic plan to increase sales of our rechargeable products for commercial, standby, defense and communications applications, as well as hand-held devices, wearable devices and other electronic portable equipment. A key part of this expansion includes increasing our design and assembly capabilities as well as building our network of distributors and value added distributors throughout the world.

At December 31, 2012 and 2011, our backlog related to Battery & Energy Products was \$8,932 and \$22,555, respectively. The decrease in our backlog related to Battery & Energy Products is mainly due to continued delays in U.S. government and defense orders. The majority of the 2012 backlog is related to orders that are expected to ship throughout 2013.

Communications Systems

We target sales of our communications systems, which include power solutions and accessories to support communications systems such as RF amplifiers, power supplies, power cables, connector assemblies, amplified speakers, equipment mounts, case equipment and integrated communication systems, to military OEMs and U.S. and international government organizations. We sell our products directly and through authorized distributors to OEMs and to defense organizations in the U.S. and internationally.

We market our products to defense organizations and OEMs in the U.S. and internationally. These efforts resulted in a number of significant contracts for us. For example, in January 2012, we received a significant order from an international customer for RF amplifiers and accessories in support of force modernization.

At December 31, 2012 and 2011, our backlog related to Communications Systems orders was approximately \$3,667 and \$1,555, respectively. The increase in our backlog related to Communications Systems orders is mainly due to a large multi-year order for RF amplifiers and accessories in support of force modernization in a foreign country. The majority of the 2012 backlog was related to orders that are expected to ship throughout 2013 and 2014.

Patents, Trade Secrets and Trademarks

We rely on licenses of technology as well as our patented and unpatented proprietary information, know-how and trade secrets to maintain and develop our competitive position. Despite our efforts to protect our proprietary information, there can be no assurance that others will neither develop the same or similar information independently nor obtain access to our proprietary information. In addition, there can be no assurance that we would prevail if we asserted our intellectual property rights against third parties, or that third parties will not successfully assert infringement claims against us in the future. We believe, however, that our success depends more on the knowledge, ability, experience and technological expertise of our employees, than on the legal protection that our patents and other proprietary rights may or will afford.

We hold seventeen patents in the U.S. and foreign countries. Our patents protect technology that makes automated production more cost-effective and protects important competitive features of our products. However, we do not consider our business to be dependent on patent protection.

In 2003, we entered into an agreement with Saft Groupe S.A. to license certain tooling for battery cases. The licensing fee associated with this agreement is based on a percentage of the sales price of the individual battery case, up to a maximum of one dollar per battery case. The total royalty expense reflected in 2012 was \$1. This agreement expires in the year 2017.

Select key employees are required to enter into agreements providing for confidentiality and the assignment of rights to inventions made by them while employed by us. These agreements also contain certain noncompetition and nonsolicitation provisions effective during the employment term and for varying periods thereafter depending on position and location. There can be no assurance that we will be able to enforce these agreements. All of our employees agree to abide by the terms of a Code of Ethics policy that provides for the confidentiality of certain information received during the course of their employment.

Trademarks are an important aspect of our business. We sell our products under a number of trademarks, which we own or use under license. The following are registered trademarks or trademarks of ours: Ultralife®, Ultralife Thin Cell®, Ultralife HiRate®, The New Power Generation®, LithiumPower®, SmartCircuit®, We Are Power®, AMTI®, ABLE™, McDowell Research®, and Max Juice For More Gigs®.

Manufacturing and Raw Materials

We manufacture our products from raw materials and component parts that we purchase. We have ISO 9001:2008 certification for our manufacturing facilities in Newark, New York, Virginia Beach, Virginia and Shenzhen, China. In addition, our manufacturing facilities in Newark, New York and Shenzhen, China are ISO 14001 certified.

We expect that in the future, raw material purchases will fluctuate based on the timing of customer orders, the related need to build inventory in anticipation of orders and actual shipment dates.

Battery & Energy Products

Our Newark, New York and Shenzhen, China facilities have the capacity to produce cylindrical cells, 9-volt batteries, and thin cells. Capacity, however, is also related to individual operations, and product mix changes can produce bottlenecks in an individual operation, constraining overall capacity. We have acquired new machinery and equipment in areas where production bottlenecks have resulted in the past and we believe that we have sufficient capacity in these areas. We continually evaluate our requirements for additional capital equipment, and we believe that the planned increases will be adequate to meet foreseeable customer demand.

We utilize lithium foil as well as other metals and chemicals to manufacture our batteries. Although we know of only three major suppliers that extrude lithium into foil and provide such foil in the form required by us, we do not anticipate any shortage of lithium foil or any difficulty in obtaining the quantities we require. Certain materials used in our products are available only from a single source or a limited number of sources. Additionally, we may elect to develop relationships with a single or limited number of sources for materials that are otherwise generally available. Although we believe that alternative sources are available to supply materials that could replace materials we use and that, if necessary, we would be able to redesign our products to make use of an alternative product, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers. Although we have experienced interruptions of product deliveries by sole source suppliers, none of such interruptions has had a material adverse effect on us. All other raw materials utilized by us are readily available from many sources.

We use various utilities to provide heat, light and power to our facilities. As energy costs rise, we continue to seek ways to reduce these costs and will initiate energy-saving projects at times to assist in this effort. It is possible, however, that rising energy costs may have an adverse effect on our financial results.

We believe that the raw materials and components utilized for our rechargeable batteries are readily available from many sources. Although we believe that alternative sources are available to supply materials that could replace materials we use, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers.

Our Newark, New York facility has the capacity to produce significant volumes of rechargeable batteries, as this operation generally assembles battery packs and chargers and is limited only by physical space and is not constrained by manufacturing equipment capacity.

The total carrying value of our Battery & Energy Products inventory, including raw materials, work in process and finished goods, amounted to approximately \$22,871 and \$20,700 as of December 31, 2012 and 2011, respectively.

Communications Systems

In general, we believe that the raw materials and components utilized by us for our communications accessories and systems, including RF amplifiers, power supplies, cables, repeaters and integration kits, are available from many sources. Although we believe that alternative sources are available to supply materials that could replace materials we use, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers.

Our Virginia Beach, Virginia facility has the capacity to produce communications products and systems. This operation generally assembles products and is limited only by physical space and is not constrained by manufacturing equipment capacity.

The total carrying value of our Communications Systems inventory, including raw materials, work in process and finished goods, amounted to approximately \$7,499 and \$14,147 as of December 31, 2012 and 2011, respectively.

Research and Development

We concentrate significant resources on research and development activities to improve upon our technological capabilities and to design new products for customers' applications. We conduct our research and development in Newark, New York, Virginia Beach, Virginia, Tallahassee, Florida and Shenzhen, China. During 2012 and 2011 we expended approximately \$7,200 and \$8,600, respectively, on research and development, including \$1,200 and \$3,200, respectively, on customer sponsored research and development activities. We expect that research and development expenditures in the future will be modestly higher than those in 2012, as new product development initiatives will drive our growth. As in the past, we will continue to make funding decisions for our research and development efforts based upon strategic demand for customer applications.

Battery & Energy Products

We continue to internally develop non-rechargeable cells and batteries that broaden our product offering to our customers.

We continue to internally develop our rechargeable product portfolio, including batteries, cables and charging systems, as our customers' needs for portable power continue to grow.

The U.S. government sponsors research and development programs designed to improve the performance and safety of existing battery systems and to develop new battery systems.

Communications Systems

We continue to internally develop a variety of communications accessories and systems for the global defense market to meet the ever-changing demands of our customers.

Safety; Regulatory Matters; Environmental Considerations

Certain of the materials utilized in our batteries may pose safety problems if improperly used. We have designed our batteries to minimize safety hazards both in manufacturing and use.

The transportation of non-rechargeable and rechargeable lithium batteries is regulated in the U.S. by the Department of Transportation's Pipeline and Hazardous Materials Safety Administration ("PHMSA"), and internationally by the International Civil Aviation Organization ("ICAO") and corresponding International Air Transport Association ("IATA") Dangerous Goods Regulations and the International Maritime Dangerous Goods Code ("IMDG"), and other country specific regulations. These regulations are based on the United Nations Recommendations on the Transport of Dangerous Goods Model Regulations and the United Nations Manual of Tests and Criteria. We currently ship our products pursuant to PHMSA, ICAO, IATA, IMDG and other country specific hazardous goods regulations. The regulations require companies to meet certain testing, packaging, labeling, marking and shipping paper specifications for safety reasons. We have not incurred, and do not expect to incur, any significant costs in order to comply with these regulations. We believe we comply with all current U.S. and international regulations for the shipment of our products, and we intend and expect to comply with any new regulations that are imposed. We have established our own testing facilities to ensure that we comply with these regulations. If we are unable to comply with the new regulations, however, or if regulations are introduced that limit our or our customers' ability to transport our products in a cost-effective manner, this could have a material adverse effect on our business, financial condition and results of operations.

The European Union's Restriction of Hazardous Substances ("RoHS") Directive places restrictions on the use of certain hazardous substances in electrical and electronic equipment. All applicable products sold in the European Union market must pass RoHS compliance. While this directive does not apply to batteries and does not currently affect our defense products, should any changes occur in the directive that would affect our products, we intend and expect to comply with any new regulations that are imposed. Our commercial chargers are in compliance with this directive. Additional European Union Directives, entitled the Waste Electrical and Electronic Equipment ("WEEE") Directive and the Directive "on batteries and accumulators and waste batteries and accumulators", impose regulations affecting our non-defense products. These directives require that producers or importers of particular classes of electrical goods are financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. These directives assign levels of responsibility to companies doing business in European Union markets based on their relative market share. These directives call on each European Union member state to enact enabling legislation to implement the directive. As additional European Union member states pass enabling legislation our compliance system should be sufficient to meet such requirements. Our current estimated costs

associated with our compliance with these directives based on our current market share are not significant. However, we continue to evaluate the impact of these directives as European Union member states implement guidance, and actual costs could differ from our current estimates.

The European Union's Battery Directive "on batteries and accumulators and waste batteries and accumulators" is intended to cover all types of batteries regardless of their shape, volume, weight, material composition or use. It is aimed at reducing mercury, cadmium, lead and other metals in the environment by minimizing the use of these substances in batteries and by treating and re-using old batteries. The Directive applies to all types of batteries except those used to protect European Member States' security, for military purposes, or sent into space. To achieve these objectives, the Directive prohibits the marketing of some batteries containing hazardous substances. It establishes schemes aimed at high level of collection and recycling of batteries with quantified collection and recycling targets. The Directive sets out minimum rules for producer responsibility and provisions with regard to labeling of batteries and their removability from equipment. Product markings are required for batteries and accumulators to provide information on capacity and to facilitate reuse and safe disposal. We currently ship our products pursuant to the requirements of the Directive.

China's "Management Methods for Controlling Pollution Caused by Electronic Information Products Regulation" ("China RoHS") provides a two-step, broad regulatory framework including similar hazardous substance restrictions as are imposed by the European Union's RoHS Directive, and applies to methods for the control and reduction of pollution and other public hazards to the environment caused during the production, sale, and import of electronic information products ("EIP") in China affecting a broad range of electronic products and parts. Currently, only the first step of the regulatory framework of China RoHS, which details marking and labeling requirements under Standard SJT11364-2006 ("Marking Standard"), is in effect. However, the methods under China RoHS only apply to EIP placed in the marketplace in China. Additionally, the Marking Standard does not apply to components sold to OEM's for use in other EIPs. Our sales in China are limited to sales to OEM's and to distributors who supply to OEM's. Should our sales strategy change to include direct sales to end-users, our compliance system is sufficient to meet our requirements under China RoHS. Our current estimated costs associated with our compliance with this regulation based on our current market share are not significant. However, we continue to evaluate the impact of this regulation, and actual costs could differ from our current estimates.

