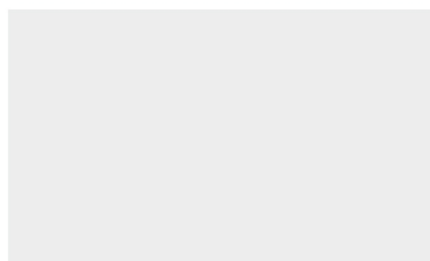
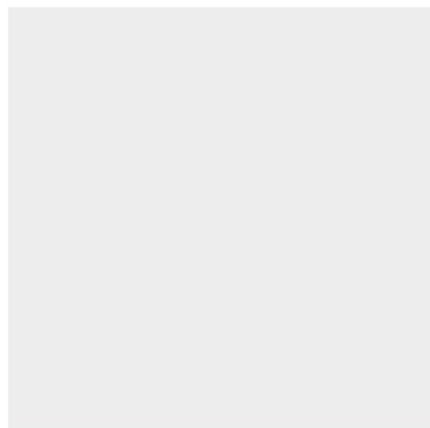
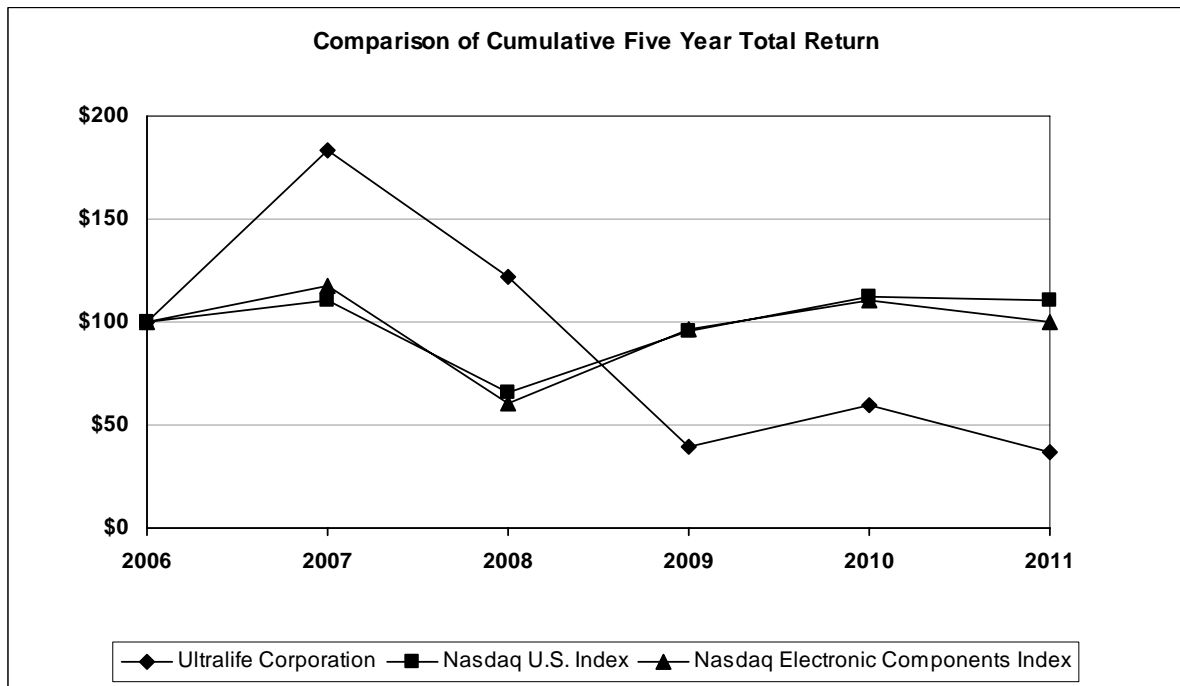


**ULTRALIFE<sup>®</sup>**  
2011 ANNUAL REPORT



## PERFORMANCE GRAPH

The graph below matches our cumulative five-year total shareholder return on common stock with the cumulative total returns of the Nasdaq U.S. Index and the Nasdaq Electronic Components Index. The graph tracks the performance of a \$100 investment in our common stock and in each of the indices from December 31, 2006 to December 31, 2011.



## TO OUR SHAREHOLDERS

My first year as CEO and President confirmed my initial thoughts that Ultralife is a fundamentally solid and financially sound manufacturing company with strong engineering expertise, an attractive array of power and energy products, and a significant foothold in the U.S. government defense business. These capabilities allow us to serve the ever-increasing need for mobile power in military, communications, energy and other commercial markets, and present us with meaningful opportunities for sustainable and profitable long-term growth.

The overarching objective remains to leverage our growth while utilizing Lean principles for operating efficiency gains to achieve scale and sustain shareholder value creation. With a more deliberate approach to organic growth from new product development and global sales supplemented by acquisitions strategically aligned with our core strengths, Ultralife has the potential to more than double in size over the next several years and to deliver significantly higher profitability.

2011 was devoted to readying the company to seize and leverage these opportunities. Our goal was to exit the year better positioned to deliver consistent, profitable growth, and we met that goal. Improving operational productivity, exiting businesses and products that were dilutive to earnings and more fully leveraging our China operations all contributed to an enhanced quality of earnings. Importantly, we accomplished a great deal relative to the priorities we set for ourselves at the beginning of the year. Following is a recap of the progress that was made during the year:

### Optimizing Profitability

We are working to optimize the company's profitability over the long term and have set achieving a 10% operating margin quality of earnings as our interim goal. The framework to deliver on this goal consists of growing our gross margin to 30% and building an operating expense structure of approximately 20% of sales that allocates 10% - 11% of sales to new product development and selling expense and 9% - 10% of sales to G&A expenses. In 2011, not only did we focus on the variable cost components of our margin improvement, but we also took a hard look at the infrastructure costs associated with our business model. In doing so, we made the tough calls, like our decisions in the first quarter to exit our Energy Services business and to settle an outstanding audit adjustment with the US government; in the third quarter to exit a lower margin and limited growth legacy amplifier product line; and our recent decision to divest our RedBlack Communications division.

For 2011, we delivered an operating margin of 4.4%, adjusting for \$3.8 million of one-time charges taken throughout 2011. Our results for the fourth quarter were particularly encouraging. We achieved a 30% gross margin based on successful implementation of Lean principles and favorable product mix. This performance along with cost reduction actions resulted in an operating margin of 6.8% for the quarter. Whereas we know that there will still be some quarter-to-quarter variation in our operating margin rate, we are well positioned for significant total year 2012 operating margin improvement of between 250 and 300 basis points.

## Develop and Execute Growth Plan

We made solid progress on the development and execution of a robust game plan for growth. Our intent is to not only further expand penetration of our global government defense customer base, but also diversify and more aggressively grow our commercial presence. To more fully control our own destiny and drive consistent growth, we developed strategic growth plans for the Battery & Energy Products and Communications Systems businesses that place a heavy emphasis on accelerating new product development and increasing the effectiveness and reach of our salesforce.

In terms of new product development, we have retooled our processes and are now more proactive in developing products ahead of clearly defined customer specifications by building functional prototypes, then gathering real-time voice of the customer feedback in order to fine-tune the designs before a broader introduction. Examples of the new products we developed during 2011 include the patent-pending GenSet Eliminator™, large format lithium ion batteries and new cells, battery product designs and chargers. We intend to continue to add to our new product pipeline and introduce meaningful new products several times each year.

To take full advantage of these emerging new product opportunities, we made structural changes in our sales leadership, expanded coverage with major OEMs and internationally, and invested in sales tools and training. We commenced 2012 with a 66% increase in the number of salespeople versus the beginning of 2011, each specifically aligned and trained for the markets they serve.

## Critical Evaluation of Products and Business Segments

We looked closely at all of the products and business segments in our portfolio and made an assessment of each of their potential mid- and long-term contribution to the sustainable growth and profitability of the company. The outcome of this process, as mentioned earlier, was the exit of our Energy Services business unit and legacy amplifier product line and the recent decision to divest our RedBlack Communications business.

We will continue to measure each of our products against other new technologies and growth opportunities that come across our radar screen to help ensure that our portfolio is well positioned to achieve scale while achieving our interim operating margin goal of 10%.

## More Fully Leverage our China Operations

We took steps to more fully leverage our established China operation to access commercial markets in China and throughout the rest of the world and to improve our cost competitiveness. Our Ultralife China team performed well throughout the entire year and grew sales by 34% over 2010 with good penetration into electric, gas and water metering applications as well as in RFID toll road passes.

In conjunction with our lean efforts, we plan to continue to invest in our China operations and to increase productivity and throughput without expanding our manufacturing footprint. In addition to improving gross margin, we look forward to China continuing to play an integral role in helping our Battery & Energy Products business grow its revenue on a global basis.

## Summary

We made considerable progress in 2011 and exited the year with an unencumbered business portfolio and an enhanced quality of earnings. While we acknowledge the challenges which lie ahead, we will continue to fully leverage the strengths of our people, products and technical expertise, and combine these strengths with dynamic and deliberate plans for product development and sales growth.

In closing, I want to thank our valued customers, employees, partners and suppliers. It is through collaboration with all of you that Ultralife has a bright future ahead, and I look forward to reporting the successful progress on our above initiatives to you next year.

A handwritten signature in blue ink, reading "Michael D. Popielec". The signature is written in a cursive style with a large initial "M".

Michael D. Popielec  
President and Chief Executive Officer

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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, 2011

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

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

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 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. [ ]

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

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 3, 2011, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$56,000,000 (in whole dollars) based upon the closing price for such common stock as reported on the NASDAQ Global Market on July 1, 2011.

As of February 26, 2012, the registrant had 17,360,435 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 5, 2012 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, future demand for our products and services, addressing the process of U.S. defense procurement, reduced U.S. defense spending, the successful commercialization of our products, our reliance on certain key customers, the impairment of our intangible assets, general domestic and global economic conditions, including the uncertainty with government budget approvals, the unique risks associated with our Chinese operations, government and environmental regulations, finalization of non-bid government contracts, competition and customer strategies, technological innovations in the non-rechargeable and rechargeable battery industries, changes in our business strategy or development plans, capital deployment, business disruptions, including those caused by fires, raw material supplies, 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, RedBlack Communications, Inc. and Ultralife Energy Services Corporation, and our majority-owned joint venture Ultralife Batteries India Private Limited.

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 and standby 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, solutions and services. 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 retail distributors, national retailers and directly to U.S. and international defense departments. We enjoy strong name recognition in our markets under our Ultralife<sup>®</sup> Batteries, McDowell Research<sup>®</sup>, AMTI<sup>™</sup>, GenSet Eliminator<sup>™</sup> and ABLE<sup>™</sup> brands. We have sales, operations and product development facilities in North America, Europe and Asia.

On January 1, 2011, we began to report chargers in the Battery & Energy Products segment, to better align the portfolio of chargers with customers for those products and with how we manage our business operations. Previously, we had reported chargers in the Communications Systems segment.

We report our results in two operating segments: Battery & Energy Products and Communications Systems. The Battery & Energy Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries, in addition to rechargeable batteries, uninterruptable power supplies, charging systems and accessories, such as cables. The Communications Systems segment includes: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment, integrated communication system kits and communications and electronics systems design. We believe that reporting performance at the gross profit level is the best indicator of segment performance. As such we report segment performance at the gross profit level and operating expenses as Corporate charges. (See Note 10 in the Notes to Consolidated Financial Statements.)

