ULTRALIFE BATTERIES INC
Form 10-Q
November 07, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 29, 2007

or

o **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 BATTERIES, INC.

(Exact name of registrant as specified in its charter)

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

2000 Technology Parkway, Newark, New York 14513
(Address of principal executive offices)
(Zip Code)
(315) 332-7100

(Registrant s telephone number, including area code)

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

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

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

Large Accelerated Filer o Accelerated Filer þ Non-accelerated filer o

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

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

Common stock, $.10 par value 15,278,212 shares of common stock outstanding, net of 727,250 treasury shares, as of November 3, 2007.

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements

ULTRALIFE BATTERIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Amounts)
(unaudited)

	September 29, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 927	$ 720
Trade accounts receivable (less allowance for doubtful accounts of $457 at September 29, 2007 and $447 at December 31, 2006)	23,794	24,197
Inventories	29,931	27,360
Due from insurance company	148	780
Deferred tax asset current	92	75
Prepaid expenses and other current assets	1,975	2,748
Total current assets	56,867	55,880
Property, plant and equipment, net	19,623	19,396
Other assets:		
Goodwill	15,474	13,344
Intangible assets, net	7,251	9,072
Security deposit	73	66
	22,798	22,482
Total Assets	$ 99,288	$ 97,758
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of debt and capital lease obligations	$ 12,789	$ 12,246
Accounts payable	13,331	15,925
Other current liabilities	9,175	9,639
Total current liabilities	35,295	37,810

Long-term liabilities:				
Debt and capital lease obligations		20,324		20,043
Other long-term liabilities		469		316
Total long-term liabilities		20,793		20,359
Commitments and contingencies (Note 11)				
Shareholders 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 - 15,991,687 at September 29, 2007 and 15,853,306 at December 31, 2006		1,591		1,578
Capital in excess of par value		136,725		134,736
Accumulated other comprehensive income (loss)		154		(321)
Accumulated deficit		(92,892)		(94,026)
		45,578		41,967
Less Treasury stock, at cost 727,250 shares outstanding		2,378		2,378
Total shareholders equity		43,200		39,589
Total Liabilities and Shareholders Equity	$	99,288	$	97,758

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

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ULTRALIFE BATTERIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts)
(unaudited)

	Three-Month Periods Ended		Nine-Month Periods Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Revenues	$ 33,291	$ 23,725	$ 100,807	$ 63,437
Cost of products sold	26,369	19,744	77,767	51,109
Gross margin	6,922	3,981	23,040	12,328
Operating expenses:				
Research and development (including $255, $278, $764 and $278, respectively, of amortization of intangible assets)	1,547	1,517	4,849	3,361
Selling, general, and administrative (including $294, $234, $866 and $234, respectively, of amortization of intangible assets)	5,177	4,601	15,685	10,415
Total operating expenses	6,724	6,118	20,534	13,776
Operating income (loss)	198	(2,137)	2,506	(1,448)
Other income (expense):				
Interest income	12	19	44	104
Interest expense	(509)	(451)	(1,770)	(863)
Gain on insurance settlement				191
Miscellaneous	171	39	354	186
Income (loss) before income taxes	(128)	(2,530)	1,134	(1,830)
Income tax provision (benefit)-current		(4)		20
Income tax provision (benefit)-deferred		(828)		(401)
Total income taxes		(832)		(381)
Net income (loss)	$ (128)	$ (1,698)	$ 1,134	$ (1,449)
Earnings (loss) per share basic	$ (0.01)	$ (0.11)	$ 0.08	$ (0.10)

Earnings (loss) per share diluted	$ (0.01)	$ (0.11)	$ 0.07	$ (0.10)
Weighted average shares outstanding basic	15,160	14,987	15,120	14,867
Weighted average shares outstanding diluted	15,160	14,987	15,346	14,867

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

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ULTRALIFE BATTERIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(unaudited)