National, state and local laws impose various environmental controls on the manufacture, transportation, storage, use and disposal of batteries and of certain chemicals used in the manufacture of batteries. Although we believe that our operations are in substantial compliance with current environmental regulations, there can be no assurance that changes in such laws and regulations will not impose costly compliance requirements on us or otherwise subject us to future liabilities. There can be no assurance that additional or modified regulations relating to the manufacture, transportation, storage, use and disposal of materials used to manufacture our batteries or restricting disposal of batteries will not be imposed or how these regulations will affect us or our customers, that could have a material adverse effect on our business, financial condition and results of operations. In 2012 and 2011, we spent approximately \$190 and \$421, respectively, on environmental controls, including costs to properly dispose of potentially hazardous waste.

Since non-rechargeable and rechargeable lithium battery chemistries react adversely with water and water vapor, certain of our manufacturing processes must be performed in a controlled environment with low relative humidity. Our Newark, New York and Shenzhen, China facilities contain dry rooms or glove box equipment, as well as specialized air-drying equipment.

Battery & Energy Products

Our non-rechargeable battery products incorporate lithium metal, which reacts with water and may cause fires if not handled properly. In the past, we have experienced fires that have temporarily interrupted certain manufacturing operations. We believe that we have adequate fire suppression systems and insurance, including business interruption insurance, to protect against the occurrence of fires and fire losses in our facilities.

Our 9-volt battery, among other sizes, is designed to conform to the dimensional and electrical standards of the American National Standards Institute, and the 9-volt battery and a range of 3-volt cells are recognized under the Underwriters Laboratories, Inc. Component Recognition Program.

Communications Systems

We are not currently aware of any other regulatory requirements regarding the disposal of communications products.

Corporate

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Section 1502 (the “Dodd-Frank Act”) requires public companies to disclose whether certain minerals (such as tantalum, tin, gold and tungsten), commonly known as “conflict minerals,” are necessary to the functionality or production of a product manufactured by a public company and if those minerals originated in the Democratic Republic of Congo or an adjoining country. To comply with the Dodd-Frank Act, as determined by the SEC, we will be required to perform due diligence and disclose whether or not our products contain such minerals and from which countries and source (smelter) the minerals were obtained. The first report is due by May 31, 2014 for the 2013 calendar year and we are implementing appropriate measures to comply with such requirements.

Competition

Competition in both the battery and communications systems markets is, and is expected to remain, intense. The competition ranges from development stage companies to major domestic and international companies, many of which have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. We compete against companies producing batteries as well as those companies producing communications systems. We compete on the basis of design flexibility, performance, price, reliability and customer support. There can be no assurance that our technologies and products will not be rendered obsolete by developments in competing technologies or services that are currently under development or that may be developed in the future or that our competitors will not market competing products and services that obtain market acceptance more rapidly than ours.

Historically, although other entities may attempt to take advantage of the growth of the battery market, the lithium battery cell industry has certain technological and economic barriers to entry. The development of technology, equipment and manufacturing techniques and the operation of a facility for the automated production of lithium battery cells require large capital expenditures, which may deter new entrants from commencing production. Through our experience in battery cell manufacturing, we have also developed expertise, which we believe would be difficult to reproduce without substantial time and expense in the non-rechargeable battery market.

Employees

As of December 31, 2012, we employed a total of 841 permanent and temporary employees: 40 in research and development, 692 in production and 109 in sales and administration. None of our employees are represented by a labor union.

ITEM 1A. RISK FACTORS

A significant portion of our revenues is derived from a certain key customer.

During the years ended December 31, 2012 and 2011, we had one major customer, a large defense prime, which comprised 21% of our revenues in each year. There were no other customers that comprised greater than 10% of our total revenues during these years. The reduction, delay or cancellation of orders from this customer for any reason could materially and adversely affect our business, operating results and financial condition.

Reductions in U.S. and foreign military spending could have a material adverse effect on our business, financial condition and results of operations.

A significant portion of our revenues is derived from contracts with the U.S. and foreign militaries or OEMs that supply the U.S. and foreign militaries. In the years ended December 31, 2012 and 2011, approximately \$66,200 or 65% and \$72,100 or 53%, respectively, of our revenues were comprised of sales made directly or indirectly to the U.S. and foreign militaries.

We are highly dependent on sales to U.S. Government customers. The percentage of our net revenue that was derived from sales to U.S. Government customers, including the DoD, whether directly or through prime contractors, was approximately \$43,700 or 43% in 2012 and \$58,400 or 43% in 2011. Therefore, any significant disruption or deterioration of our relationship with the U.S. Government would significantly reduce our revenue. Our competitors continuously engage in efforts to expand their business relationships with the U.S. Government and will continue these efforts in the future, and the U.S. Government may choose to use other contractors.

Budget and appropriations decisions made by the U.S. Government are outside of our control and have long-term consequences for our business. U.S. Government spending priorities and DoD spending levels are becoming increasingly uncertain and difficult to predict and will be affected by numerous factors. The most recent example of this is sequestration (automatic, across-the-board U.S. Government budgetary spending cuts) that became effective on March 1, 2013 as required under the Budget Control Act of 2011. The actual impact of sequestration on the DoD budget and other programs is uncertain as sequestration becomes implemented over the remaining fiscal year as the timing and impact on spending levels is determined and as new spending bills, such as a proposed continuing resolution to be negotiated and effective at the end of March 2013, alter the current spending levels. A decline in U.S. military expenditures could result in a reduction in the military's demand for our products, which could have a material adverse effect on our business, financial condition and results of operations.

We face risks related to general domestic and global economic conditions.

In general, our operating results can be significantly affected by negative economic conditions, high labor, material and commodity costs and unforeseen changes in demand for our products and services. These risks are heightened as economic conditions globally have deteriorated significantly and may not fully recover to historical levels in the short-term. The current economic conditions could continue to have a negative impact on demand for our products and services, which may have a direct negative impact on our sales and profitability, as well as our ability to generate sufficient internal cash flows or access credit at reasonable rates to meet future operating expenses, service debt and fund capital expenditures.

A decline in demand for products or services using our batteries or communications systems could reduce demand for our products or services and/or our products could become obsolete.

A substantial portion of our business depends on the continued demand for products or services using our batteries and communications systems sold by our customers, including OEM's. Our success depends significantly upon the success of those customers' products or services in the marketplace. We are subject to many risks beyond our control that influence the success or failure of a particular product or service offered by a customer, including:

- competition faced by the customer in its particular industry,
 - market acceptance of the customer's product or service,
- the engineering, sales, marketing and management capabilities of the customer,
- technical challenges unrelated to our technology or products faced by the customer in developing its products or services, and
 - the financial and other resources of the customer.

For instance, in the years ended December 31, 2012 and 2011, 14% and 12% of our revenues, respectively, were comprised of sales of our 9-volt batteries, and of this, approximately 26% and 34%, respectively, pertained to sales to smoke alarm OEMs. If the retail demand for long-life smoke alarms decreases significantly or if innovation leads to alternative sources of power for long-life smoke alarms, this could have a material adverse effect on our business, financial condition and results of operations.

The market for our products is characterized by changing technology and evolving industry standards, often resulting in product obsolescence or short product lifecycles. Although we believe that our products are comprised of state-of-the-art technology, there can be no assurance that competitors will not develop technologies or products that would render our technologies and products obsolete or less marketable. Many of the companies with which we compete have substantially greater resources than we do, and some have the capacity and volume of business to be able to produce their products more efficiently than we can at the present time. In addition, these companies are developing or have developed products using a variety of technologies that are expected to compete with our technologies. If these companies successfully market their products in a manner that renders our technologies obsolete, this could have a material adverse effect on our business, financial condition and results of operations.

Our efforts to develop new commercial applications for our products could fail.

Although we are involved with developing certain products for new commercial applications, we cannot provide assurance that acceptance of our products will occur due to the highly competitive nature of the business. There are many new product and technology entrants into the marketplace, and we must continually reassess the market segments in which our products can be successful and seek to engage customers in these segments that will adopt our products for use in their products. In addition, these companies must be successful with their products in their markets for us to gain increased business. Increased competition, failure to gain customer acceptance of products, the introduction of competitive technologies or failure of our customers in their markets could have a further adverse effect on our business.

Our growth and expansion strategy could strain or overwhelm our resources.

Rapid growth of our business could significantly strain management, operations and technical resources. If we are successful in obtaining rapid market growth of our products and services, we will be required to deliver large volumes of quality products and increased levels of services to customers on a timely basis at a reasonable cost to those customers. For example, demand for our new or existing products combined with our ability to penetrate new markets and geographies, could strain the current capacity capabilities of our manufacturing facilities and require additional equipment and time to build a sufficient support infrastructure. This demand could also create working capital issues for us, as we may need increased liquidity to fund purchases of raw materials and supplies. We cannot assure, however, that our business will grow rapidly or that our efforts to expand manufacturing and quality control activities will be successful or that we will be able to satisfy commercial scale production requirements on a timely and cost-effective basis.

We also may be required to continue to improve our operations, management and financial systems and controls in order to remain competitive. The failure to manage growth and expansion effectively could have an adverse effect on our business, financial condition, and results of operations.

Negative publicity of lithium-ion batteries may negatively impact the industries or markets we operate in.

We are unable to predict the impact, severity and duration of negative publicity and how it may impact the industries or markets we serve. Ongoing negative attention being given to lithium ion batteries that are integrated into the power systems of new commercial aircraft and electric motor vehicles may have an impact on the lithium ion battery industry as a whole, regardless of the designed usage of those batteries. The residual effects of such events could have

an adverse effect on our business, financial condition, and results of operations.

Any inability to comply with changes to the regulations for the shipment of our products could limit our ability to transport our products to customers in a cost-effective manner.

The transportation of lithium batteries is regulated by the International Civil Aviation Organization (“ICAO”) and corresponding International Air Transport Association (“IATA”) Dangerous Goods Regulations and the International Maritime Dangerous Goods Code (“IMDG”) and in the U.S. by the Department of Transportation’s Pipeline and Hazardous Materials Safety Administration (“PHMSA”). These regulations are based on the United Nations Recommendations on the Transport of Dangerous Goods Model Regulations and the United Nations Manual of Tests and Criteria. We currently ship our products pursuant to ICAO, IATA and PHMSA hazardous goods regulations. The regulations require companies to meet certain testing, packaging, labeling and shipping specifications for safety reasons. We have not incurred, and do not expect to incur, any significant costs in order to comply with these regulations. We believe we comply with all current U.S. and international regulations for the shipment of our products, and we intend and expect to comply with any new regulations that are imposed. We have established our own testing facilities to ensure that we comply with these regulations. If we are unable to comply with the new regulations, however, or if regulations are introduced that limit our ability to transport our products to customers in a cost-effective manner, this could have a material adverse effect on our business, financial condition and results of operations.

We are subject to certain safety risks, including the risk of fire, inherent in the manufacture, use and transportation of lithium batteries.