Our website address is [www.ultralifecorp.com](http://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](http://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-MnO<sub>2</sub>) non-rechargeable batteries including 9-volt, HiRate cylindrical, Thin Cell, and other form factors. We also manufacture and market a family of lithium-thionyl chloride (Li-SOCl<sub>2</sub>) non-rechargeable batteries produced at our Chinese operating unit. Applications for our 9-volt batteries include: smoke alarms, wireless security systems and intensive care monitors, among many other devices. Our HiRate and Thin Cell 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, automotive telematics, 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: 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. We believe that the chemistry of our lithium ion batteries provides significant advantages over other currently available rechargeable batteries. These advantages include: 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, 2011 were \$108,203 and segment contribution (gross profit) was \$25,169.

### *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 power supplies, power cables, connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication systems such as tactical repeaters and SATCOM systems. Products include field deployable systems, which operate from wide-ranging AC and DC sources using a basic building block approach, allowing for a quick response to specialized applications. 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, approved foreign defense organizations, and U.S. and international prime defense contractors. In addition, under our RedBlack Communications brand, we design, integrate and field mobile, modular and fixed-site communication and electronic systems.

Revenues for this segment for the year ended December 31, 2011 were \$31,183 and segment contribution (gross profit) was \$10,224.

### *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, 2011 and our corporate expenses were \$32,918.

See Management's Discussion and Analysis of Financial Condition and Results of Operations and the 2011 Consolidated Financial Statements and Notes thereto for additional information. For information relating to total assets by segment, revenues for the last three years by segment, and contribution by segment for the last three 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 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 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. The acquisition was expected to provide a natural extension to our communications systems business and open another channel of distribution for our broad portfolio of communications systems, accessories and portable power products. As described in greater detail below, we are currently seeking to divest our RedBlack operations.

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, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business. As a result of management’s ongoing 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 over the last several years, 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. 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 \$94 and were due to the difference in our actual experience compared to our expectations as of the completion of our exit activities.

On February 15, 2012, our senior management, as authorized by our Board of Directors, decided to divest our RedBlack Communications business. As a result of management’s ongoing review of our business portfolio, management had determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model and decided to refocus our operations on profitable growth opportunities presented in the other product lines that comprise our business segments, Battery & Energy Products and Communication Systems. Since 2008, our RedBlack Communications business has incurred significant operating losses. Revenues for our RedBlack business for the year ended December 31, 2011 were \$3,649 and its contribution to gross profit was \$1,202. We are seeking to sell our RedBlack business as a going concern and will be engaging appropriate professionals to assist in that effort. We anticipate that the actions taken to divest the RedBlack Communications business will result in the elimination of approximately 30 jobs and the transfer of the RedBlack facility located in Hollywood, Maryland in connection with the divestiture. We cannot predict at this time when the closing of any divestiture transaction will occur. Commencing with the first quarter of 2012 and concluding with the ultimate closing of the transaction, the results of RedBlack operations and related divestiture costs will be reported as a discontinued operation.

We cannot at this time determine an estimate or a range of estimates of the extent of the restructuring charges we will incur in connection with the RedBlack divestiture.

## **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 and lithium-thionyl chloride technologies.

Our non-rechargeable battery products are based on lithium-manganese dioxide 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, medical and music/audio. Typical applications include: smoke alarms, wireless alarm systems, bone growth stimulators, telemetry devices, blood analyzers, ambulatory infusion pumps, parking meters, wireless audio devices and guitar pickups. 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-SO<sub>2</sub> 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, automotive, 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. Automotive applications include: telematics, tire-pressure monitoring and engine electronics 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.* 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 and less maintenance to the primary power source, and silent watch capability make the GenSet Eliminator ideal for military bases that generate their own electricity.

*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*

We design and manufacture communications systems and accessories, and provide communications systems design services, through our McDowell Research®, RedBlack Communications™ (which we will be divesting) and AMTI™ brands, to support military communications systems including power supplies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication systems. We specialize in field deployable power systems, which operate from wide-ranging AC and DC sources using a basic building block approach, allowing for a quick response to specialized applications. 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:

*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.

*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.

*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.

In addition, we design, install, maintain and integrate communications equipment and power systems for maximum mobility and optimum customer utility. These include equipment installations in commercial, defense and law enforcement applications, including vehicles for satellite communications, engineering services, upgrading current fleet vehicles and integrated logistics and project management 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 year ended December 31, 2011, we had one major customer, Harris Corporation, which comprised 21% of our revenue. During the year ended December 31, 2010, we had two major customers, U.S. Department of Defense and Port Electronics Corp., which comprised 12% and 11% of our revenue, respectively. During the year ended December 31, 2009, we had two major customers, the U.S. Department of Defense and Harris Corporation, which comprised 29% and 11% of our revenue, respectively.

In 2011, sales to U.S. and non-U.S. customers were approximately \$95,808 and \$43,578, respectively. For information relating to revenues by country for the last three fiscal years and long-lived assets for the last three 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, automotive telematics, 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, 2011, 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, 2011, 2010 and 2009, our backlog related to Battery & Energy Products was approximately \$22,555, \$34,891 and \$29,081, respectively. The decrease in our backlog related to Battery & Energy Products is mainly due to continued delays in government orders. The majority of the 2011 backlog was related to orders that are expected to ship throughout 2012.

#### *Communications Systems*

We target sales of our communications systems, which include power solutions and accessories to support communications systems such as power supplies, power cables, connector assemblies, RF amplifiers, 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 May 2010, we received an order valued at \$21,000, from a U.S. defense contractor for advanced communications systems.

At December 31, 2011, 2010 and 2009, our backlog related to Communications Systems orders was approximately \$1,555, \$4,021 and \$11,962, respectively. The decrease in our backlog related to Communications Systems orders is mainly due to the completion of SATCOM systems orders in 2011. The majority of the 2011 backlog was related to orders that are expected to ship throughout 2012.

#### **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 protect 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 2011 was \$5. 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™, RedBlack™, GenSet Eliminator™, 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 facility has the capacity to produce approximately nine million 9-volt batteries per year and approximately fourteen million cylindrical cells per year. Capacity, however, is also related to individual operations, and product mix changes can produce bottlenecks in an individual operation, constraining overall capacity. Our manufacturing facility in Shenzhen, China is capable of producing approximately five million cylindrical cells per year and approximately 500,000 thin cells per year. 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, including equipment relating to the transition of our 9-volt battery manufacturing operations to China, will be adequate to meet foreseeable customer demand. In 2010, we announced that we will be transitioning a significant portion of our 9-volt battery manufacturing from our Newark, New York manufacturing facility to our Shenzhen, China manufacturing facility. At December 31, 2011, the transition was still ongoing, but we anticipate completing the transition during the first half of 2012. However, with unanticipated growth in demand for our products, demand could exceed capacity, which would require us to install additional capital equipment to meet these incremental needs, which in turn may require us to lease or contract additional space to accommodate such needs.

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 \$19,343 as of December 31, 2011.

#### *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 Hollywood, Maryland facility, which we are in the process of divesting, has the capacity to produce communications accessories and systems. This operation generally provides services, but can also assemble products and is limited only by physical space and is not constrained by manufacturing equipment capacity.

Our Virginia Beach, Virginia facility has the capacity to produce communications accessories 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 \$15,624 as of December 31, 2011.

#### **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, West Point, Mississippi, Tallahassee, Florida and Shenzhen, China. During 2011, 2010 and 2009 we expended approximately \$8,600, \$8,800 and \$9,500, respectively, on research and development, including \$3,200, \$3,300 and \$3,500, 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 2011, 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 develop non-rechargeable cells and batteries that broaden our product offering to our customers.

We continue to 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.

We work to receive contracts with defense contractors and commercial customers. For example, in December 2010, we announced that we received a contract from a major international defense contractor valued at approximately \$5,500, for the development and supply of our suite of Land Warrior lithium non-rechargeable and rechargeable lithium ion batteries and charging systems, for use with the Land 200 Battle Management System by the Australian military.

#### *Communications Systems*

We continue to develop a variety of communications accessories and systems for the 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 2011, we spent approximately \$421 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, Abingdon, England 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 accessories.

#### *Corporate*

Please refer to the description of the environmental remediation for our Newark, New York facility set forth in Item 3, Legal Proceedings of this report.

### **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, 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, 2011, we employed a total of 975 permanent and temporary employees: 39 in research and development, 782 in production and 155 in sales and administration. Of this total, 490 are employed in the U.S., 4 in Europe and 481 in Asia. None of our employees are represented by a labor union.

## **ITEM 1A. RISK FACTORS**

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

Currently, a significant portion of our revenues is comprised of sales of products used by the United States military. In the years ended December 31, 2011, 2010 and 2009, approximately 45%, 56%, and 66%, respectively, of our revenues were comprised of sales made directly or indirectly to the United States military. The U.S. military market depends significantly upon government budget trends, particularly the U.S. Department of Defense (“DoD”) budget. Future DoD budgets could be negatively impacted by several factors, including, but not limited to, a change in defense spending policy by the current and future presidential administrations and Congress, the U.S. Government’s budget deficits, spending priorities, the cost of sustaining the U.S. military presence in overseas operations and possible political pressure to reduce U.S. Government military spending, each of which could cause the DoD budget to decline. Currently, Congress is proposing approximately \$469,000,000 in defense spending cuts over the next ten years. 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.

*A significant portion of our revenues is derived from certain key customers.*

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, 2011, 2010 and 2009, approximately 54%, 70%, and 72% respectively, of our revenues were comprised of sales made directly or indirectly to the U.S. and foreign militaries. During the year ended December 31, 2011, we had one major customer, Harris Corporation, which comprised 21% of our revenue. During the year ended December 31, 2010, we had two major customers, DoD and Port Electronics Corp., which comprised 12% and 11% of our revenue, respectively. During the year ended December 31, 2009, we had two major customers, DoD and Harris Corporation, which comprised 29% and 11% of our revenue, respectively. There were no other customers that comprised greater than 10% of our total revenues during the years ended December 31, 2011, 2010 and 2009. While sales to these customers were substantial during the years ended December 31, 2011, 2010 and 2009, we do not consider these customers to be significant credit risks. Government decisions regarding military deployment and budget allocations to fund military operations may have an impact on the demand for our products and services. If the demand for products and services from the U.S. or foreign militaries were to decrease significantly, this could have a material adverse effect on our business, financial condition and results of operations.

Our overall operating results are affected by many factors, including the timing of orders from our key customers and the timing of expenditures to manufacture parts and purchase inventory in anticipation of future orders of products and services. Because we make significant sales to U.S. and foreign militaries or OEMs that supply the U.S. or foreign militaries, we are subject to the effects of delays in the government budget process and the decisions to deploy resources to support military purchases of our products. The reduction, delay or cancellation of orders from one or more of our key customers for any reason or the loss of one or more of our key customers could materially and adversely affect our business, operating results and financial condition. For example, sales of our SATCOM systems declined from \$30,900 in 2010 to \$7,500 in 2011 as military spending focus has been shifting from hardware towards soldier modernization.

We neither distribute our products to a concentrated geographical area nor is there a significant concentration of credit risks arising from individuals or groups of customers engaged in similar activities, or who have similar economic characteristics. We have no customers that comprised greater than 10% of our trade accounts receivables as of December 31, 2011 and 2010.

*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.*

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, 2011, 2010, 2009, 12%, 12% and 12% of our revenues, respectively, were comprised of sales of our 9-volt batteries, and of this, approximately 34%, 25% 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.

