ULTRALIFE CORP
Form 10-Q
August 06, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarter Ended June 29, 2014

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 0-27460

(Exact name of registrant as specified in its charter)

Delaware	**16-1387013**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer: Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The number of shares outstanding of the registrant's common stock was 17,540,382, net of 1,383,977 treasury shares, as of August 1, 2014.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ULTRALIFE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(unaudited)

ASSETS

	June 29, 2014	**December 31,** 2013
Current assets:		
Cash and cash equivalents	$17,160	$16,489
Trade accounts receivable, net of allowance for doubtful accounts of $282 and $288, respectively	10,095	14,238
Inventories, net	27,079	26,053
Prepaid expenses and other current assets	1,043	1,357
Due from insurance company	427	430
Deferred income taxes	86	91
Total current assets	55,890	58,658
Property, equipment and improvements, net	9,916	10,202
Goodwill	16,403	16,419
Other intangible assets, net	4,490	4,646
Security deposits and other non-current assets	232	269
Total assets	$86,931	$90,194
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,115	$7,053
Accrued compensation and related benefits	1,838	1,908
Accrued expenses and other current liabilities	1,865	3,111
Income taxes payable	35	94
Deferred income taxes	9	9
Total current liabilities	10,862	12,175
Deferred income taxes	4,352	4,242
Other non-current liabilities	98	132
Total liabilities	15,312	16,549
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Preferred stock – par value $.10 per share; authorized 1,000,000 shares; none issued	—	—
Common stock – par value $.10 per share; authorized 40,000,000 shares; issued – 18,924,359 shares at June 29, 2014 and 18,851,579 shares at December 31, 2013	1,892	1,888
Capital in excess of par value	175,462	174,932

Accumulated deficit	(97,450)	(94,804)
Accumulated other comprehensive loss	(479)	(614)
Treasury stock - at cost; 1,383,977 shares at June 29, 2014 and 1,372,757 shares at December 31, 2013	(7,697)	(7,658)
Total Ultralife equity	71,728	73,744
Noncontrolling interest	(109)	(99)
Total shareholders’ equity	71,619	73,645
Total liabilities and shareholders' equity	$86,931	$90,194

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

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ULTRALIFE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In Thousands except per share amounts)
(unaudited)

	Three month periods ended		Six month periods ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Revenues	$15,199	$17,279	$30,484	$38,298
Cost of products sold	10,987	12,757	21,937	27,397
Gross profit	4,212	4,522	8,547	10,901
Operating expenses:				
Research and development	1,560	1,669	2,996	3,038
Selling, general and administrative	3,976	4,727	7,971	9,362
Total operating expenses	5,536	6,396	10,967	12,400
Operating loss	(1,324)	(1,874)	(2,420)	(1,499)
Other (expense) income:				
Interest income	—	12	9	14
Interest and financing expense	(41)	(43)	(97)	(133)
Miscellaneous	46	2	30	(23)
Loss from continuing operations before income taxes	(1,319)	(1,903)	(2,478)	(1,641)
Income tax provision	57	53	117	151
Net loss from continuing operations	(1,376)	(1,956)	(2,595)	(1,792)
Income (loss) from discontinued operations, net of tax	—	(120)	(61)	144
Net loss	(1,376)	(2,076)	(2,656)	(1,648)
Net loss attributable to noncontrolling interest	16	3	10	9
Net loss attributable to Ultralife	(1,360)	(2,073)	(2,646)	(1,639)
Other comprehensive income:				
Foreign currency translation adjustments	69	148	135	21
Comprehensive loss attributable to Ultralife	$(1,291)	$(1,925)	$(2,511)	$(1,618)
Net loss per share attributable to Ultralife common shareholders – basic:				
Continuing operations	$(.08)	$(.11)	$(.15)	$(.10)
Discontinued operations	—	(.01)	(.00)	.01
Total	$(.08)	$(.12)	$(.15)	$(.09)
Weighted average shares outstanding – basic	17,533	17,459	17,523	17,458