Due to the high energy inherent in lithium batteries, our lithium batteries can pose certain safety risks, including the risk of fire. We incorporate procedures in research, development, product design, manufacturing processes and the transportation of lithium batteries that are intended to minimize safety risks, but we cannot assure that accidents will not occur or that our products will not be subject to recall for safety concerns. Although we currently carry insurance policies which cover loss of the plant and machinery, leasehold improvements, inventory and business interruption, any accident, whether at the manufacturing facilities or from the use of the products, may result in significant production delays or claims for damages resulting from injuries. While we maintain what we believe to be sufficient casualty liability coverage to protect against such occurrences, these types of losses could have a material adverse effect on our business, financial condition and results of operation.

Any impairment of goodwill and indefinite-lived intangible assets, and other intangible assets, could negatively impact our results of operations.

Our goodwill and indefinite-lived intangible assets are subject to an impairment test on an annual basis and are also tested whenever events and circumstances indicate that goodwill and/or indefinite-lived intangible assets may be impaired. Any excess goodwill and/or indefinite-lived intangible assets value resulting from the impairment test must be written off in the period of determination. Intangible assets (other than goodwill and indefinite-lived intangible assets) are generally amortized over the useful life of such assets. In addition, from time to time, we may acquire or make an investment in a business which will require us to record goodwill based on the purchase price and the value of the acquired tangible and intangible assets. We may subsequently experience unforeseen issues with such business which adversely affect the anticipated returns of the business or value of the intangible assets and trigger an evaluation of the recoverability of the recorded goodwill and intangible assets for such business. Future determinations of significant write-offs of goodwill or intangible assets as a result of an impairment test or any accelerated amortization of other intangible assets could have a negative impact on our results of operations and financial condition. We are constantly reviewing the costs and the benefits of retiring several of our current brands, the retirement of which could result in a non-cash impairment charge of the associated indefinite-lived intangible asset, reducing operating earnings by the associated amount or amounts on the balance sheet. We have completed our annual impairment analysis for goodwill and indefinite-lived intangible assets, in accordance with the applicable accounting guidance, and have concluded that we do not have any impairment of goodwill and indefinite-lived intangible assets for the year ended December 31, 2012. For 2012, we identified four trademarks for testing and, as a result of that testing, no impairment was indicated. However, due to the narrow margin of passing the testing in 2012, there is potential that the McDowell - Communications Systems trademark may become partially or fully impaired in 2013 if the projected revenue targets are not met. As of December 31, 2012, the McDowell - Communications Systems trademark had a carrying value of \$2,400.

Our operations in China are subject to unique risks and uncertainties.

Our operating facility in China presents risks including, but not limited to, changes in local regulatory requirements, including changes in labor laws, local wage laws, environmental regulations, taxes and operating licenses, compliance with U.S. regulatory requirements, including the Foreign Corrupt Practices Act, uncertainties as to local laws and enforcement of contract and intellectual property rights, currency restrictions, currency exchange controls, fluctuations of currency, and currency revaluations, civil unrest, power outages, water shortages, labor shortages, labor disputes, increase in labor costs, rapid changes in government, economic and political policies, political or civil unrest, acts of terrorism, or the threat of boycotts, and other civil disturbances that are outside of our control. Any such disruptions could have a material adverse effect on our business, financial condition and results of operations. In the first half of 2012, we completed the transition of 9-volt batteries production from the U.S. to China. While we do not foresee any potential disruption to the manufacturing of this product, unexpected circumstances could arise, which may negatively

impact our production.

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The loss of top management and key personnel could significantly harm our business, and the ability to put in place a succession plan and recruit experienced, competent management is critical to the success of the business.

The loss of top management and key personnel could significantly harm our business, and the ability to put in place a succession plan and recruit experienced, competent management is critical to the success of our business. The continuity of our officers and executive team are vital to the successful implementation of a new business model and growth strategy designed to deliver sustainable, consistent profitability. This need is accentuated by the reduction in management to right size the business during the course of 2012 and 2011. A top management priority has been the development of a succession plan to mitigate the risks associated with the loss of senior executives. There is no guarantee that we will be successful in our efforts to effectively implement our succession plan.

Because of the specialized, technical nature of our business, we are highly dependent on certain members of our management, sales, engineering and technical staffs. The loss of these employees could have a material adverse effect on our business, financial condition and results of operations. Our ability to effectively pursue our business strategy will depend upon, among other factors, the successful retention of our key personnel, recruitment of additional highly skilled and experienced managerial, sales, engineering and technical personnel, and the integration of such personnel obtained through business acquisitions. We cannot assure that we will be able to retain or recruit this type of personnel. An inability to hire sufficient numbers of people or to find people with the desired skills could result in greater demands being placed on limited management resources which could have a material adverse effect on our business, financial condition and results of operations.

We are subject to the contract rules and procedures of the U.S. and foreign governments. These rules and procedures create significant risks and uncertainties for us that are not usually present in contracts with private parties.

We will continue to develop battery products, communications systems and services to meet the needs of the U.S. and foreign governments. We compete in solicitations for awards of contracts. The receipt of an award, however, does not always result in the immediate release of an order and does not guarantee in any way any given volume of orders. Any delay of solicitations or anticipated purchase orders by, or future failure of, the U.S. or foreign governments to purchase products manufactured by us could have a material adverse effect on our business, financial condition and results of operations. Additionally, in these scenarios we are typically required to successfully meet contractual specifications and to pass various qualification-testing for the products under contract. Our inability to pass these tests in a timely fashion, as well as meet delivery schedules for orders released under contract, could have a material adverse effect on our business, financial condition and results of operations.

When a government contract is awarded, there is a government procedure that permits unsuccessful companies to formally protest such award if they believe they were unjustly treated in the evaluation process. As a result of these protests, the government is precluded from proceeding under these contracts until the protests are resolved. A prolonged delay in the resolution of a protest, or a reversal of an award resulting from such a protest could have a material adverse effect on our business, financial condition and results of operations.

We could be adversely affected by violations of the US Foreign Corrupt Practices Act (“FCPA”), the U.K. Bribery Act or other anti-corruption laws.

The FCPA, U.K. Bribery Act and other anti-corruption laws generally prohibit companies and their intermediaries from making improper payments (to foreign officials and otherwise) and require companies to keep accurate books and records and maintain appropriate internal controls. Our training program and policies mandate compliance with such laws. We operate in some parts of the world that have experienced governmental corruption to some degree, and, in certain circumstances, strict compliance with anti-bribery laws may conflict with local customs and practices. If we are found to be liable for violations of anti-corruption laws (either due to our own acts or our inadvertence, or due to the acts or inadvertence of others, including employees of our third party partners or agents), we could suffer from

civil and criminal penalties or other sanctions, incur significant internal investigation costs and suffer reputational harm.

The U.S. and foreign governments can audit our contracts with their respective defense and government agencies and, under certain circumstances, can adjust the economic terms of those contracts.

A significant portion of our business comes from sales of products and services to the U.S. and foreign governments through various contracts. These contracts are subject to procurement laws and regulations that lay out policies and procedures for acquiring goods and services. The regulations also contain guidelines for managing contracts after they are awarded, including conditions under which contracts may be terminated, in whole or in part, at the government's convenience or for default. Failure to comply with the procurement laws or regulations can result in civil, criminal or administrative proceedings involving fines, penalties, suspension of payments, or suspension or disbarment from government contracting or subcontracting for a period of time.

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 U.S. 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. To resolve these matters, we entered into a settlement agreement with the United States of America and under such agreement agreed to pay the U.S. government \$2,730 plus accrued interest in four semi-annual payments. These payments were fully completed in 2012.

Our supply of raw materials and components could be disrupted.

Certain materials and components used in our products are available only from a single or a limited number of suppliers. As such, some materials and components could become in short supply resulting in limited availability and/or increased costs. Additionally, we may elect to develop relationships with a single or limited number of suppliers for materials and components that are otherwise generally available. Due to our involvement with supplying defense products to the government, we could receive a government preference to continue to obtain critical supplies to meet military production needs. However, if the government did not provide us with a government preference in such circumstances, the difficulty in obtaining supplies could have a material adverse effect on our business, financial condition and results of operations. Although we believe that alternative suppliers are available to supply materials and components that could replace materials and components currently used and that, if necessary, we would be able to redesign our products to make use of such alternatives, any interruption in the supply from any supplier that serves as a sole source could delay product shipments and have a material adverse effect on our business, financial condition and results of operations. We have experienced interruptions of product deliveries by sole source suppliers in the past, and we cannot guarantee that we will not experience a material interruption of product deliveries from sole source suppliers in the future. Additionally, we could face increasing pricing pressure from our suppliers dependent upon volume due to rising costs by these suppliers that could be passed on to us in higher prices for our raw materials, which could have a material effect on our business, financial condition and results of operations.

Our customers may not meet the volume expectations in our supply agreements.

We sell most of our products and services through supply agreements and contracts. While supply agreements and contracts contain volume-based pricing based on expected volumes, industry practices dictate that pricing is rarely adjusted retroactively when contract volumes are not achieved. Every effort is made to adjust future prices accordingly, but our ability to adjust prices is generally based on market conditions.

Any inability to protect our proprietary and intellectual property could allow our competitors and others to produce competing products based on our proprietary and intellectual property.

Our success depends more on the knowledge, ability, experience and technological expertise of our employees than on the legal protection of patents and other proprietary rights. We claim proprietary rights in various unpatented technologies, know-how, trade secrets and trademarks relating to products and manufacturing processes. We cannot

guarantee the degree of protection these various claims may or will afford, or that competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technology. We protect our proprietary rights in our products and operations through contractual obligations, including nondisclosure agreements with certain employees, customers, consultants and strategic partners. There can be no assurance as to the degree of protection these contractual measures may or will afford. We have had patents issued and have patent applications pending in the U.S. and elsewhere. We cannot assure (1) that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology, (2) that any patents issued to us will not be challenged, invalidated or circumvented, or (3) as to the degree or adequacy of protection any patents or patent applications may or will afford. If we are found to be infringing third party patents, there can be no assurance that we will be able to obtain licenses with respect to such patents on acceptable terms, if at all. The failure to obtain necessary licenses could delay product shipments or the introduction of new products, and costly attempts to design around such patents could foreclose the development, manufacture or sale of products.

Over the last several years Arista Power, Inc. (“Arista”) has hired a member of our senior management team, several members of our sales and engineering teams and other of our employees. Many of these employees had access to our proprietary property such as our technology and know-how and took such knowledge with them. During the summer of 2011, Arista recruited David Modeen, a former senior sales and engineering employee, in violation of his Employee Confidentiality, Non-Disclosure, Non-Compete, Non-Disparagement and Assignment Agreement (the “Non-Compete Agreement”) with us. We believe that Mr. Modeen has provided certain of our trade secrets and confidential proprietary information to Arista. Such disclosure could result in loss of sales and customers. On September 23, 2011, we initiated an action against Arista and Mr. Modeen, in the State of New York Supreme Court, County of Wayne seeking to enforce the terms of the Non-Compete Agreement. Arista responded by filing a complaint against us in the State of New York Supreme Court, County of Monroe. Both of these lawsuits are currently outstanding. There can be no assurances that our lawsuit against Arista will be successful or, even if successful, that any remedy will make us whole for the damage caused by Mr. Modeen’s breach of our Non-Compete Agreement.

Our business could be negatively impacted by breaches in security and other disruptions, affecting our ability to generate revenues or contain costs.