	Nine-Month Periods Ended	
	September 29, 2007	September 30, 2006
OPERATING ACTIVITIES		
Net income (loss)	$ 1,134	$ (1,449)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of financing fees	2,871	2,747
Amortization of intangible assets	1,630	512
Loss on asset disposal	6	124
Gain on insurance settlement		(191)
Foreign exchange (gain) loss	(295)	(186)
Non-cash stock-based compensation	1,532	975
Changes in deferred income taxes		(401)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	871	(3,147)
Inventories	(2,394)	2,743
Prepaid expenses and other current assets	816	304
Insurance receivable relating to fires	664	602
Income taxes payable		19
Accounts payable and other liabilities	(2,671)	1,355
Net cash provided by operating activities	4,164	4,007
INVESTING ACTIVITIES		
Purchase of property and equipment	(1,706)	(1,030)
Payments for acquired companies, net of cash acquired	(2,457)	(7,008)
Net cash used in investing activities	(4,163)	(8,038)
FINANCING ACTIVITIES		
Net change in revolving credit facilities	1,355	2,475
Proceeds from issuance of common stock	470	1,076
Principal payments on debt and capital lease obligations	(1,849)	(1,510)
Net cash provided by (used in) in financing activities	(24)	2,041
Effect of exchange rate changes on cash	230	121
Change in cash and cash equivalents	207	(1,869)

Cash and cash equivalents at beginning of period		720		3,214
Cash and cash equivalents at end of period	$	927	$	1,345
SUPPLEMENTAL CASH FLOW INFORMATION				
Cash paid for income taxes	$		$	5
Cash paid for interest	$	1,683	$	626
Noncash investing and financing activities: Issuance of common stock and stock warrants for purchase of ABLE	$		$	1,526
Issuance of convertible note payable for purchase of McDowell	$		$	20,000
Purchase of property and equipment via capital lease payable	$	410	$	

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

ULTRALIFE BATTERIES, INC.
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 Batteries, Inc. and our subsidiaries have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 10 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 contained in our Form 10-K for the twelve-month period ended December 31, 2006.

The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Our monthly closing schedule is a weekly-based cycle as opposed to a calendar month-based cycle. 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.

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

2. ACQUISITIONS

We have accounted for the following acquisitions in accordance with the purchase method of accounting provisions of Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, whereby the purchase price paid to effect an acquisition is allocated to the acquired tangible and intangible assets and liabilities at fair value.

2007 Acquisitions

Innovative Solutions Consulting, Inc.

On September 28, 2007, we finalized the acquisition of all of the issued and outstanding shares of common stock of Innovative Solutions Consulting, Inc. (ISC), a provider of a full range of engineering and technical services for communication electronic systems to government agencies and prime contractors.

The initial cash purchase price was $943 (net of $57 in cash acquired), with up to $2,000 in additional cash consideration contingent on the achievement of certain sales milestones. The additional cash consideration is payable in up to three annual payments and subject to possible adjustments as set forth in the Stock Purchase Agreement. The contingent payments will be recorded as an addition to the purchase price when the performance milestones are attained. The initial $943 cash payment was financed through a combination of cash on hand and borrowings through the revolver component of our credit facility with our primary lending banks. We incurred $13 in acquisition related costs, which are included in the initial cost of the investment of $956, with a potential total cost of the investment of $2,956 assuming the earn-out of all contingent consideration.

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The results of operations of ISC and the estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning on the acquisition date. The estimated excess of the purchase price over the net tangible and intangible assets acquired of $271 (including $57 in cash) was recorded as goodwill in the amount of $742. We are in the process of completing the valuations of certain tangible and intangible assets acquired with the new business. The final allocation of the excess of the purchase price over the net assets acquired is subject to revision based upon our final review of valuation assumptions. The acquired goodwill will be assigned to the communications accessories segment and is expected to be fully deductible for income tax purposes.