*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, 2011. However, due to the narrow margin of passing the Step 1 goodwill impairment testing for 2011 in the RedBlack reporting unit, there is potential for a partial or full impairment of the goodwill value in 2012 if the projected operating results are not achieved or if we cannot sell the reporting unit for at least its carrying value. One of the key assumptions for achieving the projected operational results includes significant revenue growth. Although we are projecting revenue growth, we have determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model. As of December 31, 2011, the RedBlack reporting unit had a goodwill carrying value of \$2,025. For 2011, 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 2011, there is potential that the McDowell - Communications Systems trademark may become partially

or fully impaired in 2012 if the projected revenue targets are not met. As of December 31, 2011, the McDowell - Communications Systems trademark had a carrying value of \$2,400.

*Our acquisitions and business partnerships may not result in the revenue growth and profitability that we expect.*

We have integrated our acquisitions into our business and assimilated their operations, services, products and personnel with our management policies, procedures and strategies. We can provide no assurances that we will achieve the revenue growth and profitability that we expect from these acquisitions.

In 2007 we acquired RedBlack, Stationary Power and RPS, in 2008 we formed a joint venture in India and acquired USE, and in 2009 we acquired AMTI, which added new facilities and operations to our overall business. Unfortunately the acquisitions of Stationary Power, RPS and USE (which we collectively refer to as "Energy Services") did not achieve the revenue and profitability that we expected. As a result, on March 8, 2011, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business. In connection with our exit from our Energy Services businesses, we recorded total restructuring charges of approximately \$2,924, the majority of which are related to employee-related costs, including termination benefits, of approximately \$703, lease termination costs of approximately \$250, inventory and fixed asset write-downs of approximately \$941 and approximately \$1,030 of other associated costs. The cash component of the aggregate charge 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. The adjustments amount to \$94 and were due to the difference in our actual experience compared to our expectations as of the completion of our exit activities.

On February 15, 2012, our senior management, as authorized by our Board of Directors, decided to divest our RedBlack Communications business. As a result of management's ongoing review of our business portfolio, management had determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model and decided to refocus our operations on profitable growth opportunities presented in the other product lines that comprise our business segments, Battery & Energy Products and Communication Systems. Since 2008, our RedBlack Communications business has incurred significant operating losses. We are seeking to sell our RedBlack business as a going concern and will be engaging appropriate professionals to assist in that effort. We anticipate that the actions taken to divest the RedBlack Communications business will result in the elimination of approximately 30 jobs and the transfer of the RedBlack facility located in Hollywood, Maryland in connection with the divestiture. We cannot predict at this time when the closing of any divestiture transaction will occur. Commencing with the first quarter of 2012 and concluding with the ultimate closing of the transaction, the results of RedBlack operations and related divestiture costs will be reported as a discontinued operation. We cannot at this time determine an estimate or a range of estimates of the extent of the restructuring charges we will incur in connection with the RedBlack divestiture.

*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 anticipate that we will complete the transition of 9-volt 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. We believe we have minimized start-up risks and do not anticipate any production delays going forward as a result of the transition.

*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.

*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, 2011, 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.

*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 will 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.

*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 rightsize



the business during the course of 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.

*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.

*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.

*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.

*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.

*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.

*Our customers may not meet the volume requirements 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.

*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.

*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 products could become obsolete.*

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.

*We may not generate a sufficient amount of cash or generate sufficient funds from operations to fund our operations.*

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. There can be no assurance that our business will generate cash flow from operations or that future borrowings will be available to us in amounts sufficient to enable us to fund our liquidity needs or to repay our indebtedness.

*We may not be able to achieve the covenants as set forth in our asset based lending facility with RBS Capital.*

Our ability to successfully meet the covenants as set forth in our lending facility will depend on our generation of EBITDA from each of our domestic legal entities in line with our projections. Our lending facility includes a fixed charge ratio which we must achieve on a quarterly basis to avoid default. The existence of an event of default would significantly impact our ability to draw funds from our credit facility, which could have a material adverse effect on our business, financial condition and results of operations. There can be no assurances that we will generate sufficient cash flow from operations to ensure compliance with the covenants of our lending facility. In the event of a default, our interest rate will increase by 200 basis points during the default period.

*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, 2011, we had approximately \$57,977 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, 2011, 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 \$3,976 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 2011. 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.

*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.

*The re-payment of the debt outstanding under our credit facility and the vesting of options under certain of our equity compensation plans may both be accelerated by the triggering of a “change in control” as defined in our credit facility and Long-Term Incentive Plan.*

Our largest single shareholder is Mr. Bradford T. Whitmore, who beneficially owns, including shares held by Grace Brothers, Ltd., 29.5% of our issued and outstanding shares of common stock. Mr. Whitmore, general partner of Grace Brothers, Ltd., is our Chair of the Board of Directors. If Mr. Whitmore or any other beneficial owner were to increase its ownership to more than 30%, it would be deemed a “change in control” for purposes of our 2004 Amended and Restated Long Term Incentive Plan, or LTIP. If a “change in control” were to occur, the vesting of most of the outstanding options granted under our LTIP would be accelerated resulting in a significant expense being charged against our income for the period during which the “change in control” occurred. An increase in ownership to 49% or more by any beneficial owner with 5% ownership as of February 17, 2010, or to 30% by any new owner, or any owner with less than 5% ownership as of February 17, 2010, would result in a default under our new credit facility with RBS Capital. Either of these events could have a material, adverse effect on our business, financial condition and results of operations.

*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. 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.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

## ITEM 2. PROPERTIES

As of December 31, 2011, 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 lease approximately 35,000 square feet in a facility based in Abingdon, England, which serves operations primarily in the Battery & Energy Products operating segment, and approximately 130,000 square feet in four buildings on one campus in Shenzhen, China, which serves operations primarily 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 primarily in the Communications Systems operating segment. We also lease sales and administrative offices, as well as manufacturing and production facilities, in Hollywood, Maryland, which serves operations primarily in the Communications Systems operating segment, and India, which serves operations primarily in the Battery & Energy Products operating segment. Our Hollywood, Maryland facility is part of our RedBlack operations and we are seeking to divest this facility. Our research and development efforts for our Battery & Energy Products are conducted at our Newark, New York, West Point, Mississippi 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.

### *Environmental Matter*

In conjunction with our purchase/lease of our Newark, New York facility in 1998, we entered into a payment-in-lieu of tax agreement, which provided us with real estate tax concessions upon meeting certain conditions. In connection with this agreement, a consulting firm performed a Phase I and II Environmental Site Assessment, which revealed the existence of contaminated soil and ground water around one of the buildings. We retained an engineering firm, which estimated that the cost of remediation should be in the range of \$230. In February 1998, we entered into an agreement with a third party, which provides that we and this third party will retain an environmental consulting firm to conduct a supplemental Phase II investigation to verify the existence of the contaminants and further delineate the nature of the environmental concern. The third party agreed to reimburse us for fifty percent (50%) of the cost of correcting the environmental concern on the Newark property. We have fully reserved for our portion of the estimated liability. Test sampling was completed in the spring of 2001, and the engineering report was submitted to the New York State Department of Environmental Conservation (“NYSDEC”) for review. The NYSDEC reviewed the report and, in January 2002, recommended additional testing. We responded by submitting a work plan to the NYSDEC, which was approved in April 2002. We sought proposals from engineering firms to complete the remedial work contained in the work plan. A firm was selected to undertake the remediation and in December 2003 the remediation was completed, and was overseen by the NYSDEC. The report detailing the remediation project, which included the test results, was forwarded to the NYSDEC and to the New York State Department of Health (“NYSDOH”). The NYSDEC, with input from the NYSDOH, requested that we perform additional sampling. A work plan for this portion of the project was written and delivered to the NYSDEC and approved. In November 2005, additional soil, sediment and surface water samples were taken from the area outlined in the work plan, as well as groundwater samples from the monitoring wells. We received the laboratory analysis and met with the NYSDEC in March 2006 to discuss the results. On June 30, 2006, the Final Investigation Report was delivered to the NYSDEC by our outside environmental consulting firm. In November 2006, the NYSDEC completed its review of the Final Investigation Report and requested additional groundwater, soil and sediment sampling. A work plan to address the additional investigation was submitted to the NYSDEC in January 2007 and was approved in April 2007. Additional investigation work was performed in May 2007. A preliminary report of results was prepared by our outside environmental consulting firm in August 2007 and a meeting with the NYSDEC and NYSDOH took place in September 2007. As a result of this meeting, the NYSDEC and NYSDOH requested additional investigation work. A work plan to address this additional investigation was submitted to and approved by the NYSDEC in November 2007. Additional investigation work was performed in December 2007. Our environmental consulting firm prepared and submitted a Final Investigation Report in January 2009 to the NYSDEC for review. The NYSDEC reviewed and approved the Final Investigation Report in June 2009 and requested the development of a Remedial Action Plan. Our environmental consulting firm developed and submitted the requested plan for review and approval by the

NYSDEC. In October 2009, we received comments back from the NYSDEC regarding the content of the remediation work plan. Our environmental consulting firm incorporated the requested changes and submitted a revised work plan to the NYSDEC in January 2010 for review and approval. Upon approval from the NYSDEC, environmental remediation work was completed in July and August 2010. Our environmental consulting firm prepared a Final Engineering report which was submitted to the NYSDEC for review and approval in October 2010. Comments on the Final Engineering report and associated documents were received from the NYSDEC in December 2010. Our environmental consulting firm revised the Final Engineering report and submitted the report and associated documents to the NYSDEC for review and approval in January 2011. In May 2011, the NYSDEC administratively closed remedial activities associated with the approved work plan. In September 2011, the NYSDEC issued an Assignable Release and Covenant Not to Sue document. As a result, anticipated costs are not expected to exceed those currently reserved. Through December 31, 2011, total costs incurred have amounted to approximately \$383, none of which has been capitalized. At December 31, 2011 and December 31, 2010, we had \$8 and \$22, respectively, reserved for this matter.

#### *Workers' Compensation Self-Insured Trust*

From August 2002 through August 2006, we participated in a self-insured trust to manage our workers' compensation activity for our employees in New York State. All members of this trust had, by design, joint and several liability during the time they participated in the trust. In August 2006, we left the self-insured trust and obtained alternative coverage for our workers' compensation program through a third-party insurer. In the third quarter of 2006, we confirmed that the trust was in an underfunded position (i.e. the assets of the trust were insufficient to cover the actuarially projected liabilities associated with the members in the trust). In the third quarter of 2006, we recorded a liability and an associated expense of \$350 as an estimate of our potential future cost related to the trust's underfunded status based on our estimated level of participation. On April 28, 2008, we, along with all other members of the trust, were served by the State of New York Workers' Compensation Board ("Compensation Board") with a Summons with Notice that was filed in Albany County Supreme Court, wherein the Compensation Board put all members of the trust on notice that it would be seeking approximately \$1,000 in previously billed and unpaid assessments and further assessments estimated to be not less than \$25,000 arising from the accumulated estimated under-funding of the trust. The Summons with Notice did not contain a complaint or a specified demand. We timely filed a Notice of Appearance in response to the Summons with Notice. On June 16, 2008, we were served with a Verified Complaint. Subject to the results of a deficit reconstruction that was pending, the Verified Complaint estimated that the trust was underfunded by \$9,700 during the period of December 1, 1997 – November 30, 2003 and an additional \$19,400 for the period December 1, 2003 – August 31, 2006. The Verified Complaint estimated our pro-rata share of the liability for the period of December 1, 1997 – November 30, 2003 to be \$195. The Verified Complaint did not contain a pro-rata share liability estimate for the period of December 1, 2003-August 31, 2006. Further, the Verified Complaint stated that all estimates of the underfunded status of the trust and the pro-rata share liability for the period of December 1, 1997-November 30, 2003 were subject to adjustment based on a forensic audit of the trust that was being conducted on behalf of the Compensation Board by a third-party audit firm. We timely filed our Verified Answer with Affirmative Defenses on July 24, 2008. In November 2009, the New York Attorney General's office presented the results of the deficit reconstruction of the trust. As a result of the deficit reconstruction, the State of New York has determined that the trust was underfunded by \$19,100 instead of \$29,100 during the period December 1, 1997 to August 31, 2006. Our pro-rata share of the liability was determined to be \$452. The Attorney General's office proposed a settlement by which we could avoid joint and several liability in exchange for a settlement payment of \$520. Under the terms of the settlement agreement, we could satisfy our obligations by either paying (i) a lump sum of \$468, representing a 10% discount, (ii) paying the entire amount in twelve monthly installments of \$43 commencing the month following execution of the settlement agreement, or (iii) paying the entire amount in monthly installments over a period of up to five years, with interest of 6.0, 6.5, 7.0, and 7.5% for the two, three, four and five year periods, respectively. We elected the twelve monthly installments option and on May 3, 2010, we received written notice from the Attorney General's office that the Compensation Board had decided to proceed with the settlement, as proposed, and that payments would commence in June 2010. As of December 31, 2011, we have made all payments under this settlement and have no further obligations outstanding relating to this matter. On October 11, 2011, an order was filed with the Albany County Clerk wherein this lawsuit was discontinued against us.