We face certain security threats, including threats to our information technology infrastructure, attempts to gain access to our proprietary or classified information, and threats to physical security. Our information technology networks and related systems are critical to the operation of our business and essential to our ability to successfully perform day-to-day operations. The risks of a security breach or disruption, particularly through cyber attack or cyber intrusion, including by computer hackers, foreign governments and cyber terrorists, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased. Although we have developed systems and processes that are designed to protect our proprietary or classified information, failure to prevent these types of events could disrupt our operations, require significant management attention and resources, and could negatively impact our reputation among our customers and the public, which could have a negative impact on our financial condition, results of operations and liquidity.

We may incur significant costs because of the warranties we supply with our products and services.

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 systems products, we now offer up to a three-year warranty. Previously, we had offered up to a four-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 will be sufficient. This could have a material adverse effect on our business, financial condition and results of operations.

Our quarterly and annual results and the price of our common stock could fluctuate significantly.

Our future operating results may vary significantly from quarter to quarter and from year to year depending on factors such as the timing and shipment of significant orders, new product introductions, delays in customer releases of purchase orders, delays in receiving raw materials from vendors, the mix of distribution channels through which we sell our products and services and general economic conditions. Frequently, a substantial portion of our revenue in each quarter is generated from orders booked and fulfilled during that quarter. As a result, revenue levels are difficult to predict for each quarter. If revenue results are below expectations, operating results will be adversely affected as we have a sizeable base of fixed overhead costs that do not fluctuate much with the changes in revenue. Due to such variances in operating results, we have sometimes failed to meet, and in the future may not meet, market expectations or even our own guidance regarding our future operating results.

In addition to the uncertainties of quarterly and annual operating results, future announcements concerning us or our competitors, including technological innovations or commercial products, litigation or public concerns as to the safety or commercial value of one or more of our products may cause the market price of our common stock to fluctuate substantially for reasons which may be unrelated to our operating results. These fluctuations, as well as general economic, political and market conditions, may have a material adverse effect on the market price of our common stock.

We may not generate a sufficient amount of cash or generate sufficient funds from operations to fund our operations or we may be unable to obtain financing to fund ongoing operations and future growth.

Our ability to draw funds and make payments on our asset-based credit facility will depend on our ability to consistently generate cash flow from operations in the future. This ability, to a certain extent, is subject to general economic, financial, competitive, regulatory and other factors beyond our control. Our future cash flows from operations, combined with our accessibility to cash and credit, may not be sufficient to allow us to finance ongoing operations or to make required investments for future growth. We may need to seek additional credit or access capital markets for additional funds. There is no assurance, given our historical operating performance, that we would be successful in this regard.

We are seeking to replace our 2010 Credit Facility that expired on February 17, 2013 and was extended through May 15, 2013; however, there can be no assurance that we will be able to replace our present Credit Facility on terms acceptable to us or at all.

We are currently exploring options for replacing our 2010 Credit Facility that expired on February 17, 2013, and was extended through May 15, 2013, with RBS or another lender. During the course of 2012, we have solidified our liquidity position and ended the year with cash, including restricted cash, of \$10,078 and no outstanding debt. While at December 31, 2012, we had no borrowings outstanding under our Credit Facility and have no reason to believe that we will not be able obtain satisfactory financing, there can be no assurances that we will be able to replace the Credit Facility on terms acceptable to us or at all. Our financial flexibility may be limited if we are unable to replace our 2010 Credit Facility.

We are subject to foreign currency fluctuations.

We maintain manufacturing operations in North America, Europe and Asia, and we export products to various countries. We purchase materials and sell our products in foreign currencies, and therefore currency fluctuations may impact our pricing of products sold and materials purchased. In addition, our foreign subsidiaries maintain their books in local currency, and the translation of those subsidiary financial statements into U.S. dollars for our consolidated financial statements could have an adverse effect on our consolidated financial results, due to changes in local currency relative to the U.S. dollar. Accordingly, currency fluctuations could have a material adverse effect on our business, financial condition and results of operations.

Our ability to use our Net Operating Loss Carryforwards in the future may be limited, which could have an adverse impact on our tax liabilities.

At December 31, 2012, we had approximately \$58,030 of net operating loss carryforwards (“NOL’s”) available to offset future taxable income. We continually assess the carrying value of this asset based on the relevant accounting standards. As of December 31, 2012, we reflected a full valuation allowance against our deferred tax asset to the extent the asset is not able to be offset by future reversing temporary differences. As a result, we have reflected a net deferred tax liability of \$4,040 in the U.S. We have reflected a net deferred tax asset of \$-0- in the U. K. due to our current assessment that it is more likely than not to not be realized. As we continue to assess the realizability of our deferred tax assets, the amount of the valuation allowance could be reduced. In addition, 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. Achieving our business plan targets, particularly those relating to revenue and profitability, is integral to our assessment regarding the recoverability of our net deferred tax asset.

We have determined that a change in ownership, as defined under Internal Revenue Code Section 382, occurred in 2005 and 2006. As such, our domestic NOL carryforward will be subject to an annual limitation estimated to be in the range of approximately \$12,000 to \$14,500. This limitation did not have an impact on income taxes determined for

2012. Such a limitation could result in the possibility of a cash outlay for income taxes in a future year when earnings exceed the amount of NOL carryforwards that can be used by us. 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.

We may incur significant costs because of known and unknown environmental matters.

National, state and local laws impose various environmental controls on the manufacture, transportation, storage, use and disposal of batteries and of certain chemicals used in the manufacture of batteries. Although we believe that our operations are in substantial compliance with current environmental regulations and that, except as noted below, there are no environmental conditions that will require material expenditures for clean-up at our present or former facilities or at facilities to which we have sent waste for disposal, there can be no assurance that changes in such laws and regulations will not impose costly compliance requirements on us or otherwise subject us to future liabilities. There can be no assurance that additional or modified regulations relating to the manufacture, transportation, storage, use and disposal of materials used to manufacture our batteries or restricting disposal of batteries will not be imposed or how these regulations will affect us or our customers. Such changes in regulations could have a material adverse effect on our business, financial condition and results of operations.

The European Union's Restriction of Hazardous Substances ("RoHS") Directive places restrictions on the use of certain hazardous substances in electrical and electronic equipment. All applicable products sold in the European Union market after July 1, 2006 must pass RoHS compliance. While this directive does not apply to batteries and does not currently affect our defense products, should any changes occur in the directive that would affect our products, we intend and expect to comply with any new regulations that are imposed. Our commercial chargers are in compliance with this directive. Additional European Union Directives, entitled the Waste Electrical and Electronic Equipment ("WEEE") Directive and the Directive "on batteries and accumulators and waste batteries and accumulators", impose regulations affecting our non-defense products. These directives require that producers or importers of particular classes of electrical goods are financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. These directives assign levels of responsibility to companies doing business in European Union markets based on their relative market share. These directives call on each European Union member state to enact enabling legislation to implement the directive. As additional European Union member states pass enabling legislation our compliance system should be sufficient to meet such requirements. Our current estimated costs associated with our compliance with these directives based on our current market share are not significant. However, we continue to evaluate the impact of these directives as European Union member states implement guidance, and actual costs could differ from our current estimates.

The European Union's Battery Directive "on batteries and accumulators and waste batteries and accumulators" is intended to cover all types of batteries regardless of their shape, volume, weight, material composition or use. It is aimed at reducing mercury, cadmium, lead and other metals in the environment by minimizing the use of these substances in batteries and by treating and re-using old batteries. The Directive applies to all types of batteries except those used to protect European Member States' security, for military purposes, or sent into space. To achieve these objectives, the Directive prohibits the marketing of some batteries containing hazardous substances. It establishes schemes aimed at high level of collection and recycling of batteries with quantified collection and recycling targets. The Directive sets out minimum rules for producer responsibility and provisions with regard to labeling of batteries and their removability from equipment. Product markings are required for batteries and accumulators to provide information on capacity and to facilitate reuse and safe disposal. We currently ship our products pursuant to the requirements of the Directive.

China's "Management Methods for Controlling Pollution Caused by Electronic Information Products Regulation" ("China RoHS") provides a two-step, broad regulatory framework, including similar hazardous substance restrictions as are imposed by the European Union's RoHS Directive, and applies to methods for the control and reduction of pollution and other public hazards to the environment caused during the production, sale, and import of electronic information products ("EIP") in China affecting a broad range of electronic products and parts. Currently, only the first step of the regulatory framework of China RoHS, which details marking and labeling requirements under Standard SJT11364-2006 ("Marking Standard"), is in effect. However, the methods under China RoHS only apply to EIP placed in the marketplace in China. Additionally, the Marking Standard does not apply to components sold to OEMs for use in other EIPs. Our sales in China are limited to sales to OEMs and to distributors who supply to OEMs. Should our sales strategy change to include direct sales to end-users, our compliance system is sufficient to meet our requirements under China RoHS. Our current estimated costs associated with our compliance with this regulation based on our current market share are not significant. However, we continue to evaluate the impact of this regulation, and actual costs could differ from our current estimates.

A number of domestic and international communities are prohibiting the landfill disposal of batteries and requiring companies to make provisions for product recycling. Of particular note are the European Union's Batteries Directive and the New York State Rechargeable Battery Recycling law. We are committed to responsible product stewardship and ongoing compliance with these and future regulations. The compliance costs associated with current recycling regulations are not expected to be significant at this time. However, we continue to evaluate the impact of this regulation, and actual costs could differ from our current estimates.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

As of December 31, 2012, we own two buildings in Newark, New York comprising approximately 250,000 square feet, which serves operations primarily in the Battery & Energy Products operating segment. Our corporate headquarters are located in our Newark, New York facility. In addition, we leased approximately 46,000 square feet in a facility based in Abingdon, England, which we have decided to not renew. As such, subsequent to year end, we have relocated our Abingdon, England operations to a smaller facility nearby that is better suited to our sales and service needs going forward, reducing to the usable space to approximately 3,500 square feet. Both facilities serve the operations in the Battery and Energy Services Products operating segment. We also lease approximately 130,000 square feet in four buildings on one campus in Shenzhen, China, which serves operations in the Battery & Energy Products operating segment. The Shenzhen, China campus location includes dormitory facilities. We lease approximately 32,500 square feet in a facility based in Virginia Beach, Virginia, which serves operations in the Communications Systems operating segment. We also lease sales and administrative offices, as well as manufacturing and production facilities, in India, which serves operations in the Battery & Energy Products operating segment. Our research and development efforts for our Battery & Energy Products are conducted at our Newark, New York and Shenzhen, China facilities, while our research and development efforts for our Communications Systems products are conducted in Tallahassee, Florida and at our facility in Virginia Beach, Virginia. On occasion, we rent additional warehouse space to store inventory and non-operational equipment. We believe that our facilities are adequate and suitable for our current needs. However, we may require additional manufacturing and administrative space if demand for our products and services continues to grow.

ITEM 3. LEGAL PROCEEDINGS

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

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, in the State of New York Supreme Court, County of Wayne (Index No. 73379). In our initial Complaint, we alleged that Arista recruited all but one of the members of its executive team from us, subsequently changed 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 alleged 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 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 February 16, 2012, we filed an Amended Complaint in the action in Supreme Court, Wayne County, adding claims in that action against Modeen and Arista for misappropriation of our trade secrets and unfair competition, based on Arista's strategy to hire Modeen and other former Ultralife employees, and thereby obtain improper access to information that is confidential and proprietary to us for Arista's own benefit. We seek damages and injunctive relief limiting Arista's employment of Modeen, and precluding Arista from using or disclosing information and trade secrets it acquired from us. Arista and Modeen answered the Amended Complaint on March 19, 2012, and discovery has commenced and is ongoing in both cases.