The following table represents the preliminary allocation of the purchase price to assets acquired and liabilities assumed at the acquisition date:

ASSETS	
Current assets:	
Cash	$ 57
Trade accounts receivables, net	535
Inventories	117
Prepaid expenses and other current assets	175
Total current assets	884
Property, plant and equipment, net	787
Goodwill	742
Total assets acquired	2,413
LIABILITIES	
Current liabilities:	
Current portion of long-term debt	720
Accounts payable	333
Other current liabilities	159
Total current liabilities	1,212
Long-term liabilities:	
Debt	188
Total liabilities assumed	1,400
Total Purchase Price	$ 1,013

The following table summarizes the unaudited pro forma financial information for the periods indicated as if the ISC acquisition had occurred at the beginning of the period being presented. The pro forma information contains the actual combined results of ISC and us, with the results prior to the acquisition date including pro forma impact of: the impact on interest expense in connection with funding the cash portion of the acquisition purchase price. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of each of the periods presented or that may be obtained in the future.

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		Three-Month Periods Ended		Nine-Month Periods Ended	
(in thousands, except per share data)		September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Revenues		$ 34,271	$ 24,468	$ 102,909	$ 65,999
Net Income (Loss)		$ (107)	$ (1,925)	$ 784	$ (3,126)
Earnings (Loss) per share	Basic	$ (0.01)	$ (0.13)	$ 0.05	$ (0.21)
Earnings (Loss) per share	Diluted	$ (0.01)	$ (0.13)	$ 0.05	$ (0.21)

2006 Acquisitions

ABLE New Energy Co., Ltd.

On May 19, 2006, we acquired 100% of the equity securities of ABLE New Energy Co., Ltd. (ABLE), an established manufacturer of lithium batteries located in Shenzhen, China. With more than 50 products, including a wide range of lithium-thionyl chloride and lithium-manganese dioxide batteries and coin cells, this acquisition broadens our expanding portfolio of high-energy power sources, enabling us to further penetrate large and emerging markets such as remote meter reading, RFID (Radio Frequency Identification) and other markets that will benefit from these chemistries. We expect this acquisition will strengthen our global presence, facilitate our entry into the rapidly growing Chinese market, and improve our access to lower material and manufacturing costs.

The total consideration given for ABLE was a combination of cash and equity. The initial cash purchase price was $1,896 (net of $104 in cash acquired), with an additional $500 cash payment contingent on the achievement of certain performance milestones, payable in separate $250 increments, when cumulative ABLE revenues from the date of acquisition attain $5,000 and $10,000, respectively. The contingent payments will be recorded as an addition to the purchase price when the performance milestones are attained. In August 2007, the $5,000 cumulative revenues milestone was attained, and as such, we have recorded the first $250 contingent cash payment, which resulted in an increase in goodwill of $250. The equity portion of the purchase price consisted of 96,247 shares of our common stock valued at $1,000, based on the closing price of the stock on the closing date of the acquisition, and 100,000 stock warrants valued at $526, for a total equity consideration of $1,526. The fair value of the stock warrants was estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions as of May 19, 2006 (the date of acquisition):

Risk-free interest rate	4.31%
Volatility factor	61.25%
Dividends	0.00%
Weighted average expected life (years)	2.50

We have incurred $59 in acquisition related costs, which are included in the total potential cost of the investment of $3,981.

The results of operations of ABLE and the estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning on the acquisition date. The estimated excess of the purchase price over the net tangible and intangible assets acquired of $2,268 (including $104 in cash) was recorded as goodwill in the amount of $1,567. The acquired goodwill

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has been assigned to the Non-Rechargeable Products segment and is not expected to be deductible for income tax purposes.