#### *Arista Power Litigation*

On September 23, 2011, we initiated an action against Arista Power, Inc. ("Arista") and our former senior sales and engineering employee, David Modeen, in the State of New York Supreme Court, County of Wayne (Index No. 73379). In our Complaint, we allege that Arista recruited all but one of the members of its executive team from us, subsequently changed its business to compete directly with us by using our confidential information, and during the summer of 2011, recruited Modeen to become an Arista employee. We allege that, as a result of actions by Arista and Modeen: (i) Modeen has breached the terms of his Employee Confidentiality, Non-Disclosure, Non-Compete, Non-Disparagement and Assignment Agreement with us; (ii) Modeen has breached certain agreements, duties and obligations

he owed us, including to protect and refrain from disclosing our trade secrets and confidential and proprietary information; (iii) Arista's employment of Modeen will inevitably lead to the disclosure and use of our trade secrets by Arista, in violation of Modeen's duties and obligations to us; (iv) Arista unlawfully induced Modeen to breach his agreements with and duties and obligations to us; and (v) Arista's recruitment and employment of Modeen has breached a subcontract between Arista and us. We seek damages as determined at trial and preliminary and permanent injunctive relief. The defendants have answered the allegations set forth in the Complaint, without asserting any counterclaims. Discovery has commenced and is ongoing.

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. We and our officers, directors and employee named in the Complaint have yet to answer the allegations set forth in the Complaint.

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 dismissing 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.

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

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

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

#### **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 2010 and 2011:

	Closing Sales Prices	
	<u>High</u>	<u>Low</u>
2010:		
Quarter ended March 28, 2010	\$ 5.35	\$ 3.83
Quarter ended June 27, 2010	4.94	3.97
Quarter ended September 26, 2010	4.91	4.02
Quarter ended December 31, 2010	7.16	4.29
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

#### Holder

As of February 17, 2012, there were 364 registered holders of record of our common stock.

#### Recent Sales of Unregistered Securities

None.

#### 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

The financial results presented in this table include results from the last five fiscal years ended December 31, 2011, 2010, 2009, 2008 and 2007.

### SELECTED FINANCIAL DATA

(In Thousands, Except Per Share Amounts)

	Year Ended December 31,				
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statement of Operations Data:					
Revenues	\$ 139,386	\$ 166,819	\$ 154,295	\$ 243,379	\$ 136,088
Cost of products sold	103,993	120,163	118,986	187,799	107,385
Gross margin	35,393	46,656	35,309	55,580	28,703
Research and development expenses	8,595	8,755	9,451	8,069	6,992
Selling, general and administrative expenses	24,323	26,039	29,407	28,081	21,777
Total operating expenses	32,918	34,794	38,858	36,150	28,769
Operating income (loss)	2,475	11,862	(3,549)	19,430	(66)
Interest (expense) income, net	(554)	(1,138)	(1,431)	(921)	(2,185)
Gain on insurance settlement	-	-	-	39	-
Gain on McDowell settlement	-	-	-	-	7,550
Gain on debt conversion	-	-	-	313	-
Other income (expense), net	171	145	(23)	724	490
Income (loss) from continuing operations before income taxes	2,092	10,869	(5,003)	19,585	5,789
Income tax provision (benefit) - current	32	(557)	31	582	-
Income tax provision (benefit) - deferred	496	258	171	3,111	77
Total income taxes	528	(299)	202	3,693	77
Net income (loss) from continuing operations	\$ 1,564	\$ 11,168	\$ (5,205)	\$ 15,892	\$ 5,712
Loss from discontinued operations, net of tax	(3,702)	(17,377)	(4,026)	(2,267)	(129)
Net income (loss)	\$ (2,138)	\$ (6,209)	\$ (9,231)	\$ 13,625	\$ 5,583
Net (income) loss attributable to noncontrolling interest	58	30	(10)	38	-
Net income (loss) attributable to Ultralife	\$ (2,080)	\$ (6,179)	\$ (9,241)	\$ 13,663	\$ 5,583
Net income (loss) attributable to Ultralife common shares - basic					
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)	\$ 0.92	\$ 0.37
Discontinued operations	\$ (0.21)	\$ (1.01)	\$ (0.23)	\$ (0.13)	\$ (0.01)
Net income (loss) attributable to Ultralife common shares - diluted					
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)	\$ 0.91	\$ 0.37
Discontinued operations	\$ (0.21)	\$ (1.01)	\$ (0.23)	\$ (0.13)	\$ (0.01)
Weighted average shares outstanding-basic	17,304	17,157	16,989	17,230	15,316
Weighted average shares outstanding-diluted	17,336	17,166	16,989	17,681	15,538
December 31,					
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Balance Sheet Data:					
Cash and cash equivalents	\$ 5,320	\$ 4,641	\$ 6,094	\$ 1,878	\$ 2,245
Working capital	\$ 41,075	\$ 39,309	\$ 27,824	\$ 42,937	\$ 26,461
Total assets	\$ 100,815	\$ 114,835	\$ 131,166	\$ 129,587	\$ 122,048
Total long-term debt and capital lease obligations	\$ -	\$ 251	\$ 267	\$ 4,670	\$ 16,224
Shareholders' equity	\$ 73,226	\$ 73,795	\$ 78,114	\$ 88,153	\$ 63,007

## **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, future demand for our products and services, addressing the process of U.S. defense procurement, the successful commercialization of our products, our reliance on certain key customers, the impairment of our intangible assets, general domestic and global economic conditions, including the uncertainty with government budget approvals, the unique risks associated with our Chinese operations, government and environmental regulations, finalization of non-bid government contracts, competition and customer strategies, technological innovations in the non-rechargeable and rechargeable battery industries, changes in our business strategy or development plans, capital deployment, business disruptions, including those caused by fires, raw material supplies, environmental regulations, 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 and solutions. We sell our products worldwide through a variety of trade channels, including original equipment manufacturers ("OEMs"), industrial and retail distributors, national retailers 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: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment, integrated communication system kits and communications and electronics systems design. On January 1, 2011, we began to report chargers in the Battery & Energy Products segment, to better align the portfolio of chargers with customers for those products and with how we manage our business operations. Previously, we had reported chargers in the Communications Systems segment. 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 20, 2009, we acquired substantially all of the assets and assumed substantially all of the liabilities of the tactical communications products business of Science Applications International Corporation. The tactical communications products business ("AMTI"), located in Virginia Beach, Virginia, designs, develops and manufactures

tactical communications products including amplifiers, man-portable systems, cables, power solutions and ancillary communications equipment. The AMTI business is part of our Communications Systems operating segment. Under the terms of the asset purchase agreement for AMTI, the purchase price consisted of \$5,717 in cash. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On March 8, 2011, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business. As a result of management's ongoing 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 over the last several years, 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. 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 \$94 and were due to the difference in our actual experience compared to our expectations as of the completion of our exit activities.

On February 15, 2012, our senior management, as authorized by our Board of Directors, decided to divest our RedBlack Communications business. As a result of management's ongoing review of our business portfolio, management had determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model and decided to refocus our operations on profitable growth opportunities presented in the other product lines that comprise our business segments, Battery & Energy Products and Communication Systems. Since 2008, our RedBlack Communications business has incurred significant operating losses. Revenues for our RedBlack Communications business for the year ended December 31, 2011 were \$3,649 and its contribution to gross profit was \$1,202. We are seeking to sell our RedBlack subsidiary as a going concern and will be engaging appropriate professionals to assist in that effort. We anticipate that the actions taken to divest the RedBlack Communications business will result in the elimination of approximately 30 jobs and the transfer of the RedBlack facility located in Hollywood, Maryland in connection with the divestiture. We cannot predict at this time when the closing of any divestiture transaction will occur. Commencing with the first quarter of 2012 and concluding with the ultimate closing of the transaction, the results of RedBlack operations and related divestiture costs will be reported as a discontinued operation.

In 2011, we implemented a series of Lean initiatives throughout the 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 through becoming more efficient.

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 for the year ended December 31, 2011 decreased by \$27,433, or 16.4%, from the year ended December 31, 2010. This decrease was primarily caused by lower revenues in our Communications Systems segment in 2011 when compared to 2010, as a result of significant deliveries that were part of the SATCOM systems order received in May 2010. Also contributing to the decrease was a \$2,730 charge recorded in the first quarter of 2011 to reflect the settlement with the U.S. Government related to exigent contracts completed between 2003 and 2004. Gross margin decreased to 25.4% for the year ended December 31, 2011, as opposed to 28.0% for the year ended December 31, 2010. Excluding the impact of the aforementioned \$2,730 charge and a \$1,050 non-cash charge in the third quarter to write-off components for legacy amplifiers that we had discontinued, gross margin for 2011 would have been 27.6%.

Operating expenses decreased by \$1,876 or 5.4% to \$32,918 during the year ended December 31, 2011 compared to \$34,794 during the year ended December 31, 2010, reflecting continued Lean initiatives and actions to

reduce general and administrative expenses while investing a portion of our savings in the development of new products and the expansion of the sales force to increase our geographic coverage and penetrate new markets. Operating expenses as a percentage of revenues increased to 23.6% in 2011 from 20.9% reported in 2010 due to the impact of lower revenues in 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 \$8,248 for the year ended December 31, 2011 compared to \$17,636 for the year ended December 31, 2010. See the section "Adjusted EBITDA" beginning on page 36 for a reconciliation of Adjusted EBITDA to net income (loss) attributable to Ultralife.

As a result of careful working capital management and cash generated from operations and our Lean initiatives, our liquidity remains solid with cash of \$5,320 and no debt. We had nothing outstanding on our revolver at the end of 2011. Our inventory levels at the end of 2011 increased by \$1,845 over year-end 2010, due to delays in the shipments of rechargeable batteries into January 2012 and building amplifier inventory to help fulfill our recently announced A-320 amplifier system contract with a major international defense contractor.