We initiated the September 23, 2011, Complaint against Arista 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 action Arista filed on November 29, 2011, 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 attributable to us, and claims for recovery of this or any other amount are legally and factually baseless.

Accordingly, we are vigorously pursuing our complaint against Arista and defending what we believe to be a meritless action on the part of Arista.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is listed on the NASDAQ Global Market under the symbol "ULBI."

The following table sets forth the quarterly high and low closing sales prices of our common stock during 2011 and 2012:

	Closing Sales Prices	
	High	Low
2011:		
Quarter ended April 3, 2011	\$7.38	\$4.81
Quarter ended July 3, 2011	5.20	3.94
Quarter ended October 2, 2011	5.04	4.57
Quarter ended December 31, 2011	4.89	3.96
2012:		
Quarter ended April 1, 2012	\$5.45	\$4.02
Quarter ended July 1, 2012	5.17	3.60
Quarter ended September 30, 2012	3.94	2.67
Quarter ended December 31, 2012	3.53	2.58

Holders

As of February 28, 2013, there were 356 registered holders of record of our common stock.

Recent Issuances of Unregistered Securities

Recently we discovered that we had inadvertently issued stock awards to our independent directors in excess of the 200,000 share limitation under our Amended and Restated 2004 Long-Term Incentive Plan, as amended (the "LTIP"), on the number of shares of our common stock that may be used for awards other than stock options or stock appreciation rights (the "Limitation"). The issuances of our common stock in excess of the Limitation (the "Excess Shares") occurred during 2010 and after and were disclosed and were properly accounted for in our periodic reports and proxy statements filed with the Securities and Exchange Commission. We issued a total of 179,512 Excess Shares to our independent directors in the form of outright stock grants or restricted stock awards as part of their annual retainers as described in detail in the table below:

Date	Number of Shares Issued	Number of Directors Receiving Awards
May 15, 2010	8,534	8
August 16, 2010	16,616	7
November 15, 2010	11,811	7
February 15, 2011	8,371	7
May 16, 2011	17,036	7

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August 15, 2011	15,981	7
November 15, 2011	17,350	7
February 15, 2012	16,271	7
May 15, 2012	17,473	7
August 15, 2012	24,311	7
November 15, 2012	25,758	7

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Since the Excess Shares were issued in excess of the Limitation, they were not issued pursuant to the LTIP and hence the issuances of the Excess Shares were not registered under the Securities Act of 1933, as amended (the "Securities Act") by our Form S-8 registration statement for the LTIP. Although the Excess Shares were not issued under the LTIP, we plan to treat the Excess Shares as being issued under the LTIP and we will therefore count the Excess Shares against the 2.9 million shares of our common stock authorized for grant under the LTIP. As a result, the issuance of the Excess Shares will not result in us granting more than 2.9 million shares of our common stock to our directors, executive officers, employees, or consultants. The issuances of the Excess Shares qualify for an exemption under Section 4(2) of the Securities Act. The Excess Shares are exempt from registration under Section 4(2) of the Securities Act because the issuances of the Excess Shares did not involve a "public offering," as defined in Section 4(2) of the Securities Act due to the small number of persons involved in the transaction, the size of the offering, the manner of the offering, the number of Excess Shares offered, the financial sophistication of our directors and their access to our financial information. To address this issue, we plan to have our shareholders consider a proposal at the 2013 Annual Meeting to increase the Limitation from 200,000 to 800,000 shares and to ratify the grant of the Excess Shares.

Purchases of Equity Securities by the Issuer

None.

Dividends

We have never declared or paid any cash dividends on our capital stock. We intend to retain earnings, if any, to finance future operations and expansion and, therefore, do not anticipate paying any cash dividends in the foreseeable future. Any future payment of dividends will depend upon our financial condition, capital requirements and earnings, as well as upon other factors that our Board of Directors may deem relevant. Pursuant to our current credit facility, we are precluded from paying any dividends.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company we are not required to provide this information.

ITEM 7. 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, 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, government and environmental regulations, business disruptions, including those caused by fires, 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 "Risk Factors" in Item 1A of this annual report.

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 annual report on Form 10-K to reflect new information, future events or other developments.

The following discussion and analysis should be read in conjunction with the accompanying Consolidated Financial Statements and Notes thereto appearing elsewhere in this Form 10-K.

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, communications and electronics systems and accessories and custom engineered systems. 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, such as cables. The Communications Systems segment includes: RF amplifiers, power supplies, cable and connector assemblies, 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.

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.

On March 8, 2011, we decided to exit our Energy Services business. As a result of management's review of our business segments and products, and taking into account the lack of growth and profitability potential of the Energy Services segment as well as its sizeable operating losses, we determined it was appropriate to refocus our operations on profitable growth opportunities presented in our other segments, Battery & Energy Products and Communications Systems. In the fourth quarter of 2010, we recorded a non-cash impairment charge of \$13,793 to write-off the goodwill and intangible assets and certain fixed assets associated with the standby power portion of our Energy Services business. The actions taken to exit our Energy Services business resulted in the elimination of approximately 40 jobs and the closing of five facilities, primarily in California, Florida and Texas. We completed all exit activities with respect to our Energy Services segment by the end of the second quarter of 2011, and have reclassified our Energy Services segment as a discontinued operation.

In connection with the exit activities described above, we recorded total restructuring charges of approximately \$2,924 in 2011. The restructuring charges include approximately \$703 of employee-related costs, including termination benefits, approximately \$250 of lease termination costs, approximately \$941 of inventory and fixed asset write-downs and approximately \$1,030 of other associated costs. The cash component of the aggregate total restructuring charges was approximately \$1,984. Subsequent to the completion of our exit activities, adjustments have been made to estimates of certain reserves and accruals that existed at that time. These adjustments amount to \$241 and were due to the difference in our actual experience compared to our expectations as of the completion of our exit activities.

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 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, there will be a customary post-closing working capital adjustment to the purchase price. 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. Certain items included within income from discontinued operations are based upon management’s best estimates as of the date of sale and may change should our estimates be different from our actual experience.

During the fourth quarter of 2012, management elected not to renew the lease for its U.K. manufacturing facility which expires on March 24, 2013, and to relocate its sales and services operations to a smaller facility. As a result of this decision, Ultralife is required to restore the facility back to its original condition per a previous contractual commitment. The estimated costs associated with the restoration total approximately \$950 of which \$200 was recorded in fourth quarter of 2012 as general & administrative expenses and \$750 has been recorded as discontinued operations. In addition, we expect to realize net savings of approximately \$500 on an annualized basis beginning in the second quarter of 2013.

In 2011, we implemented a series of Lean initiatives throughout our entire organization. Lean is a disciplined management philosophy which is 100% focused on using resources more effectively and the elimination of non-value added functions to any process. The expected result is a reduction in costs and increased efficiency.

Currently, we do not experience significant seasonal sales trends in any of our operating segments, although sales to the U.S. Defense Department and other international defense organizations can be sporadic based on the needs of those particular customers.

Overview

Consolidated revenues decreased by \$34,080 or 25.1% to \$101,657 for the year-ended December 31, 2012 compared to \$135,737 during the year ended December 31, 2011. This decrease was caused by declining revenues in our Battery & Energy Products segment in 2012 when compared to 2011, as a result of lower government and defense

sales, the completion of a long-running telematics contract in 2011 that was not continued, and lower sales of rechargeable batteries to commercial customers, partially offset by the impact of the \$2,730 non-recurring charge related to the DCAA settlement during the first quarter of 2011 and increased shipments of 20-Watt amplifier sales in our Communications Systems segment. Gross margin increased to 28.3% for the year ended December 31, 2012, as opposed to 25.2% for the year ended December 31, 2011, due to favorable product mix, increased pricing for some of our products and Lean manufacturing improvements, as well as, last year's non-recurring \$2,730 DCAA settlement charge and \$1,100 charge to write-off components associated with a discontinued amplifier line.

Operating expenses decreased by \$2,935 or 9.2% to \$28,844 during the year ended December 31, 2012, compared to \$31,779 during the year ended December 31, 2011, reflecting continued Lean initiatives, actions to reduce general and administrative expenses, as well as more focused spending on the development of new products, while investing a portion of our savings in the expansion of the sales force to increase our geographic coverage and penetrate new markets. Operating expenses as a percentage of revenues increased to 28.4% in 2012 from 23.4% reported in 2011 due to the impact of lower revenues in 2012.

Net loss from continuing operations was \$1,128, or \$0.06 per share, for the year ended December 31, 2012, compared to net income of \$1,549, or \$0.09 per share, for the year ended December 31, 2011. Net loss from discontinued operations, net of tax, was \$501, or \$0.03 per share, for the year ended December 31, 2012, compared to a net loss, net of tax of \$3,687, or \$0.21 per share, for the year ended December 31, 2011.

Adjusted EBITDA, 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 operations, amounted to \$5,054 for the year ended December 31, 2012 compared to \$7,913 for the year ended December 31, 2011. See the section "Adjusted EBITDA" beginning on page 32 for a reconciliation of Adjusted EBITDA to net loss attributable to Ultralife.

As a result of careful working capital management and cash generated from operations, our liquidity remains solid with cash of \$10,078, a \$4,592 improvement over the cash position of \$5,486 as of December 31, 2011. The company had no debt as of December 31, 2012. Our inventory levels decreased by \$4,597, or 13.1%, to \$30,370 at the end of 2012 from \$34,967 at the end of 2011 due to more focused inventory management and planning.

Outlook

For 2013, management expects low- to mid-single digit organic revenue growth reflecting strong growth in Communications Systems sales and modest gains in the Battery & Energy Products business, despite continued constraints on U.S. government spending. Based on this outlook for revenue growth, ongoing productivity improvements and plans to continue prudently investing in new product development, management expects to increase operating profitability for the year and to generate a mid-single digit operating margin.

Management cautions that the timing of orders and shipments may cause variability in quarterly results.

Results of Operations

Twelve Months Ended December 31, 2012 Compared With the Twelve Months Ended December 31, 2011

	12 Months Ended		Increase /
	12/31/2012	12/31/2011	(Decrease)
Revenues	\$101,657	\$135,737	\$ (34,080)
Cost of products sold	72,927	101,546	(28,619)
Gross margin	28,730	34,191	(5,461)
Operating expenses	28,844	31,779	(2,935)
Operating income (loss)	(114)	2,412	(2,526)
Other expense, net	(460)	(383)	(77)
Income (loss) from continuing operations before taxes	(574)	2,029	(2,603)
Income tax provision	554	480	74
Net income (loss) from continuing operations	(1,128)	1,549	(2,677)
Loss from discontinued operations, net of tax	(501)	(3,687)	3,186
Net loss	(1,629)	(2,138)	509
Net loss attributable to noncontrolling interest	31	58	(27)
Net loss attributable to Ultralife	\$(1,598)	\$(2,080)	482
Net income (loss) attributable to Ultralife common shares - basic			
Continuing operations	\$(0.06)	\$0.09	\$ (0.15)
Discontinued operations	\$(0.03)	\$(0.21)	\$ 0.18
Net income (loss) attributable to Ultralife common shares - diluted			
Continuing operations	\$(0.06)	\$0.09	\$ (0.15)
Discontinued operations	\$(0.03)	\$(0.21)	\$ 0.18
Weighted average shares outstanding-basic	17,403,000	17,304,000	99,000
Weighted average shares outstanding-diluted	17,403,000	17,336,000	67,000

Revenues. Total revenues for the twelve months ended December 31, 2012 amounted to \$101,657, a decrease of \$34,080, or 25.1% from the \$135,737 reported for the twelve months ended December 31, 2011.