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

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ULTRALIFE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(unaudited)

	Six month periods ended	
	June 29, 2014	June 30, 2013
OPERATING ACTIVITIES:		
Net loss	$(2,656)	$(1,648)
Loss (gain) from discontinued operations, net of tax	61	(144)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:		
Depreciation and amortization of financing fees	1,501	1,637
Amortization of intangible assets	154	199
Loss on long-lived asset impairment	—	56
Foreign exchange loss	—	22
Stock-based compensation	523	430
Changes in deferred income taxes	110	172
Changes in operating assets and liabilities:		
Accounts receivable	4,128	8,543
Inventories	(1,042)	(592)
Prepaid expenses and other assets	313	(1,248)
Accounts payable and other liabilities	(2,106)	(4,384)
Net cash provided by (used in) operating activities from continuing operations	986	3,043
Net cash used in operating activities of discontinued operations	—	(998)
Net cash provided by operating activities	986	2,045
INVESTING ACTIVITIES:		
Cash paid for property, equipment and improvements	(398)	(444)
Change in restricted cash	—	4
Net cash used in investing activities	(398)	(440)
FINANCING ACTIVITIES:		
Cash paid to repurchase treasury stock	(39)	—
Proceeds from issuance of common stock	11	12
Net cash (used in) provided by financing activities	(28)	12
Effect of exchange rate changes on cash and cash equivalents	111	(115)
INCREASE IN CASH AND CASH EQUIVALENTS	671	1,502
Cash and cash equivalents, beginning of period	16,489	9,656
Cash and cash equivalents, end of period	$17,160	$11,158
NON-CASH ITEMS:		
Construction in progress in accounts payable	$790	$—

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

ULTRALIFE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands – except share and per share amounts)

(unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements of Ultralife Corporation (the "Company") and subsidiaries have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and with the instructions to Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the Condensed Consolidated Financial Statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the Consolidated Financial Statements and related notes thereto contained in our Form 10-K for the year ended December 31, 2013.

The December 31, 2013 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

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

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

2. SHARE REPURCHASE PROGRAM

On April 28, 2014, the Company's Board of Directors approved a share repurchase program (the "Share Repurchase Program") which became effective on May 1, 2014, under which the Company plans to repurchase up to 1.8 million shares of its outstanding common stock over a period not to exceed twelve months. Share repurchases, if any, will be made in accordance with SEC Rule 10b-18 using a variety of methods, which may include open market purchases, privately negotiated transactions and block trades, or any combination of such methods, in accordance with applicable insider trading and other securities laws and regulations. The timing, manner, price and amount of any repurchase will be determined at the Company's discretion and the Share Repurchase Program may be suspended, terminated or modified by the Company at any time and for any reason. The Share Repurchase Program does not obligate the Company to repurchase any specific number of shares. No purchases have been made under this program through the period ended June 29, 2014.

3. INVENTORIES

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

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	June 29, 2014	December 31, 2013
Raw materials	$15,819	$16,239
Work in process	2,501	2,412
Finished goods	8,759	7,402
Total	$27,079	$26,053

4. PROPERTY, EQUIPMENT AND IMPROVEMENTS

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

	June 29, 2014	December 31, 2013
Land	$123	$123
Buildings and leasehold improvements	7,564	7,412
Machinery and equipment	47,886	47,405
Furniture and fixtures	1,895	1,866
Computer hardware and software	4,287	4,247
Construction in process	1,534	1,073
	63,289	62,126
Less-accumulated depreciation	(53,373)	(51,924)
Net property, equipment and improvements	$9,916	$10,202

Depreciation expense for property, equipment and improvements was as follows:

	Three-month periods ended		Six-month periods ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Depreciation expense	$754	$729	$1,465	$1,559

5. GOODWILL, INTANGIBLE ASSETS AND LONG TERM ASSETS

a. Goodwill

The following table summarizes the goodwill activity by segment for the six-month periods ended June 29, 2014 and June 30, 2013:

	Battery & Energy Products	Communi-cations Systems	Total
Balance - December 31, 2012	$4,851	$ 11,493	$16,344
Effect of foreign currency translation	13	—	13
Balance – June 30, 2013	4,864	11,493	16,357
Effect of foreign currency translation	62	—	62
Balance - December 31, 2013	4,926	11,493	16,419
Effect of foreign currency translation	(16)	—	(16)
Balance – June 29, 2014	$4,910	$ 11,493	$16,403

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b. Intangible Assets

The composition of intangible assets was:

	at June 29, 2014		
	Cost	Accumulated amortization	Net
Trademarks	$3,567	$—	$3,567
Patents and technology	4,508	(4,025)	483
Customer relationships	4,026	(3,615)	411
Distributor relationships	390	(361)	29
Non-compete agreements	218	(218)	—
Total intangible assets	$12,709	$(8,219)	$4,490

	at December 31, 2013		
	Cost	**Accumulated amortization**	**Net**
Trademarks	$3,568	$—	$3,568
Patents and technology	4,511	(3,941)	570
Customer relationships	4,033	(3,562)	471
Distributor relationships	393	(356)	37
Non-compete agreements	218	(218)	—
Total intangible assets	$12,723	$(8,077)	$4,646

Amortization expense for intangible assets was as follows:

	Three-month periods ended		Six-month periods ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Amortization included in:				
Research and development	$45	$55	$87	$111
Selling, general and administrative	35	43	67	88
Total amortization expense	$80	$98	$154	$199

The change in the cost value of total intangible assets from December 31, 2013 to June 29, 2014 is a result of the effect of foreign currency translations.

6. REVOLVING CREDIT AGREEMENT

We have financing through a Revolving Credit, Guaranty and Security Agreement, dated as of May 24, 2013, (the “Credit Agreement”) and related security agreements with PNC Bank, National Association (“PNC”), which provides a $20 million secured asset-based revolving credit facility that includes a $1 million letter of credit sub-facility (the “Credit Facility”). The Credit Agreement provides that the Credit Facility may be increased with PNC’s concurrence to an amount not to exceed $35 million, provided such increase must occur prior to the last six months of the term, which expires on May 24, 2017.

Our available borrowing limit under the Credit Facility is based on a borrowing base formula equal to a percentage of accounts receivable, inventory and eligible foreign in-transit inventory. Interest is payable quarterly and accrues on outstanding indebtedness under the Credit Agreement at either a LIBOR-based rate or an alternate base rate, as defined in the Credit Agreement. We pay a quarterly fee on the Credit Facility’s unused availability at 0.375% per annum.

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As of June 29, 2014, we had approximately $12,361 of borrowing capacity in addition to our cash on hand of $17,160, and we had no outstanding borrowings or outstanding letters of credit under the Credit Facility at either June 29, 2014 or December 31, 2013.

On April 30, 2014, the Company and PNC entered into an amendment (the “Amendment”) to the Credit Agreement. The Amendment permits the Company to commence the Share Repurchase Program described in Note 2 above, provided that (a) the Company is not in default under the Credit Agreement, (b) the Company’s undrawn availability under the Credit Agreement is at least $6 million both prior to and immediately following any repurchase, (c) the Company’s undrawn availability under the Credit Agreement plus domestic unrestricted cash is at least $8 million both prior to and immediately following any repurchase, and (d) the Company uses its unrestricted cash for such repurchases and does not request advances against the Credit Agreement for such purposes.