## Outlook

Management expects year-over-year percentage revenue growth approaching double digits. Operating income growth is expected to outpace revenue growth and generate an operating margin of approximately 7% to 7.5%. Management cautions that the timing of orders and shipments may cause variability in quarterly results.

## Results of Operations

### *Twelve Months Ended December 31, 2011 Compared With the Twelve Months Ended December 31, 2010*

	12 Months Ended		Increase /
	12/31/2011	12/31/2010	(Decrease)
Revenues	\$ 139,386	\$ 166,819	\$ (27,433)
Cost of products sold	103,993	120,163	(16,170)
Gross margin	35,393	46,656	(11,263)
Operating expenses	32,918	34,794	(1,876)
Operating income (loss)	2,475	11,862	(9,387)
Other income (expense), net	(383)	(993)	610
Income (loss) from continuing operations before taxes	2,092	10,869	(8,777)
Income tax provision (benefit)	528	(299)	827
Net income (loss) from continuing operations	1,564	11,168	(9,604)
Loss from discontinued operations, net of tax	(3,702)	(17,377)	13,675
Net income (loss)	(2,138)	(6,209)	4,071
Net (income) loss attributable to noncontrolling interest	58	30	28
Net income (loss) attributable to Ultralife	\$ (2,080)	\$ (6,179)	4,099
Net income (loss) attributable to Ultralife common shares - basic			
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.56)
Discontinued operations	\$ (0.21)	\$ (1.01)	\$ 0.80
Net income (loss) attributable to Ultralife common shares - diluted			
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.56)
Discontinued operations	\$ (0.21)	\$ (1.01)	\$ 0.80
Weighted average shares outstanding-basic	17,304,000	17,157,000	147,000
Weighted average shares outstanding-diluted	17,336,000	17,166,000	170,000

*Revenues.* Total revenues for the twelve months ended December 31, 2011 amounted to \$139,386, a decrease of \$27,433, or 16.4% from the \$166,819 reported for the twelve months ended December 31, 2010.

Battery & Energy Products revenues increased \$3,077, or 2.9%, to \$108,203 for the twelve months ended December 31, 2011 from the \$105,126 reported for the twelve months ended December 31, 2010. Included in Battery & Energy Products' 2011 sales was a \$2,730 charge recorded in the first quarter to reflect the settlement with the U.S. Government related to exigent contracts completed between 2003 and 2004. Excluding this charge, Battery & Energy Products' sales increased by 5.5%.

Communications Systems revenues decreased \$30,510, or 49.5%, from \$61,693 last year to \$31,183 this year. The decrease in Communications Systems revenues was mainly due to higher deliveries of SATCOM systems in 2010 driven by the completion of the contract for these vehicle mounted systems. SATCOM systems shipments amounted to \$7,549 in 2011 versus \$30,865 in 2010. Excluding sales of SATCOM systems in 2011 and 2010, Communications Systems sales would have only decreased by \$7,194 or 23.3%, due to delays in the U.S. Government's funding approval for amplifier orders.

*Cost of Products Sold.* Cost of products sold decreased \$16,170, or 13.5%, from \$120,163 for the year ended December 31, 2010 to \$103,993 for the year ended December 31, 2011. Consolidated cost of products sold as a percentage of total revenue increased from 72.0% for the year ended December 31, 2010 to 74.6% for the year ended December 31, 2011. Correspondingly, consolidated gross margin was 25.4% for the year ended December 31, 2011, compared with 28.0% for the year ended December 31, 2010. The decrease is primarily attributable to the \$2,730 charge recorded in the first quarter of 2011 to reflect the settlement with the U.S. Government related to exigent contracts completed between 2003 and 2004 and the \$1,050 non-cash charge in the third quarter of 2011 to write-off components for legacy amplifiers that we had discontinued. Excluding these one time items, gross margin for 2011 would have been 27.6%, a slight decrease from 28.0% for the year ended December 31, 2010.

In our Battery & Energy Products segment, the cost of products sold increased \$2,752, from \$80,282 for the year ended December 31, 2010 to \$83,034 in 2011. Battery & Energy Products gross margin for 2011 was \$25,169 or 23.3%, an increase of \$325 from 2010's gross margin of \$24,844, or 23.6%. Included in Battery & Energy Products' 2011 sales was a \$2,730 charge recorded in the first quarter to reflect the settlement with the U.S. Government related to exigent contracts completed between 2003 and 2004. Excluding this charge, Battery & Energy Products' gross margin percentage increased to 25.1% from the 23.6% gross margin percentage in 2010, reflecting the manufacturing efficiencies resulting from our ongoing Lean initiative and a greater mix of higher margin rechargeable batteries and chargers in comparison to the year ended December 31, 2010.

In our Communications Systems segment, the cost of products sold decreased \$18,922 from \$39,881 in 2010 to \$20,959 in 2011. Communications Systems gross margin for 2011 was \$10,224, or 32.8%, a decrease of \$11,588 from 2010's gross margin of \$21,812, or 35.4%. The decrease in the gross margin for Communications Systems resulted from a third quarter \$1,050 non-cash charge to write-off components for legacy amplifiers that we have discontinued. Adjusting for the \$1,050 write-off, the Communication Systems gross margin percentage for 2011 increased to 36.2% from the 35.4% gross margin in 2010.

*Operating Expenses.* Operating expenses decreased by \$1,876, or 5.4%, to \$32,918 for the year ended December 31, 2011 compared to \$34,794 for the year ended December 31, 2010, reflecting continued Lean initiatives and actions to reduce general and administrative expenses while investing a portion of our savings in the development of new products and 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 23.6% in 2011 from 20.9% reported for the prior year due to the impact of lower revenues in 2011. Amortization expense associated with intangible assets related to our acquisitions was \$627 for 2011 (\$314 in selling, general and administrative expenses and \$313 in research and development costs), compared with \$817 for 2010 (\$408 in selling, general, and administrative expenses and \$409 in research and development costs). Research and development costs were \$8,595 in 2011, a decrease of \$160 or 1.8%, over the \$8,755 reported in 2010. Selling, general, and administrative expenses decreased \$1,716, or 6.6%, to \$24,323. This decrease represents the results of our broad actions to reduce our overall spending base in non-revenue producing functions.

*Other Income (Expense).* Other income (expense) totaled (\$383) for the year ended December 31, 2011, compared to (\$993) for the year ended December 31, 2010. Interest expense, net of interest income, decreased \$584, from \$1,138 for 2010 to \$554 for 2011, mainly as a result of lower average borrowings under our revolving credit facilities during the course of 2011. Miscellaneous income amounted to \$171 for 2011 compared with \$145 for 2010. The income in both 2011 and 2010 was primarily due to transactions impacted by changes in foreign currencies relative to the U.S. dollar.

*Income Taxes.* We reflected a tax provision of \$528 for the year ended December 31, 2011 compared with a tax benefit of \$299 for the same period of 2010. The 2010 tax benefit was principally a result of our realization of a current tax benefit related to our election in 2010 to carry back the 2009 net operating loss to the prior five tax years. This amount was

partially offset by state income taxes due for 2010. This election resulted in us receiving a refund of alternative minimum taxes paid in the prior five years.

The effective consolidated tax rate for the years ended December 31, 2011 and 2010 was:

	Years Ended December 31,	
	2011	2010
Income (Loss) before Incomes Taxes (a)	\$ 2,092	\$ 10,869
Total Income Tax Provision (Benefit) (b)	\$ 528	\$ (299)
Effective Tax Rate (b/a)	25.2%	(2.8%)

In 2011 and 2010, 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 2011. 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.) In 2010, we reported a valuation allowance for our deferred tax assets in China. As a result of our assessment at December 31, 2011, there is no longer a need to record a valuation allowance for the Chinese deferred tax assets as it is more likely than not that they will be realized. We are more likely than not to fully utilize the NOL in China and therefore have removed the valuation allowance during 2011. We continually assess the carrying value of this asset based on relevant accounting standards.

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 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 the 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 2011 and 2010. For further discussion, see "Risk Factors" in Item 1A of this annual report.

*Discontinued Operations.* Loss from discontinued operations, net of tax, totaled \$3,702 for the year ended December 31, 2011, compared to a loss of \$17,377 in the same period of 2010. 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. For more information, see Note 2 to the Condensed Consolidated Financial Statements.

*Net Income (Loss) Attributable to Ultralife.* Net loss attributable to Ultralife and net loss attributable to Ultralife common shareholders per diluted share were \$2,080 and \$0.12, respectively, for the year ended December 31, 2011, compared to net loss attributable to Ultralife and net loss attributable to Ultralife common shareholders per diluted share of \$6,179 and \$0.36, respectively, for the year ended December 31, 2010, primarily as a result of the reasons described above. Average common shares outstanding used to compute diluted earnings per share increased from 17,166,000 in 2010 to 17,336,000 in 2011, mainly due to stock option exercises and shares of common stock issued to our non-employee directors.

**Twelve Months Ended December 31, 2010 Compared With the Twelve Months Ended December 31, 2009**

	12 Months Ended		Increase / (Decrease)
	12/31/2010	12/31/2009	
Revenues	\$ 166,819	\$ 154,295	\$ 12,524
Cost of products sold	120,163	118,986	1,177
Gross margin	46,656	35,309	11,347
Operating expenses	34,794	38,858	(4,064)
Operating income (loss)	11,862	(3,549)	15,411
Other income (expense), net	(993)	(1,454)	461
Income (loss) from continuing operations before taxes	10,869	(5,003)	15,872
Income tax provision (benefit)	(299)	202	(501)
Net income (loss) from continuing operations	11,168	(5,205)	16,373
Loss from discontinued operations, net of tax	(17,377)	(4,026)	(13,351)
Net income (loss)	(6,209)	(9,231)	3,022
Net (income) loss attributable to noncontrolling interest	30	(10)	40
Net income (loss) attributable to Ultralife	\$ (6,179)	\$ (9,241)	3,062
Net income (loss) attributable to Ultralife common shares - basic			
Continuing operations	\$ 0.65	\$ (0.31)	\$ 0.96
Discontinued operations	\$ (1.01)	\$ (0.23)	\$ (0.78)
Net income (loss) attributable to Ultralife common shares - diluted			
Continuing operations	\$ 0.65	\$ (0.31)	\$ 0.96
Discontinued operations	\$ (1.01)	\$ (0.23)	\$ (0.78)
Weighted average shares outstanding-basic	17,157,000	16,989,000	168,000
Weighted average shares outstanding-diluted	17,166,000	16,989,000	177,000

*Revenues.* Total revenues for the twelve months ended December 31, 2010 amounted to \$166,819, an increase of \$12,524, or 8.1% from the \$154,295 reported for the twelve months ended December 31, 2009.

Battery & Energy Products revenues decreased \$2,039, or 1.9%, from \$107,165 for the twelve months ended December 2009 to \$105,126 reported for the twelve months ended December 31, 2010. The decrease in Battery & Energy Products revenues was primarily attributable to higher demand for our rechargeable batteries, including automotive telematics batteries resulting from favorable economic conditions in the automotive industry, offset by lower battery sales to the U.S. Department of Defense.

Communications Systems revenues increased \$14,563, or 30.9%, from \$47,130 for the twelve months ended December 31, 2009 to \$61,693 reported for the twelve months ended December 31, 2010. The increase in Communications Systems revenues was mainly due to deliveries on the SATCOM systems order we received in May 2010 and amplifier sales resulting from our acquisition of AMTI on March 20, 2009 and continued favorable demand for these products.