Battery & Energy Products revenues decreased \$37,119, or 34.3%, to \$71,084 for the twelve months ended December 31, 2012 from the \$108,203 reported for the twelve months ended December 31, 2011 as a result of lower government and defense sales, the completion of a long-running telematics contract in 2011, as well as lower sales of rechargeable batteries to commercial customers, partially offset by last year's \$2,730 non-recurring DCAA settlement charge. The decline in government and defense sales and lower sales of rechargeable batteries was primarily caused by reductions in government spending that negatively impacted our entire industry.

Communications Systems revenues increased \$3,039, or 11.0%, from \$27,534 for the twelve months ended December 31, 2011 to \$30,573 for the twelve months ended December 31, 2012, as a result of the ongoing successful international business development efforts leading to increased shipments of 20-Watt amplifiers in our Communications Systems segment.

Cost of Products Sold. Cost of products sold decreased \$28,619, or 28.2%, from \$101,546 for the year ended December 31, 2011 to \$72,927 for the year ended December 31, 2012. Consolidated cost of products sold as a percentage of total revenue decreased from 74.8% for the year ended December 31, 2011 to 71.7% for the year ended December 31, 2012. Correspondingly, consolidated gross margin was 28.3% for the year ended December 31, 2012, compared with a gross margin of 25.2% for the year ended December 31, 2011. The increase is primarily attributable

to favorable product mix, increased pricing for some of our products and Lean manufacturing improvements, as well as, last year's \$2,730 non-recurring DCAA settlement charge and \$1,100 charge to write-off components associated with a discontinued amplifier line.

In our Battery & Energy Products segment, the cost of products sold decreased \$29,512, from \$83,034 for the year ended December 31, 2011 to \$53,522 for the year ended December 31, 2012. Battery & Energy Products gross margin for 2012 was \$17,562 or 24.7%, a decrease of \$7,607 from 2011's gross margin of \$25,169, or 23.3%. Battery & Energy Products' gross margin increased by 140 basis points for the twelve-month period ended December 31, 2012, primarily as a result of last year's non-recurring DCAA settlement charge.

In our Communications Systems segment, the cost of products sold increased \$893 from \$18,512 for the year ended December 31, 2011 to \$19,405 for the year ended December 31, 2012. Communications Systems gross margin for 2012 was \$11,168, or 36.5%, an increase of \$2,146 from 2011's gross margin of \$9,022, or 32.8%. The year-over-year comparison was impacted by the \$1,100 non-cash charge recorded in the third quarter of 2011 to write-off discontinued legacy amplifiers. Excluding this adjustment, the gross margin for 2011 would have been 36.8%. The slight decrease in gross margin after excluding the non-cash amplifier charge from 2011 was attributable to sales mix, as well as, reduced volume pricing for certain large projects earlier in the year.

Operating Expenses. Operating expenses decreased by \$2,935, or 9.2%, to \$28,844 for the year ended December 31, 2012 compared to \$31,779 for the year ended December 31, 2011, reflecting continued Lean initiatives, actions to reduce general and administrative expenses and focused spending in the development of new products while investing a portion of our savings in the expansion of the sales force to increase our geographic coverage and penetrate new markets. Overall, operating expenses as a percentage of revenues increased to 28.4% in 2012 from 23.4% reported for the prior year, due to the impact of lower revenues in 2012. Amortization expense associated with intangible assets related to our acquisitions was \$497 for 2012 (\$237 in selling, general and administrative expenses and \$260 in research and development costs), compared with \$627 for 2011 (\$314 in selling, general, and administrative expenses and \$313 in research and development costs). Research and development costs were \$7,216 in 2012, a decrease of \$1,377 or 16.0%, over the \$8,593 reported in 2011. Selling, general, and administrative expenses decreased \$1,558, or 6.7%, to \$21,628 for the year ended December 31, 2012 from \$23,186 for the year ended December 31, 2011, reflecting on-going actions to reduce general and administrative expenses, while investing a portion of our savings in the expansion of our sales force to increase our geographic coverage and penetrate new markets.

Other Income (Expense). Other income (expense) totaled (\$460) for the year ended December 31, 2012, compared to (\$383) for the year ended December 31, 2011. Interest expense, net of interest income, decreased \$118, from \$554 during 2011 to \$436 during 2012, as a result of lower average borrowings under our revolving credit facilities during the course of 2012. Miscellaneous expense amounted to \$24 for 2012 compared with income of \$171 for 2011, primarily due to transactions impacted by changes in foreign currencies relative to the U.S. dollar.

Income Taxes. We recorded a tax provision of \$554 for the year ended December 31, 2012 compared with a tax provision of \$480 for the same period of 2011. The expense is primarily due to (a) the income reported for our China operations during the periods, and (b) 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 effective consolidated tax rate for the years ended December 31, 2012 and 2011 was:

	Years Ended December			
	2012		2011	
Income (Loss) before Incomes Taxes (a)	\$ (574)	\$ 2,029	
Total Income Tax Provision (Benefit) (b)	\$ 554		\$ 480	
Effective Tax Rate (b/a)	96.5	%	23.7	%

In 2012 and 2011, in the U.S. and the U.K., we continue to report a valuation allowance for our deferred tax assets that cannot be offset by reversing temporary differences. This results from the conclusion that it is more likely than not that we would not utilize our U.S. and U.K. NOL's that had accumulated over time. The recognition of a valuation allowance on our deferred tax assets resulted from our evaluation of all available evidence, both positive and negative. The assessment of the realizability of the NOL's was based on a number of factors including, our history of net operating losses, the volatility of our earnings, our historical operating volatility, our historical inability to accurately forecast earnings for future periods and the continued uncertainty of the general business climate as of the

end of 2012. We concluded that these factors represent sufficient negative evidence and have concluded that we should record a full valuation allowance under Financial Accounting Standards Board's ("FASB") guidance on the accounting for income taxes. (See Notes 1 and 8 in the Notes to Consolidated Financial Statements for additional information.)

We have determined that a change in ownership, as defined under Internal Revenue Code Section 382, occurred in 2005 and 2006. As such, the domestic net operating loss ("NOL") carryforward will be subject to an annual limitation estimated to be in the range of approximately \$12,000 to \$14,500. The unused portion of the annual limitation can be carried forward to subsequent periods. Our ability to utilize NOL carryforwards due to successive ownership changes is currently limited to a minimum of approximately \$12,000 annually, plus the carryover from unused portions of the annual limitations. We believe such limitation will not impact our ability to realize the deferred tax asset.

In addition, 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 second quarters of 2012 and 2011. 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. Loss from discontinued operations, net of tax, totaled \$501 for the year ended December 31, 2012, compared to a loss of \$3,687 in the same period of 2011. The 2012 charge is primarily due to restoration costs related to our decision to not renew the lease of our present UK manufacturing facility and to relocate our UK sales and services operations to a small facility. Discontinued operations for 2011 include the operating results of the RedBlack business, which was sold in the third quarter of 2012, as well as, the costs associated with exiting the Energy Services business. For more information, see Note 2 to the Condensed Consolidated Financial Statements.

Net Loss Attributable to Ultralife. Net loss attributable to Ultralife and net loss attributable to Ultralife common shareholders per diluted share were \$1,598 and \$0.09, respectively, for the year ended December 31, 2012, compared to net loss attributable to Ultralife and net loss attributable to Ultralife common shareholders per diluted share of \$2,080 and \$0.12, respectively, for the year ended December 31, 2011, primarily as a result of the reasons described above. Average common shares outstanding used to compute diluted earnings per share increased from 17,336,000 in 2011 to 17,403,000 in 2012, 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:

- a. 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;
- b. 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;
- c. 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;
- d. although discontinued operations does not reflect our current business operations, discontinued operations includes the costs we incurred by exiting our Energy Services business and divesting our RedBlack Communications business; and
- e. 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:

	Years ended December 31,	
	2012	2011
Net loss attributable to Ultralife	\$ (1,598)	\$ (2,080)
Add: interest expense, net	436	554
Add: income tax provision	554	480
Add: depreciation	3,285	3,420
Add: amortization of intangible assets	497	627
Add: stock-based compensation expense	1,379	1,225
Add: loss from discontinued operations, net of tax	501	3,687
Adjusted EBITDA	\$ 5,054	\$ 7,913

Liquidity and Capital Resources

Cash Flows and General Business Matters

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

As of December 31, 2012, cash and cash equivalents totaled \$9,656, an increase of \$4,336 from the beginning of the year. During the twelve months ended December 31, 2012, we generated \$4,768 of cash from operating activities as compared to generating \$10,962 of cash for the twelve months ended December 31, 2011. The generation of cash from operating activities was caused primarily to a decline in the cash generated by accounts receivable year over year offset by the generation of cash from the reductions in inventory. The cash from operating activities provided in 2012

was mainly attributable to our net loss of \$1,629, plus an add back of \$5,343 for non-cash expenses of depreciation, amortization and stock-based compensation and a loss from discontinued operations, net of tax of \$501. Approximately \$823 of cash was generated from working capital due mainly to decreases in our inventory due to the continued focus on improving inventory management, a decrease in our insurance receivable relating to fires and a decrease in accounts receivable. These cash generations were offset partially by a decrease in our accounts payable. For 2011, the cash generated from operating activities of \$10,962 was mainly attributable to a net loss of \$2,138, plus an add back of \$5,452 for non-cash expenses of depreciation, amortization and stock-based compensation and a loss from discontinued operations of \$3,687. Approximately \$1,345 of cash was generated from working capital due mainly to a decrease in accounts receivable, offset by an increase in inventories and a decrease in accounts payable.

We used \$812 in cash for investing activities during 2012 compared with \$1,999 in cash used for investing activities in 2011. In 2012, we spent \$2,685 to purchase plant, property, and equipment and increased our restricted cash by \$260. Offsetting these outlays was a cash inflow for our divestiture of RedBlack Communications of \$2,133. In 2011, we spent \$2,362 to purchase plant, property and equipment and \$50 was used in connection with the contingent purchase price payout related to RPS Power Systems, Inc. (“RPS”). In addition, we received \$13 in cash proceeds from dispositions of property, plant and equipment and \$298 relating to the reduction of the UK restricted cash.

During 2012, we received \$115 in funds from financing activities compared to the use of \$8,604 in funds from financing activities in 2011. The financing activities in 2012 were solely due to the proceeds of the issuance of our common stock. The financing activities in 2011 included outflows of \$8,541 for repayments on the revolver portion of our primary credit facility, \$8 for principal payments on debt and capital lease obligations, \$128 relating to discontinued operations and an inflow of cash from stock option exercises of \$73.

Although we booked a full reserve for our deferred tax asset during the fourth quarter of 2006 and continued to carry this reserve as of December 31, 2012 and 2011, we continue to have significant U.S. NOL’s available to us to utilize as an offset to taxable income. As of December 31, 2012, none of our U.S. NOL’s have expired. (See Note 8 in the Notes to the Consolidated Financial Statements for additional information.)