7. SHAREHOLDERS’ EQUITY

a. Common Stock

In the three-month and six-month periods ended June 29, 2014, we issued 14,153 and 28,792 shares of common stock to our non-employee directors, respectively, valued at $57 and $114, respectively.

b. Stock Options

We have stock options outstanding from various stock-based employee compensation plans, for which we record compensation cost relating to share-based payment transactions in our 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). Compensation cost related to stock options was $198 and $200 for the three-month periods ended June 29, 2014 and June 30, 2013, respectively. Compensation cost related to stock options was $371 and $390 for the six-month periods ended June 29, 2014 and June 30, 2013, respectively. As of June 30, 2014, there was $766 of total unrecognized compensation cost related to outstanding stock options, which is expected to be recognized over a weighted average period of 1.4 years.

The following table summarizes stock option activity for the first quarter of 2014:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	2,131,622	$ 6.99		
Granted	252,500	3.94		
Exercised	(2,900)	3.69		
Forfeited	(28,630)	3.95		
Expired	(80,669)	7.85		
Outstanding at June 29, 2014	2,271,923	6.61	3.97	$ 227
Vested and expected to vest at June 29, 2014	2,077,123	6.82	3.90	$ 186
Exercisable at June 29, 2014	1,247,185	$ 6.14	3.06	$ 82

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The following assumptions were used to value stock options granted during the six months ended June 29, 2014:

Risk-free interest rate	1.10 %
Volatility factor	59.94%
Dividends	0.00 %
Weighted average expected life (years)	4.15

Cash flows from excess tax benefits are required to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised stock options in excess of the deferred tax asset attributable to stock compensation costs for such stock options. We did not record any excess tax benefits in the first six months of 2014 and 2013. Cash received from stock option exercises under our stock-based compensation plans for the three-month periods ended June 29, 2014 and June 30, 2013 was $11 and $0, respectively. Cash received from stock option exercises for the six-month periods ended June 29, 2014 and June 30, 2013 was $11 and $12, respectively.

c. Restricted Stock Awards

No restricted stock was awarded during the three or six month periods ending June 29, 2014. Included in stock compensation expense recorded in our financial statements in the three and six months ended June 29, 2014 was $34 and $83, respectively, relating to the restricted stock units held by our President and Chief Executive Officer. There was $40 in stock compensation expense relating to restricted stock awards in both the three and six month periods ended June 30, 2013. There is $67 of unrecognized compensation cost related to restricted stock units as of June 29, 2014. 30,000 shares of restricted stock units vested during the first six months of 2014.

8. INCOME TAXES

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

For the three-month periods ended June 29, 2014 and June 30, 2013, we recorded $57 and $53, respectively, in income tax expense. For the six-month periods ended June 29, 2014 and June 30, 2013, we recorded $117 and $151, respectively, in income tax expense. The expense is primarily due to the recognition of deferred tax liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. The remaining expense in 2014 was due to state income taxes, and in 2013 was primarily due to the income reported for our China operations during the period.

Our effective consolidated tax rates for the three and six month periods ended June 29, 2014 and June 30, 2013 were:

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	Three-month periods ended		Six-month periods ended	
	June 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
Loss from continuing operations before income taxes (a)	$(1,319)	$(1,903)	$(2,478)	$(1,641)
Income tax provision (b)	57	53	117	151
Effective income tax rate (b/a)	-4.3 %	-2.8 %	-4.7 %	-9.2 %

The overall effective tax rate is the result of the combination of income and losses in each of our tax jurisdictions, which is particularly influenced by the fact that we have recorded a full reserve against our deferred tax assets pertaining to cumulative historical losses for our U.S. operations and our U.K. subsidiary, as management does not believe, at this time, that it is more likely than not that we will realize the benefit of these losses. We have substantial net operating loss ("NOL") carryforwards which offset taxable income in the United States. However, we remain subject to the alternative minimum tax in the United States. The alternative minimum tax limits the amount of NOL available to offset taxable income to 90% of the current year income. We incurred $0 and $12 in alternative minimum tax for the three and six months ended June 30, 2013, respectively, and no alternative minimum tax in 2014. The payment of the alternative minimum tax normally results in the establishment of a deferred tax asset; however, we have established a valuation allowance for this related deferred tax asset.