*Cost of Products Sold.* Cost of products sold increased \$1,177 or 1.0%, from \$118,986 for the year ended December 31, 2009 to \$120,163 for the year ended December 31, 2010, primarily as a result of the increase in revenues. Consolidated cost of products sold as a percentage of total revenue decreased from 77.1% for the twelve months ended December 31, 2009 to 72.0% for the year ended December 31, 2010. Correspondingly, consolidated gross margin percentage was 28.0% for the year ended December 31, 2010, compared with 22.9% for the year ended December 31, 2009, primarily attributable to the margin improvements in the Battery & Energy Products and Communications Systems business segments.

In our Battery & Energy Products segment, the cost of products sold decreased \$5,504, from \$85,786 in the year ended December 31, 2009 to \$80,282 in 2010. Battery & Energy Products gross margin for 2010 was \$24,844, or 23.6%, an increase of \$3,465 from 2009's gross margin of \$21,379, or 19.9%. Battery & Energy Products gross margin and gross margin as a percentage of revenues both increased for the year ended December 31, 2010, primarily as a result of manufacturing efficiencies and higher selling prices and volumes realized for some of our products, in comparison to the year ended December 31, 2009.



In our Communications Systems segment, the cost of products sold increased \$6,681, from \$33,200 in 2009 to \$39,881 in 2010. Communications Systems gross margin for 2010 was \$21,812, or 35.4%, an increase of \$7,882 from 2009's gross margin of \$13,930, or 29.6%. The increase in both the gross margin and the gross margin percentage for Communications Systems resulted from deliveries under the SATCOM systems order we received in May 2010 and from our acquisition of the AMTI amplifier business in March 2009 and increased sales of its higher margin products.

*Operating Expenses.* Total operating expenses decreased \$4,064, from \$38,858 for the year ended December 31, 2009 to \$34,794 for the year ended December 31, 2010. Overall, operating expenses as a percentage of sales decreased to 20.9% in 2010 from 25.2% reported the prior year, due to "across the board" cost reduction and consolidation actions we commenced in the latter half of 2009. Amortization expense associated with intangible assets related to our acquisitions was \$817 for 2010 (\$408 in selling, general, and administrative expenses and \$409 in research and development costs), compared with \$944 for 2009 (\$496 in selling, general, and administrative expenses and \$448 in research and development costs). Research and development costs were \$8,755 in 2010, a decrease of \$696, or 7.4%, over the \$9,451 reported in 2009, with the decrease due to the timing of development projects relating to both our business segments. Selling, general, and administrative expenses decreased \$3,368, or 11.5%, to \$26,039. This decrease represents the results of our broad actions to reduce our overall spending base in non-revenue producing functions.

*Other Income (Expense).* Other income (expense) totaled (\$993) for the year ended December 31, 2010, compared to (\$1,454) for the year ended December 31, 2009. Interest expense, net of interest income, decreased \$293, from \$1,431 for 2009 to \$1,138 for 2010, mainly as a result of lower average borrowings under our revolving credit facility. Miscellaneous income/expense amounted to income of \$145 for 2010 compared with expense of \$23 for 2009. The income in 2010 and the expense in 2009 were primarily due to the transactions impacted by changes in foreign currencies relative to the U.S. dollar.

*Income Taxes.* We reflected a tax benefit of \$299 for the year ended December 31, 2010 compared with a tax provision of \$202 in the same period of 2009. The 2010 tax benefit is principally a result of our realization of a current tax benefit related to our election in 2010 to carry back the 2009 net operating loss to the prior five tax years. This amount was partially offset by state income taxes due for 2010. This election resulted in us receiving a refund of alternative minimum taxes paid in the prior five years.

The effective consolidated tax rate for the years ended December 31, 2010 and 2009 was:

	Years Ended December 31,	
	2010	2009
Income (Loss) before Incomes Taxes (a)	\$ 10,869	\$ (5,003)
Total Income Tax Provision (b)	\$ (299)	\$ 202
Effective Tax Rate (b/a)	(2.8%)	4.0%

In 2010 and 2009, we continue to report a valuation allowance for our deferred tax assets that cannot be offset by reversing temporary differences in the U.S., the U.K. and China arising from the conclusion that we would not be able to utilize our U.S., U.K. and China NOL's that had accumulated over time. The recognition of the valuation allowance on our deferred tax asset 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 2010. 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. (See Notes 1 and 8 in the Notes to Consolidated Financial Statements for additional information.) We continually assess the carrying value of this asset based on relevant accounting standards.

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 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 the 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 2010 and 2009.

*Discontinued Operations.* Loss from discontinued operations, net of tax, totaled \$17,377 for the year ended December 31, 2010, compared to a loss of \$4,026 in the same period of 2009. 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. For more information, see Note 2 to the Condensed Consolidated Financial Statements.

*Net Income (Loss) Attributable to Ultralife.* Net loss attributable to Ultralife and loss attributable to Ultralife common shareholders per diluted share were \$6,179 and \$0.36, respectively, for the year ended December 31, 2010, compared to net loss attributable to Ultralife and earnings attributable to Ultralife common shareholders per diluted share of \$9,241 and \$0.54, respectively, for the year ended December 31, 2009, primarily as a result of the reasons described above. Average common shares outstanding used to compute diluted earnings per share increased from 16,989,000 in 2009 to 17,166,000 in 2010, mainly due to the issuance of 200,000 shares of our common stock to the former principals of U.S. Energy pursuant to an amendment to our purchase agreement with them, stock option exercises and shares of common stock issued to our non-employee directors.

### **Adjusted EBITDA**

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

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

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

- Adjusted EBITDA from continuing operations does not reflect (1) our cash expenditures or future requirements for capital expenditures or contractual commitments; (2) changes in, or cash requirements for, our working capital needs; (3) the interest expense, or the cash requirements necessary to service interest or

principal payments, on our debt; (4) income taxes or the cash requirements for any tax payments; and (5) all of the costs associated with operating our business;

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and Adjusted EBITDA from continuing operations does not reflect any cash requirements for such replacements;
- while stock-based compensation is a component of cost of products sold and operating expenses, the impact on our consolidated financial statements compared to other companies can vary significantly due to such factors as assumed life of the stock-based awards and assumed volatility of our common stock;
- although discontinued operations does not reflect our current business operations, discontinued operations does include the costs we incurred by exiting our Energy Services business; and
- other companies may calculate Adjusted EBITDA from continuing operations differently than we do, limiting its usefulness as a comparative measure.

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

	<b>Years ended December 31,</b>		
	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
Net income (loss) attributable to Ultralife	\$ (2,080)	\$ (6,179)	\$ (9,241)
Add: interest expense, net	554	1,138	1,431
Add (Less): income tax provision (benefit)	528	(299)	202
Add: depreciation and amortization of financing fees	3,692	3,705	3,866
Add: amortization of intangible assets	627	817	944
Add: stock-based compensation expense	1,225	1,077	1,330
Add (Less): loss (gain) from discontinued operations, net of tax	<u>3,702</u>	<u>17,377</u>	<u>4,026</u>
Adjusted EBITDA	<u>\$ 8,248</u>	<u>\$ 17,636</u>	<u>\$ 2,558</u>

## **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, 2011, cash and cash equivalents totaled \$5,320, an increase of \$679 from the beginning of the year. During the twelve months ended December 31, 2011, we generated \$10,962 of cash from operating activities as compared to generating \$10,909 of cash for the twelve months ended December 31, 2010. The cash from operating activities provided in 2011 was mainly attributable to our net loss of \$2,138, plus an addback of \$5,544 for non-cash expenses of depreciation, amortization and stock-based compensation and a loss from discontinued operations, net of tax of \$3,702. Approximately \$1,190 of cash was generated from working capital due mainly to decreases in accounts receivable, due to timing of orders and a decrease in accounts payable, coupled with an increase in inventories. For 2010, the cash generated from operating activities of \$10,909 was mainly attributable to a net loss of \$6,209, plus an addback of \$5,599 for non-cash expenses of depreciation, amortization and stock-based compensation and a loss from discontinued operations of \$17,377 that included an impairment charge of goodwill and long-lived assets of \$13,793. Approximately \$6,424 of cash was used for working capital due mainly to a decrease in inventories, offset by increases in accounts receivable due to timing of orders and a decrease in accounts payable.

We used \$1,999 in cash for investing activities during 2011 compared with \$1,951 in cash used for investing activities in 2010. 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 \$28 in cash proceeds from dispositions of property, plant and equipment and \$298 relating to the reduction of the UK restricted

cash. In 2010, we spent \$1,762 to purchase plant, property and equipment, \$464 was used to establish a restricted cash fund in connection with our U.K. operations, and \$137 was used in connection with the contingent purchase price payout related to RPS. In addition, we received \$445 in cash proceeds from dispositions of property, plant and equipment.

During 2011, we used \$8,604 in funds from financing activities compared to the use of \$10,629 in funds in 2010. 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. The financing activities in 2010 included outflows of \$6,959 for repayments on the revolver portion of our primary credit facilities, \$3,574 for principal payments on debt and capital lease obligations, \$151 relating to discontinued operations and an inflow of cash from stock option exercises of \$55.

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, 2011 and 2010, we continue to have significant U.S. NOL's available to us to utilize as an offset to taxable income. As of December 31, 2011, 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, 2011 averaged 3.0 turns compared to 3.4 turns for 2010. The decrease in this metric is mainly due to a buildup of amplifier inventory in the fourth quarter of 2011 in anticipation of a Communication Systems international contract that was announced by us on January 31, 2012, as well as the buildup of inventory for a major defense contractor order which was shipped in January 2012.

Our order backlog at December 31, 2011 was approximately \$24,110, lower than in prior years, mostly due to continued delays in government orders and the completion of SATCOM systems orders in 2011. The majority of the backlog was related to orders that are expected to ship throughout 2012.

As of December 31, 2011, we had made commitments to purchase approximately \$849 of production machinery and equipment, which we expect to fund through operating cash flows or the use of debt.

#### *Potential Commitments*

In connection with our acquisition of Stationary Power on November 16, 2007, the purchase agreement specified an adjustment mechanism based upon Stationary Power's closing date net worth balance relative to a previously-agreed amount of \$500. The final net value of the "Net Worth", under the stock purchase agreement, was \$339, resulting in a revised initial purchase price of \$9,839. In addition, there is a contingent payout of up to 100,000 shares of our common stock to be earned upon the achievement of certain post-acquisition annual sales milestones through the measurement period ended December 31, 2012. Through the year ended December 31, 2011, we have issued no shares of our common stock relating to this contingent consideration, and since we have discontinued the services offered by Stationary Power, we do not expect to make any contingent payments.

#### *Debt and Lease Commitments*

On February 17, 2010, we entered into a new senior secured asset based revolving credit facility ("Credit Facility") of up to \$35,000 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 has a maturity date of February 17, 2013 ("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 amounts of eligible accounts receivable and eligible inventory. Available borrowings under the Credit Facility equals the lesser of (1) \$35,000 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:

<u>Excess Availability</u>	<u>LIBOR Rate Plus</u>
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%

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.

In addition to paying interest on the outstanding principal under the Credit Facility, we are required to pay an unused line fee of 0.50% on the unused portion of the \$35,000 Credit Facility. 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, 2011, our fixed charge ratio was 3.41 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, 2011, we had \$0- outstanding under the Credit Facility. At December 31, 2011, the interest rate on the asset based revolver component of the Credit Facility was 3.27%. As of December 31, 2011, the revolver arrangement had approximately \$14,078 of borrowing capacity, including outstanding letters of credit. At December 31, 2011, 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.