Inventory turnover for the year ended December 31, 2012 averaged 2.2 turns compared to 3.0 turns for 2011. The decrease in this metric is due mainly to lower sales year over year offset slightly by a reduction in average inventory over that same period.

Our order backlog at December 31, 2012 was approximately \$12,599, lower than in prior years, mostly due to continued delays in government orders. The majority of the backlog was related to orders that are expected to ship throughout 2013 and 2014.

As of December 31, 2012, we had made commitments to purchase approximately \$457 of production machinery and equipment, which we expect to fund through operating cash flows or the use of debt.

Debt and Lease Commitments

On February 17, 2010, we entered into a senior secured asset based revolving credit facility (“Credit Facility”) of up to \$35,000, which was subsequently reduced to \$20,000 as described in greater detail below, with RBS Business Capital, a division of RBS Asset Finance, Inc. (“RBS”). The proceeds from the Credit Facility can be used for general working capital purposes, general corporate purposes, and letter of credit foreign exchange support. The Credit Facility had a maturity date of February 17, 2013, that was subsequently extended to May 15, 2013, as discussed in greater detail below (“Maturity Date”). The Credit Facility is secured by substantially all of our assets. At closing, we paid RBS a facility fee of \$263.

On February 18, 2010, we drew down \$9,870 from the Credit Facility to repay all outstanding amounts due under our previous credit facility with JP Morgan Chase Bank, N.A. and Manufacturers and Traders Trust Company. Our available borrowing under the Credit Facility fluctuates from time to time based upon the amounts of eligible accounts receivable and eligible inventory. Available borrowings under the Credit Facility, as amended, equals the lesser of (1) \$20,000 or (2) 85% of eligible accounts receivable plus the lesser of (a) up to 70% of the book value of our eligible inventory or (b) 85% of the appraised net orderly liquidation value of our eligible inventory. The borrowing base under the Credit Facility is further reduced by (1) the face amount of any letters of credit outstanding, (2) any liabilities of ours under hedging contracts with RBS and (3) the value of any reserves as deemed appropriate by RBS. We are required to have at least \$3,000 available under the Credit Facility at all times.

On January 19, 2011, we entered in a First Amendment to Credit Agreement (“First Amendment”) with RBS. The First Amendment amended the Credit Facility as follows:

(i) Eligible accounts receivable under the Credit Facility (for the determination of available borrowings) now include foreign (non-U.S.) accounts subject to credit insurance payable to RBS (formerly, such accounts were not eligible without arranging letter of credit facilities satisfactory to RBS).

(ii) Decreased the interest rate that will accrue on outstanding indebtedness, as set forth in the following table:

Excess Availability	LIBOR Rate Plus
Greater than \$10,000	3.00 %
Greater than \$6,000 but less than or equal to \$10,000	3.25 %
Greater than \$3,000 but less than or equal to \$6,000	3.50 %

On September 28, 2012, we entered into a Second Amendment to the Credit Facility (“Second Amendment”) with RBS. The Second Amendment amended the Credit Facility to consent to the sale of the stock of RedBlack and to release any and all liens on RedBlack.

On February 15, 2013, we entered into a Third Amendment to the Credit Facility (“Third Amendment”) with RBS. The Third Amendment amended the Credit Facility to extend the Maturity Date from February 17, 2013 to May 15, 2013, reduced the maximum amount available under the Credit Facility to \$20,000, and reduced the unused line fee to 0.40% per year.

Interest currently accrues on outstanding indebtedness under the Credit Facility at LIBOR plus 3.00%. We have the ability, in certain circumstances, to fix the interest rate for up to 90 days from the date of borrowing.

As of December 31, 2012, in addition to paying interest on the outstanding principal under the Credit Facility, we were required to pay an unused line fee of 0.50% on the unused portion of the \$35,000 Credit Facility. As of the Third Amendment, we now pay an unused line fee of 0.40% on the unused portion of the lowered \$20,000 Credit Facility. In both instances, we must also pay customary letter of credit fees equal to the LIBOR rate and the applicable margin and any other customary fees or expenses of the issuing bank. Interest that accrues under the Credit Facility is to be paid monthly with all outstanding principal, interest and applicable fees due on the Maturity Date.

We are required to maintain a fixed charge ratio of 1.20 to 1.00 or greater at all times as of and after March 28, 2010. As of December 31, 2012, our fixed charge ratio was 2.15 to 1.00. Accordingly, we were in compliance with the financial covenants of the Credit Facility. All borrowings under the Credit Facility are subject to the satisfaction of customary conditions, including the absence of an event of default and accuracy of our representations and warranties. The Credit Facility also includes customary representations and warranties, affirmative covenants and events of default. If an event of default occurs, RBS would be entitled to take various actions, including accelerating the amount due under the Credit Facility, and all actions permitted to be taken by a secured creditor.

As of December 31, 2012, we had \$-0- outstanding under the Credit Facility. At December 31, 2012, the interest rate on the asset based revolver component of the Credit Facility was 3.21%. As of December 31, 2012, the revolver arrangement had approximately \$13,157 of borrowing capacity, including outstanding letters of credit. At December 31, 2012, we had \$413 of outstanding letters of credit related to this facility.

See Note 5 in the Notes to Consolidated Financial Statements for additional information.

Other Matters

Our Credit Facility, including the recently enacted extension, expires in May of 2013. We are currently seeking to enter into a new credit facility with RBS or another lender that will become effective when the Credit Facility matures. We anticipate seeking a new credit facility with availability comparable to our current Credit Facility, but on terms reflecting our improved liquidity position. While we can provide no assurances that we will be able to execute a new credit agreement on terms acceptable to us or at all, we believe that that we will be able to enter into a new credit

agreement on favorable terms due primarily to our improved liquidity position.

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. Previously, we had offered up to a four-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.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Critical Accounting Policies and Estimates

The above 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 generally accepted accounting principles in the U.S. The preparation of these financial statements requires management to make estimates and assumptions that affect amounts reported therein. The estimates and assumptions that require management's most difficult, subjective or complex judgments are described below.

Revenue recognition:

Product Sales – In general, revenues from the sale of products are recognized when products are shipped. When products are shipped with terms that require transfer of title upon delivery at a customer's location, revenues are recognized on date of delivery. A provision is made at the time the revenue is recognized for warranty costs expected to be incurred. Customers, including distributors, do not have a general right of return on products shipped.

Technology Contracts – We recognize revenue using the proportional method, measured by the percentage of actual costs incurred to date to the total estimated costs to complete the contract. Elements of cost include direct material, labor and overhead. If a loss on a contract is estimated, the full amount of the loss is recognized immediately. We allocate costs to all technology contracts based upon actual costs incurred including an allocation of certain research and development costs incurred.

Deferred Revenue - For each source of revenues, we defer recognition if: i) evidence of an agreement does not exist, ii) delivery or service has not occurred, iii) the selling price is not fixed or determinable, or iv) collectability is not reasonably assured.

Valuation of Inventory:

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out (FIFO) method. Our inventory includes raw materials, work in process and finished goods. We record provisions for excess, obsolete or slow moving inventory based on changes in customer demand, technology developments or other economic factors. The factors that contribute to inventory valuation risks are our purchasing practices, material and product obsolescence, accuracy of sales and production forecasts, introduction of new products, product lifecycles, product support and foreign regulations governing hazardous materials (see Item 1A – Risk Factors for further information on foreign regulations). We manage our exposure to inventory valuation risks by maintaining safety stocks, minimum purchase lots, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing certain inventory minimization strategies such as vendor-managed inventories. We believe that the accounting estimate related to valuation of inventories is a "critical accounting estimate" because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors ranging from purchasing, to sales, to production, to after-sale support. If actual demand, market conditions or product lifecycles are adversely different from those estimated by management, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs and a decrease to gross margins.

Warranties:

We maintain provisions related to normal warranty claims by customers. We evaluate these reserves quarterly based on actual experience with warranty claims to date and our assessment of additional claims in the future. 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.

Impairment of Long-Lived Assets:

We regularly assess all of our long-lived assets for impairment when events or circumstances indicate their carrying amounts may not be recoverable. This is accomplished by comparing the expected undiscounted future cash flows of the assets with the respective carrying amount as of the date of assessment. Should aggregate future cash flows be less than the carrying value, a write-down would be required, measured as the difference between the carrying value and the fair value of the asset. Fair value is estimated either through the assistance of an independent valuation or as the present value of expected discounted future cash flows. The discount rate used by us in our evaluation approximates our weighted average cost of capital. If the expected undiscounted future cash flows exceed the respective carrying amount as of the date of assessment, no impairment is recognized.

Environmental Issues:

Environmental expenditures that relate to current operations are expensed or capitalized, as appropriate, in accordance with FASB's guidance on environmental remediation liabilities. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

Goodwill and Other Intangible Assets:

In accordance with the revised FASB guidance for business combinations, the purchase price paid to effect an acquisition is allocated to the acquired tangible and intangible assets and liabilities at fair value. In accordance with FASB's guidance for the accounting of goodwill and other intangible assets, we do not amortize goodwill and intangible assets with indefinite lives, but instead evaluate these assets for impairment at least annually, or when events indicate that impairment exists. 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 goodwill consists first of a review of various qualitative factors of the identified reporting units to determine whether it is more likely than not that the fair value of a reporting unit exceeds its carrying amount, including goodwill. This review includes, but is not limited to, an evaluation of the macroeconomic, industry or market, and cost factors relevant to the reporting unit as well as financial performance and entity or reporting unit events that may affect the value of the reporting unit. If this review leads to the determination that it is more likely than not that the fair value of the reporting unit 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 reporting unit is greater than its carrying amount, or at our discretion, quantitative impairment steps are performed. Similarly, the analysis for indefinite-lived intangible assets consists of review of various qualitative factors to determine if it is more likely than not that the indefinite-lived intangible asset is not impaired. If a conclusion that it is more likely than not that the indefinite-lived asset is not impaired cannot be supported, or at our discretion, quantitative impairment steps are performed.

The quantitative impairment test for goodwill consists of a comparison of the fair value of the reporting unit with the carrying amount of the reporting unit to which it is assigned. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, a second step of the goodwill impairment test shall be performed to measure the amount of impairment loss, if any. 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 the reporting unit for goodwill impairment testing based on a discounted cash flow model. We determine the fair value of our intangibles assets with indefinite lives (trademarks) through the royalty relief income valuation approach.

We conduct our annual impairment analysis for goodwill and intangible assets with indefinite lives in October of each fiscal year. For 2012, we have identified three goodwill reporting units for analysis. We performed a qualitative analysis for two reporting units and determined it was more likely than not that the fair value of each reporting unit was greater than its respective carrying amount. We performed a quantitative analysis on our Communications Systems reporting unit as of September 30, 2012 as we determined that a triggering event, as defined within relevant accounting guidance, occurred in the third quarter as a result of the decrease in our market valuation in relation to our shareholder's equity. This testing indicated no impairment.

For 2012, we identified four trademarks for analysis. We performed a qualitative analysis for two trademarks and determined it was more likely than not that the fair value of each trademark was greater than its respective carrying amount. We performed an early impairment test on the two trademarks associate with Communications Systems in conjunction with the goodwill testing referenced above. No impairment of either trademark tested was indicated. However, due to the narrow margin of passing the testing in 2012, there is potential that the McDowell -

Communications Systems trademark may become partially or fully impaired in 2013 if the projected revenue targets are not met. As of December 31, 2012, the McDowell - Communications Systems trademark had a carrying value of \$2,400.