As of June 29, 2014, we have foreign and domestic NOL's totaling approximately $64,700 available to reduce future taxable income. Foreign loss carryforwards of approximately $12,600 can be carried forward indefinitely. The domestic NOL carryforward of $52,100 expires from 2019 through 2034. The domestic NOL carryforward includes approximately $2,949 for which a benefit will be recorded in capital in excess of par value when realized.

Our unrecognized tax benefits related to uncertain tax positions at March 30, 2014 relate to Federal and various state jurisdictions. The following table summarizes the activity related to our unrecognized tax benefits:

	Six month periods ended	
	June 29, 2014	June 30, 2013
Balance – beginning of period	$7,296	$7,508
Increases related to current year tax positions	—	—
Increases related to prior year tax positions	—	—
Decreases related to prior year tax positions	—	—
Expiration of statute of limitations for assessment of taxes	—	—
Settlements	—	—
Balance – end of period	$7,296	$7,508

The unrecognized tax benefits balance has been recorded as a decrease in the deferred tax asset relating to our NOL carryforward. Because we have recorded a full valuation allowance against our deferred tax assets, the unrecognized tax benefits balance has no effect on our net (loss) income or financial position, as presented. Interest and penalties would begin to accrue in the period in which the NOL carryforwards related to the uncertain tax positions are utilized. We do not expect our unrecognized tax benefits to change significantly over the next twelve months.

We file income tax returns in various jurisdictions including U.S. federal, U.S. state and foreign jurisdictions. We are routinely subject to examination by taxing authorities in these various jurisdictions. Our U.S. tax matters for the years 2000 through 2013 remain subject to examination by the Internal Revenue Service ("IRS") and by various state and local tax jurisdictions due to our NOL carryforwards. Our tax matters for the years 2007 through 2013 remain subject to examination by the respective foreign tax jurisdiction authorities. The IRS has completed the examination of our 2009 U.S. federal income tax return, with no resulting material effect to our financial position or results of operations, and has initiated an examination of our 2011 and 2012 U.S. federal income tax returns.

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9. EARNINGS PER SHARE

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

Basic earnings per share ("EPS") is determined using the Two-Class Method and is computed by dividing earnings attributable to the Company's common shareholders by the weighted-average shares outstanding during the period. The Two-Class Method is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Diluted EPS includes the dilutive effect of securities, if any, and reflects the more dilutive EPS amount calculated using the treasury stock method or the Two-Class Method. Due to our net losses in the three and six month periods ended June 29, 2014 and June 30, 2013, no dilutive securities were considered.

There were 2,271,923 and 2,289,538 outstanding stock options at June 29, 2014 and June 30, 2013, respectively, that were not included in EPS for the three and six month periods presented as the effect would be anti-dilutive.

10. COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENT

a. Purchase Commitments

As of June 29, 2014, we have made commitments to purchase approximately $518 of production machinery and equipment.

b. Product Warranties

We estimate future costs associated with expected product failure rates, material usage and service costs in the development of our warranty obligations. Warranty reserves are based on historical experience of warranty claims and generally will be estimated as a percentage of sales over the warranty period. In the event the actual results of these items differ from the estimates, an adjustment to the warranty obligation would be recorded. Changes in our product warranty liability during the first three months of 2014 and 2013 were as follows:

	Six month periods ended	
	June 29, 2014	June 30, 2013
Accrued warranty obligations – beginning	$513	$607
Accruals for warranties issued	66	120
Settlements made	(50)	(46)
Accrued warranty obligations – ending	$529	$681

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c. Contingencies and Legal Matters

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

Arista Power Litigation

On September 23, 2011, we initiated an action against Arista Power, Inc. ("Arista") and our former senior sales and engineering employee, David Modeen ("Modeen") in the State of New York Supreme Court, County of Wayne (the "Wayne County Action"). In our initial Complaint, we alleged that Arista recruited all but one of the members of its executive team from us, subsequently changed and redirected its business to compet