#### *Equity Transactions*

In October 2008, the Board of Directors authorized a share repurchase program of up to \$10,000 to be implemented over the course of a six-month period. Repurchases were made from time to time at management's discretion, either in the open market or through privately negotiated transactions. The repurchases were made in compliance with Securities and Exchange Commission guidelines and were subject to market conditions, applicable legal requirements, and other factors. We had no obligation under the program to repurchase shares and the program could have been suspended or discontinued at any time without prior notice. We funded the purchase price for shares acquired primarily with current cash on hand and cash generated from operations, in addition to borrowing from our credit facility, as necessary. We spent \$5,141 to repurchase 628,413 shares of common stock, at an average price of approximately \$8.15 per share, under this share repurchase program. During the first quarter of 2009, we repurchased 416,305 shares of common stock at an average price of approximately \$7.99 per share, under this share repurchase program; all other share repurchases were made in the fourth quarter of 2008. In April 2009, this share repurchase program expired.

In some of our recent acquisitions, we utilized securities as consideration in these transactions in part to reduce the need to draw on the liquidity provided by our cash and cash equivalents and revolving credit facility.

See Note 7 in the Notes to Consolidated Financial Statements for additional information.

## Other Matters

We continually explore various sources of liquidity to ensure financing flexibility, including leasing alternatives, issuing new or refinancing existing debt, and raising equity through private or public offerings. Although we stay abreast of such financing alternatives, we believe we have the ability during the next 12 months to finance our operations primarily through internally generated funds or through the use of additional financing that currently is available to us. In the event that we are unable to finance our operations with the internally generated funds or through the use of additional financing that currently is available to us, we may need to seek additional credit or access capital markets for additional funds.

If we are unable to achieve our plans or unforeseen events occur, we may need to implement alternative plans in addition to plans that we have already initiated. While we believe we can complete our original plans or alternative plans, if necessary, there can be no assurance that such alternatives would be available on acceptable terms and conditions or that we would be successful in our implementation of such plans.

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.

## Contractual Obligations

	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations:					
Long-Term Debt Obligations	\$ -	\$ -	\$ -	\$ -	\$ -
Capital Lease Obligations	-	-	-	-	-
Operating Lease Obligations	2,003	855	825	323	-
Purchase Obligations	<u>14,745</u>	<u>14,745</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 16,748</u>	<u>\$ 15,600</u>	<u>\$ 825</u>	<u>\$ 323</u>	<u>\$ -</u>

Purchase obligations consist of commitments for property, plant and equipment, open purchase orders for materials and supplies, and other general commitments for various service contracts.

## 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.

**Service Contracts** – Revenue from the sale of installation services is recognized upon customer acceptance, generally the date of installation. Revenue from fixed price engineering contracts is recognized on a proportional method, measured by the percentage of actual costs incurred to total estimated costs to complete the contract. Revenue from time and material engineering contracts is recognized as work progresses through monthly billings of time and materials as they are applied to the work pursuant to the terms in the respective contract. Revenue from

customer maintenance agreements is recognized using the straight-line method over the term of the related agreements, which range from six months to three years.

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. This qualitative review is not applied to our other indefinite-lived intangible assets.

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 relief from a royalty income valuation approach.

We conduct our annual impairment analysis for goodwill and intangible assets with indefinite lives in October of each fiscal year. For 2011, we have identified five goodwill reporting units for analysis. We performed a qualitative analysis for four 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. Due to the narrow margin of passing the impairment testing in 2010, we elected to forego the qualitative assessment and perform quantitative impairment testing on our RedBlack reporting unit. Although this analysis did not indicate impairment, the margin of passing was again narrow for our 2011 analysis. As a result, a potential full or partial impairment may occur in 2012 if the projected operating results are not achieved or if we cannot sell the reporting unit for at least its carrying value. One of the key assumptions for achieving the projected operational results includes significant revenue growth. Although we are projecting revenue growth, we have determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model. As of December 31, 2011, the RedBlack reporting unit had a goodwill carrying value of \$2,025.

For 2011, 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 2011, there is potential that the McDowell - Communications Systems trademark may become partially or fully impaired in 2012 if the projected revenue targets are not met. As of December 31, 2011, 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 2011, 2010 and 2009, 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 2011. 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. In 2010 and 2009, we reported a valuation allowance for our deferred tax assets in China. As a result of our assessment at December 31, 2011, there is no longer a need to record a valuation allowance for the Chinese deferred tax assets as we determined that it is more likely than not that they will be realized. We are more likely than not to fully utilize the NOL in China and therefore have removed the immaterial valuation allowance during 2011. We continually assess the carrying value of this asset based on relevant accounting standards.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to various market risks in the normal course of business, primarily interest rate risk and foreign currency risk. Our primary interest rate risk is derived from our outstanding variable-rate credit facility. In connection with our credit facility with RBS, at December 31, 2011, the interest rate is variable based on LIBOR plus 3.00%. The impact of a one percentage point change in the interest rate associated with the RBS credit facility would not have a material impact on our interest expense.

We are subject to foreign currency risk, due to fluctuations in currencies relative to the U.S. dollar. In the year ended December 31, 2011, approximately 89.7% of our sales were denominated in U.S. dollars. The remainder of our sales was denominated in U.K. pounds sterling, euros, Australian dollars, Canadian dollars, Indian rupee and Chinese yuan renminbi. A 10% change in the value of the pound sterling, the euro, Australian dollar, Canadian dollar, the rupee or the yuan renminbi to the U.S. dollar would have impacted our revenues during such period by approximately 1.0%. We monitor the relationship between the U.S. dollar and other currencies on a continuous basis and adjust sales prices for products and services sold in these foreign currencies as appropriate to safeguard against the fluctuations in the currency relative to the U.S. dollar.

We currently do not utilize derivative or other similar financial instruments to hedge our interest rate or foreign currency risks.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

46. The financial statements and schedules listed in Item 15(a)(1) and (2) are included in this Report beginning on page

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Consolidated Financial Statements:	
Consolidated Balance Sheets as of December 31, 2011 and 2010	46
Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009	47
Consolidated Statements of Changes in Shareholders' Equity and Accumulated Other Comprehensive Income (Loss) for the years ended December 31, 2011, 2010 and 2009	48
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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Ultralife Corporation  
Newark, New York

We have audited the accompanying consolidated balance sheets of Ultralife Corporation as of December 31, 2011 and 2010 and the related consolidated statements of operations, changes in shareholders' equity and accumulated other comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of Ultralife Corporation's management. Our responsibility is to express an opinion on these financial statements and schedule 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. 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, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Ultralife Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 13, 2012 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Troy, Michigan  
March 13, 2012

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

	December 31,	
ASSETS	2011	2010
<b>Current assets:</b>		
Cash and cash equivalents	\$ 5,320	\$ 4,641
Restricted cash	166	464
Trade accounts receivable, net of allowance for doubtful accounts of \$683 and \$490, respectively	19,903	34,270
Inventories	34,967	33,122
Due from insurance company	1,730	1,000
Deferred tax asset - current	161	208
Income taxes receivable	220	-
Prepaid expenses and other current assets	1,766	1,949
	64,233	75,654
<b>Property, plant and equipment, net</b>	<b>12,588</b>	<b>14,485</b>
<b>Other assets:</b>		
Goodwill	18,356	18,276
Intangible assets, net	5,533	6,150
Security deposits and other long-term assets	105	270
	23,994	24,696
Total Assets	\$ 100,815	\$ 114,835
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Current portion of debt and capital lease obligations	\$ -	\$ 8,717
Accounts payable	13,766	16,338
Income taxes payable	11	54
Accrued compensation	1,394	1,701
Accrued vacation	784	681
Deferred revenue	1,786	2,887
Deferred tax liability - current	187	-
Other current liabilities	5,230	5,967
Total current liabilities	23,158	36,345
<b>Long-term liabilities:</b>		
Debt and capital lease obligations	-	251
Deferred tax liability - long-term	4,170	3,906
Other long-term liabilities	261	538
Total long-term liabilities	4,431	4,695
<b>Commitments and contingencies (Note 6)</b>		
<b>Shareholders' equity:</b>		
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 - 18,716,921 and 18,639,683, respectively	1,874	1,865
Capital in excess of par value	172,309	171,020
Accumulated other comprehensive income (loss)	(985)	(1,262)
Accumulated deficit	(92,280)	(90,200)
	80,918	81,423
Less --Treasury stock, at cost - 1,372,757 and 1,371,900 shares outstanding, respectively	7,658	7,652
Total Ultralife equity	73,260	73,771
Noncontrolling interest	(34)	24
Total shareholders' equity	73,226	73,795
Total Liabilities and Shareholders' Equity	\$ 100,815	\$ 114,835

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

ULTRALIFE CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Per Share Amounts)

	Years Ended December 31,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Revenues</b>	\$ 139,386	\$ 166,819	\$ 154,295
<b>Cost of products sold</b>	<u>103,993</u>	<u>120,163</u>	<u>118,986</u>
<b>Gross profit</b>	<u>35,393</u>	<u>46,656</u>	<u>35,309</u>
<b>Operating expenses:</b>			
Research and development (including \$313, \$409 and \$448 of amortization of intangible assets, respectively)	8,595	8,755	9,451
Selling, general, and administrative (including \$314, \$408 and \$496 of amortization of intangible assets, respectively)	<u>24,323</u>	<u>26,039</u>	<u>29,407</u>
<b>Total operating expenses</b>	<u>32,918</u>	<u>34,794</u>	<u>38,858</u>
<b>Operating income (loss)</b>	2,475	11,862	(3,549)
<b>Other income (expense):</b>			
Interest income	5	-	21
Interest expense	(559)	(1,138)	(1,452)
Miscellaneous	<u>171</u>	<u>145</u>	<u>(23)</u>
<b>Income (loss) from continuing operations before income taxes</b>	<u>2,092</u>	<u>10,869</u>	<u>(5,003)</u>
Income tax provision (benefit) - current	32	(557)	31
Income tax provision - deferred	<u>496</u>	<u>258</u>	<u>171</u>
Total income taxes provision (benefit)	<u>528</u>	<u>(299)</u>	<u>202</u>
<b>Net income (loss) from continuing operations</b>	1,564	11,168	(5,205)
<b>Discontinued operations:</b>			
Loss from discontinued operations, net of tax	<u>(3,702)</u>	<u>(17,377)</u>	<u>(4,026)</u>
<b>Net income (loss)</b>	(2,138)	(6,209)	(9,231)
Net (income) loss attributable to noncontrolling interest	<u>58</u>	<u>30</u>	<u>(10)</u>
<b>Net income (loss) attributable to Ultralife</b>	<u>\$ (2,080)</u>	<u>\$ (6,179)</u>	<u>\$ (9,241)</u>
<b>Net income (loss) attributable to Ultralife common shareholders - basic</b>			
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)
Discontinued operations	<u>\$ (0.21)</u>	<u>\$ (1.01)</u>	<u>\$ (0.23)</u>
Total	<u>\$ (0.12)</u>	<u>\$ (0.36)</u>	<u>\$ (0.54)</u>
<b>Net income (loss) attributable to Ultralife common shareholders - diluted</b>			
Continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)
Discontinued operations	<u>\$ (0.21)</u>	<u>\$ (1.01)</u>	<u>\$ (0.23)</u>
Total	<u>\$ (0.12)</u>	<u>\$ (0.36)</u>	<u>\$ (0.54)</u>
<b>Weighted average shares outstanding - basic</b>	<u>17,304</u>	<u>17,157</u>	<u>16,989</u>
<b>Weighted average shares outstanding - diluted</b>	<u>17,336</u>	<u>17,166</u>	<u>16,989</u>