Stock-Based Compensation:

We follow the provisions of FASB's 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). 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.

Income Taxes:

We apply FASB's guidance 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 may be in effect when the differences are expected to reverse.

In 2012 and 2011, in the U.S. and the U.K., we continued to report a valuation allowance for our deferred tax assets that cannot be offset by reversing temporary differences. This results from the conclusion that it is more likely than not that we would not be able to utilize our U.S. and U.K. NOL's that had accumulated over time. The recognition of a valuation allowance on our deferred tax assets resulted from our evaluation of all available evidence, both positive and negative. The assessment of the realizability of the NOL's was based on a number of factors including, our history of net operating losses, the volatility of our earnings, our historical operating volatility, our historical inability to accurately forecast earnings for future periods and the continued uncertainty of the general business climate as of the end of 2012. We concluded that these factors represent sufficient negative evidence and have concluded that we should record a full valuation allowance under FASB's guidance on the accounting for income taxes. We currently carry a deferred tax asset in China that we have determined does not require a valuation allowance as we are more likely than not to fully utilize the NOL in China. We continually assess the carrying value of this asset based on relevant accounting standards.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide this information.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and schedules listed in Item 15(a)(1) are included in this Report beginning on page 41.

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Consolidated Financial Statements:	
<u>Consolidated Balance Sheets as of December 31, 2012 and 2011</u>	<u>41</u>
<u>Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended December 31, 2012 and 2011</u>	<u>42</u>
<u>Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2012 and 2011</u>	<u>43</u>
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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Ultralife Corporation
Newark, New York

We have audited the accompanying consolidated balance sheets of Ultralife Corporation as of December 31, 2012 and 2011 and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2012. These financial statements are the responsibility of Ultralife Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ultralife Corporation at December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP
Troy, Michigan
March 15, 2013

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

	December 31, 2012 2011	
ASSETS		
Current assets:		
Cash and cash equivalents	\$9,656	\$5,320
Restricted cash	422	166
Trade accounts receivable, net of allowance for doubtful accounts of \$322 and \$683, respectively	20,913	19,903
Inventories	30,370	34,967
Due from insurance company	723	1,730
Deferred tax asset - current	120	161
Income taxes receivable	28	220
Prepaid expenses and other current assets	1,590	1,766
Total current assets	63,822	64,233
Property, plant and equipment, net	12,415	12,588
Other assets:		
Goodwill	16,344	18,356
Intangible assets, net	5,039	5,533
Security deposits and other long-term assets	98	105
	21,481	23,994
Total Assets	\$97,718	\$100,815
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of debt and capital lease obligations	\$-	\$-
Accounts payable	11,357	13,766
Income taxes payable	2	11
Accrued compensation	2,049	2,015
Accrued vacation	603	784
Deferred revenue	1,851	1,786
Deferred tax liability - current	-	187
Other current liabilities	4,030	4,609
Total current liabilities	19,892	23,158
Long-term liabilities:		
Debt and capital lease obligations	-	-
Deferred tax liability - long-term	4,160	4,170
Other long-term liabilities	210	261
Total long-term liabilities	4,370	4,431

Commitments and contingencies (Note 6)

Shareholders' equity:

Ultralife equity:		
Preferred stock, par value \$0.10 per share, authorized 1,000,000 shares; none issued and outstanding	-	-
Common stock, par value \$0.10 per share, authorized 40,000,000 shares; issued - 18,828,734 and 18,716,921, respectively	1,886	1,874
Capital in excess of par value	173,791	172,309
Accumulated other comprehensive income (loss)	(620)	(985)
Accumulated deficit	(93,878)	(92,280)
	81,179	80,918
Less --Treasury stock, at cost - 1,372,757 shares outstanding in each year	7,658	7,658
Total Ultralife equity	73,521	73,260
Noncontrolling interest	(65)	(34)
Total shareholders' equity	73,456	73,226
Total Liabilities and Shareholders' Equity	\$97,718	\$100,815

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

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

	Years Ended December 31,	
	2012	2011
Revenues	\$ 101,657	\$ 135,737
Cost of products sold	72,927	101,546
Gross profit	28,730	34,191
Operating expenses:		
Research and development (including \$ 260 and \$313 of amortization of intangible assets, respectively)	7,216	8,593
Selling, general, and administrative (including \$237 and \$314 of amortization of intangible assets, respectively)	21,628	23,186
Total operating expenses	28,844	31,779
Operating income (loss)	(114)	2,412
Other income (expense):		
Interest income	4	5
Interest expense	(440)	(559)
Miscellaneous	(24)	171
Income (loss) from continuing operations before income taxes	(574)	2,029
Income tax provision (benefit) - current	539	32
Income tax provision - deferred	15	448
Total income taxes provision (benefit)	554	480
Net income (loss) from continuing operations	(1,128)	1,549
Discontinued operations:		
Loss from discontinued operations, net of tax	(501)	(3,687)
Net income (loss)	(1,629)	(2,138)
Net (income) loss attributable to noncontrolling interest	31	58
Net income (loss) attributable to Ultralife	\$ (1,598)	\$ (2,080)
Other comprehensive income (loss):		
Foreign currency translation adjustments	365	277
Comprehensive income (loss) attributable to Ultralife	\$ (1,233)	\$ (1,803)
Net income (loss) attributable to Ultralife common shareholders - basic		
Continuing operations	\$ (0.06)	\$ 0.09

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Discontinued operations	\$ (0.03)	\$ (0.21)
Total	\$ (0.09)	\$ (0.12)
Net income (loss) attributable to Ultralife common shareholders - diluted		
Continuing operations	\$ (0.06)	\$ 0.09
Discontinued operations	\$ (0.03)	\$ (0.21)
Total	\$ (0.09)	\$ (0.12)
Weighted average shares outstanding - basic	17,403	17,304
Weighted average shares outstanding - diluted	17,403	17,336

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

ULTRALIFE CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in Thousands, Except Per Share Amounts)

	Common Stock Number of Shares	Common Stock Amount	Capital in excess of Par Value	Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss) Foreign Currency Translation Adjustment Net Gain (Loss)	Accumulated Deficit	Treasury Stock	Noncontrolling Interest	Total
Balance as of December 31, 2010	18,639,683	\$1,865	\$171,020	\$(1,262)	\$-	\$(90,200)	\$(7,652)	\$24	\$73,795
Net loss						(2,080)		(58)	(2,138)
Foreign currency translation adjustments				277					277
Stock-based compensation related to stock options			946				-		946
Shares issued (cancelled) and compensation under restricted stock grants	(2,905)	-	(27)				(6)		(33)
Shares issued to directors	61,643	7	299						306
Shares issued under stock option exercises	18,500	2	71						73
Balance as of December 31, 2011	18,716,921	\$1,874	\$172,309	\$(985)	\$-	\$(92,280)	\$(7,658)	\$(34)	\$73,226
Net loss						(1,598)		(31)	(1,629)
Foreign currency translation adjustments				365					365
Stock-based compensation related to stock options			1,073				-		1,073
Shares issued to directors	83,813	9	298						307
Shares issued under stock option exercises	28,000	3	111						114
Balance as of December 31, 2012	18,828,734	\$1,886	\$173,791	\$(620)	\$-	\$(93,878)	\$(7,658)	\$(65)	\$73,456

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

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

	Year Ended December 31,	
	2012	2011
OPERATING ACTIVITIES		
Net loss	\$ (1,629)	\$ (2,138)
Loss from discontinued operations, net of tax	501	3,687
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:		
Depreciation and amortization of financing fees	3,467	3,600
Amortization of intangible assets	497	627
(Gain) loss on long-lived asset disposal and write-offs	13	91
Foreign exchange (gain) loss	43	(95)
Non-cash stock-based compensation	1,379	1,225
Changes in deferred income taxes	15	448
Provision for loss on accounts receivable	9	237
Provision for inventory obsolescence	375	1,537
Provision for warranty charges	370	591
Provision for workers' compenstion obligation	-	(217)
Changes in operating assets and liabilities:		
Accounts receivable	1,183	15,035
Inventories	4,122	(5,738)
Income taxes receivable	194	(220)
Prepaid expenses and other current assets	(75)	266
Insurance receivable relating to fires	1,019	(1,730)
Income taxes payable	(9)	(43)
Accounts payable and other liabilities	(5,611)	(6,225)
Net cash provided by operating activities from continuing operations	5,863	10,938
Net cash provided by operating activities from discontinued operations	(1,095)	24
Net cash provided by operating activities	4,768	10,962
INVESTING ACTIVITIES		
Purchase of property and equipment	(2,685)	(2,362)
Proceeds from asset disposal	-	13
Change in restricted cash	(260)	298
Payment for acquired companies, net of cash acquired	-	(50)
Net cash used in investing activities from continuing operations	(2,945)	(2,101)
Net cash provided from (used in) investing activities from discontinued operations	2,133	102
Net cash used in investing activities	(812)	(1,999)
FINANCING ACTIVITIES		
Net change in revolving credit facilities	-	(8,541)
Proceeds from issuance of common stock	115	73
Proceeds from issuance of debt	-	-
Principal payments on debt and capital lease obligations	-	(8)
Purchase of treasury stock	-	-
Short-swing profit recovery	-	-

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Net cash provided from (used in) financing activities from continuing operations	115	(8,476)
Net cash used in financing activities from discontinued operations	-	(128)
Net cash provided from (used in) financing activities	115	(8,604)
Effect of exchange rate changes on cash	265	320
Change in cash and cash equivalents	4,336	679
Cash and cash equivalents at beginning of period	5,320	4,641
Cash and cash equivalents at end of period	\$ 9,656	\$ 5,320
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for interest	\$ 237	\$ 353
Cash paid for income taxes	\$ 357	\$ 158

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

Notes to Consolidated Financial Statements
(Dollars in Thousands, Except Per Share Amounts)

Note 1 - Summary of Operations and Significant Accounting Policies

a. Description of Business

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 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.

b. Principles of Consolidation

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States and include the accounts of Ultralife Corporation, our wholly-owned subsidiaries, Ultralife Batteries (UK) Ltd. (“Ultralife UK”), ABLE New Energy Co., Limited, and its wholly-owned subsidiary ABLE New Energy Co., Ltd. (“ABLE” collectively), and our majority-owned subsidiary Ultralife Batteries India Private Limited (“India JV”). Intercompany accounts and transactions have been eliminated in consolidation.

Operations of RedBlack Communications, Inc. (“RedBlack”), our divested company, and Ultralife Energy Services Corporation (“UES”), our wholly owned subsidiary, are reported as discontinued operations.

c. Management's Use of Judgment and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at year end and the reported amounts of revenues and expenses during the reporting period. Key areas affected by estimates include: (a) reserves for deferred tax assets, excess and obsolete inventory, warranties, and bad debts; (b) profitability on development contracts; (c) various expense accruals; (d) stock-based compensation; and, (e) carrying value of goodwill and intangible assets. Our actual results could differ from these estimates.

d. Reclassifications

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

e. Cash and Cash Equivalents

For purposes of the Consolidated Statements of Cash Flows, we consider all demand deposits with financial institutions and financial instruments with original maturities of three months or less to be cash equivalents. For purposes of the Consolidated Balance Sheet, the carrying value approximates fair value because of the short maturity of these instruments.

f. Accounts Receivable and Allowance for Doubtful Accounts