The following table represents the final allocation of the purchase price to assets acquired and liabilities assumed at the acquisition date:

ASSETS	
Current assets:	
Cash and cash equivalents	$ 104
Trade accounts receivables, net	318
Inventories	737
Prepaid expenses and other current expenses	73
Total current assets	1,232
Property, plant and equipment, net	740
Goodwill	1,567
Intangible assets:	
Trademarks	90
Patents and technology	390
Customer relationships	820
Distributor relationships	300
Non-compete agreements	40
Total assets acquired	5,179
LIABILITIES	
Current liabilities:	
Accounts payable	1,085
Other current liabilities	110
Total current liabilities	1,195
Long-term liabilities:	
Other long-term liabilities	65
Deferred tax liability	84
Total liabilities assumed	1,344
Total Purchase Price	$ 3,835

The trademarks intangible asset has an indefinite life and is not being amortized. The intangible assets related to patents and technology, customer relationships and distributor relationships are being amortized as the economic benefits of the intangible assets are being utilized over their weighted-average estimated useful life of eleven years. The non-compete agreements intangible asset is being amortized on a straight-line basis over its estimated useful life of three years.

McDowell Research, Ltd.

On July 3, 2006, we finalized the acquisition of substantially all of the assets of McDowell Research, Ltd. (McDowell), a manufacturer of military communications accessories located in Waco, Texas.

Under the terms of the acquisition agreement, the purchase price of approximately $25,000 consisted of $5,000 in cash and a $20,000 non-transferable, subordinated convertible promissory note to be held by the sellers. The purchase price is subject to a post-closing adjustment based on a final valuation of trade accounts receivable, inventory and trade accounts payable that were acquired or assumed on the date of the closing, using a base value of $3,000. The final net value of these assets, under our contractual obligation under the acquisition agreement, was $6,389, resulting in a revised

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purchase price of approximately $28,448. A cash payment of $1,500 was made to the sellers during the first quarter of 2007 and as of September 29, 2007, we have accrued $1,889 for the remaining final post-closing adjustment of $3,389. As of December 31, 2006, we had accrued $3,000 for the post-closing adjustment. The respective accruals for the post-closing adjustment are included in the Other Current Liabilities line on our Consolidated Balance Sheet.

The initial $5,000 cash portion was financed through a combination of cash on hand and borrowing through the revolver component of our credit facility with our primary lending banks, which was amended to accommodate the acquisition of McDowell. The $20,000 convertible note carries a five-year term, an annual interest rate of 4% and is convertible at $15 per share into 1.33 million shares of our common stock, with a forced conversion feature, at our option, at any time after the 30-day average closing price of our common stock exceeds $17.50 per share. The conversion price is subject to adjustment as defined in the subordinated convertible promissory note. Interest is payable quarterly in arrears, with all unpaid accrued interest and outstanding principal due in full on July 3, 2011. In April 2007, in connection with its dissolution, McDowell distributed the convertible note to its members in proportion to their membership interests, resulting in six separate convertible notes aggregating $20,000. We have incurred $59 in acquisition related costs, which are included in the approximate total cost of the investment of $28,448.

On October 5, 2007, we announced a settlement agreement with the sellers of McDowell, which reduced the overall purchase price by approximately $7,900, by reducing the principal amount on the convertible note from $20,000 to $14,000, and eliminating a $1,889 liability related to the purchase price adjustment. In addition, the interest rate on the convertible notes was increased from 4% to 5%. The settlement agreement, including the reduction in the purchase price and related interest rate increase, is subject to termination retroactively by the sellers of McDowell, if we do not make prepayments totaling $3,500 on the convertible notes on or before November 18, 2007. Upon payment of the $3,500, we anticipate that we will report a one-time, non-operating gain of approximately $7,500 to account for the purchase price reduction, net of certain adjustments related to the change in the interest rate on the convertible notes.

The results of operations of McDowell and the estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning on the acquisition date. The estimated excess of the purchase price over the net tangible and intangible assets acquired of $15,373 was recorded as goodwill in the amount of $13,075. The acquired goodwill has been assigned to the Rechargeable Products and the Communications Accessories segments and is expected to be fully deductible for income tax purposes.

The following table represents the final allocation of the purchase price to assets acquired and liabilities assumed at the acquisition date:

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ASSETS	
Current assets:	
Trade accounts receivables, net	$ 3,532
Inventories	5,155
Prepaid inventory and other current expenses	10