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

ULTRALIFE CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)  
(Dollars in Thousands, Except Per Share Amounts)

	Common Stock		Capital in excess of Par Value	Accumulated Other Comprehensive Income (Loss)			Treasury Stock	Noncontrolling Interest	Total
	Number of Shares	Amount		Foreign Currency Translation Adjustment	Other Unrealized Net Gain (Loss)	Accumulated Deficit			
Balance as of December 31, 2008	18,227,009	\$ 1,815	\$ 167,259	\$ (1,918)	\$ (12)	\$ (74,780)	\$ (4,232)	\$ 21	\$ 88,153
Comprehensive loss:									
Net loss						(9,241)		10	(9,231)
Other comprehensive income (loss):									
Foreign currency translation adjustments				662					662
Unrealized loss on interest rate swap arrangements					12				12
Other comprehensive income									674
Comprehensive loss									(8,557)
Investment in India JV by noncontrolling interest								23	23
Short-swing profit recovery			6						6
Stock-based compensation related to stock options			964				-		964
Shares issued and compensation under restricted stock grants	7,756	-	100						100
Shares purchased in connection with stock repurchase program	-	-	-				(3,326)		(3,326)
Shares issued in connection with AMTI acquisition	21,340	2	134						136
Shares issued to directors	46,339	5	261						266
Shares issued under stock option and warrant exercises	82,472	9	340						349
Balance as of December 31, 2009	18,384,916	\$ 1,831	\$ 169,064	\$ (1,256)	\$ -	\$ (84,021)	\$ (7,558)	\$ 54	\$ 78,114
Comprehensive loss:									
Net loss						(6,179)		(30)	(6,209)
Other comprehensive income (loss):									
Foreign currency translation adjustments				(6)					(6)
Other comprehensive loss									(6)
Comprehensive loss									(6,215)
Stock-based compensation related to stock options			670				-		670
Shares issued (cancelled) and compensation under restricted stock grants	(27,535)	-	92				(94)		(2)
Shares issued in connection with US Energy acquisition contingent earn-out	200,000	20	838						858
Shares issued to directors	66,301	13	302						315
Shares issued under stock option and warrant exercises	16,001	1	54						55
Balance as of December 31, 2010	18,639,683	\$ 1,865	\$ 171,020	\$ (1,262)	\$ -	\$ (90,200)	\$ (7,652)	\$ 24	\$ 73,795
Comprehensive loss:									
Net loss						(2,080)		(58)	(2,138)
Other comprehensive income (loss):									
Foreign currency translation adjustments				277					277
Other comprehensive income									277
Comprehensive loss									(1,861)
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, 2010	18,716,921	\$ 1,874	\$ 172,309	\$ (985)	\$ -	\$ (92,280)	\$ (7,658)	\$ (34)	\$ 73,226

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,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>OPERATING ACTIVITIES</b>			
Net loss	\$ (2,138)	\$ (6,209)	\$ (9,231)
Loss from discontinued operations, net of tax	3,702	17,377	4,026
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:			
Depreciation and amortization of financing fees	3,692	3,705	3,866
Amortization of intangible assets	627	817	944
(Gain) loss on long-lived asset disposal and write-offs	76	(217)	79
Foreign exchange (gain) loss	(95)	(124)	49
Gain on litigation settlement	-	-	(1,256)
Non-cash stock-based compensation	1,225	1,077	1,330
Changes in deferred income taxes	496	258	171
Provision for loss on accounts receivable	237	(216)	188
Provision for inventory obsolescence	1,537	387	1,123
Provision for warranty charges	591	602	436
Provision for workers' compenstion obligation	(217)	(303)	170
Changes in operating assets and liabilities:			
Accounts receivable	14,081	(3,096)	(125)
Inventories	(5,453)	2,113	5,527
Income taxes receivable	(220)	-	-
Prepaid expenses and other current assets	232	(737)	(99)
Insurance receivable relating to fires	(1,730)	-	-
Income taxes payable	(43)	26	(554)
Accounts payable and other liabilities	(5,677)	(4,730)	(4,829)
Net cash provided by operating activities from continuing operations	<u>10,923</u>	<u>10,730</u>	<u>1,815</u>
Net cash provided by operating activities from discontinued operations	39	179	217
Net cash provided by operating activities	<u>10,962</u>	<u>10,909</u>	<u>2,032</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of property and equipment	(2,362)	(1,762)	(1,820)
Proceeds from asset disposal	28	445	-
Change in restricted cash	298	(464)	-
Payment for acquired companies, net of cash acquired	(50)	(137)	(6,766)
Net cash used in investing activities from continuing operations	<u>(2,086)</u>	<u>(1,918)</u>	<u>(8,586)</u>
Net cash provided from (used in) investing activities from discontinued operations	87	(33)	(215)
Net cash used in investing activities	<u>(1,999)</u>	<u>(1,951)</u>	<u>(8,801)</u>
<b>FINANCING ACTIVITIES</b>			
Net change in revolving credit facilities	(8,541)	(6,959)	15,500
Proceeds from issuance of common stock	73	55	349
Proceeds from issuance of debt	-	-	751
Principal payments on debt and capital lease obligations	(8)	(3,574)	(2,359)
Purchase of treasury stock	-	-	(3,326)
Short-swing profit recovery	-	-	6
Net cash used in financing activities from continuing operations	<u>(8,476)</u>	<u>(10,478)</u>	<u>10,921</u>
Net cash used in financing activities from discontinued operations	(128)	(151)	(160)
Net cash used in financing activities	<u>(8,604)</u>	<u>(10,629)</u>	<u>10,761</u>
Effect of exchange rate changes on cash	<u>320</u>	<u>218</u>	<u>224</u>
Change in cash and cash equivalents	679	(1,453)	4,216
Cash and cash equivalents at beginning of period	<u>4,641</u>	<u>6,094</u>	<u>1,878</u>
Cash and cash equivalents at end of period	<u>\$ 5,320</u>	<u>\$ 4,641</u>	<u>\$ 6,094</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>			
Cash paid for interest	<u>\$ 413</u>	<u>\$ 845</u>	<u>\$ 1,289</u>
Cash paid for income taxes	<u>\$ 295</u>	<u>\$ 1</u>	<u>\$ 605</u>
Noncash investing and financing activities:			
Issuance of common stock for acquired companies	<u>\$ -</u>	<u>\$ 858</u>	<u>\$ -</u>
Purchase of property and equipment via capital lease payable	<u>\$ -</u>	<u>\$ 303</u>	<u>\$ 102</u>

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

**Note 1 - Summary of Operations and Significant Accounting Policies**

a. *Description of Business*

We offer products and services ranging from portable and standby 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 and solutions. We sell our products worldwide through a variety of trade channels, including original equipment manufacturers (“OEMs”), industrial and retail distributors, national retailers 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), RedBlack Communications, Inc. (“RedBlack”) and Ultralife Energy Services Corporation (“UES”), and our majority-owned subsidiary Ultralife Batteries India Private Limited (“India JV”). Intercompany accounts and transactions have been eliminated in consolidation. Investments in entities in which we do not have a controlling interest are accounted for using the equity method, if our interest is greater than 20%. Investments in entities in which we have less than a 20% ownership interest are accounted for using the cost method.

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*

We extend credit to our customers in the normal course of business. We perform ongoing credit evaluations and generally do not require collateral. Trade accounts receivable are recorded at their invoiced amounts, net of allowance for doubtful accounts. We evaluate the adequacy of our allowance for doubtful accounts quarterly. Accounts outstanding longer than contractual payment terms are considered past due and are reviewed individually for collectability. We maintain reserves for potential credit losses based upon our loss history and specific receivables aging analysis. Receivable balances are written off when collection is deemed unlikely.



Changes in our allowance for doubtful accounts during the years ended December 31, 2011, 2010 and 2009 were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year	\$ 490	\$1,024	\$1,086
Amounts charged (credited) to expense	237	(216)	188
Amounts credited to other accounts	(2)	(7)	(42)
Uncollectible accounts written-off, net of recovery	(42)	(311)	(208)
Balance at end of year	<u>\$ 683</u>	<u>\$ 490</u>	<u>\$1,024</u>

g. *Inventories*

Inventories are stated at the lower of cost or market with cost determined under the first-in, first-out (FIFO) method. We record provisions for excess, obsolete or slow-moving inventory based on changes in customer demand, technology developments or other economic factors.

h. *Property, Plant and Equipment*

Property, plant and equipment are stated at cost. Estimated useful lives are as follows:

Buildings	10 – 20 years
Machinery and Equipment	5 – 10 years
Furniture and Fixtures	3 – 10 years
Computer Hardware and Software	3 – 5 years
Leasehold Improvements	Lesser of useful life or lease term

Depreciation and amortization are computed using the straight-line method. Betterments, renewals and extraordinary repairs that extend the life of the assets are capitalized. Other repairs and maintenance costs are expensed when incurred. When disposed, the cost and accumulated depreciation applicable to assets retired are removed from the accounts and the gain or loss on disposition is recognized in operating income (expense).

i. *Long-Lived Assets, Goodwill and Intangibles*

We regularly assess all of our long-lived assets for impairment when events or circumstances indicate that their carrying amounts may not be recoverable. For property, plant and equipment and amortizable intangible assets, 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. As a result of this assessment, we recognized a non-cash impairment of \$269 and \$4,250 in property, plant and equipment and amortizable intangible assets, respectively, in the year ended December 31, 2010. (See Note 3 for additional information.) We did not record any material impairments of long-lived assets in the years ended December 31, 2011 and 2009.

In accordance with the Financial Accounting Standards Board's ("FASB") guidance for goodwill and other intangible assets, we do not amortize goodwill and intangible assets with indefinite lives, but instead measure 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. This qualitative review is not applied to our other indefinite-lived intangible assets.

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 relief from a royalty income valuation approach.

As a result of this assessment, we recognized a non-cash impairment of \$7,974 and \$1,300 in goodwill and intangible assets with indefinite lives, respectively, in the year ended December 31, 2010. (See Note 3 for additional information.) There were no impairments of goodwill and intangible assets with indefinite lives in the years ended December 31, 2011 and 2009.

Based on the final valuations for amortizable intangible assets acquired in the AMTI acquisition during 2009, and the ABL and McDowell acquisitions during 2006, we project our amortization expense will be approximately \$496, \$401, \$308, \$228 and \$167 for the fiscal years ending December 31, 2012 through 2016, respectively.

j. *Translation of Foreign Currency*

The financial statements of our foreign affiliates are translated into U.S. dollar equivalents in accordance with FASB's guidance for foreign currency translation, with translation adjustments recorded as a component of accumulated other comprehensive income. Exchange gains (losses) relate to foreign currency transactions included in net income (loss) for the years ended December 31, 2011, 2010 and 2009 were \$95, \$124, and \$(49), respectively.

k. *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 the 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.

Services – Revenue from the sale of installation services is recognized upon customer acceptance, generally the date of installation. Revenue from fixed price engineering contracts is recognized on a proportional method, measured by the percentage of actual costs incurred to total estimated costs to complete the contract. Revenue from time and material engineering contracts is recognized as work progresses through monthly billings of time and materials as they are applied to the work pursuant to the terms in the respective contract. Revenue from customer maintenance agreements is recognized using the straight-line method over the term of the related agreements, which range from six months to three years.

Technology Contracts – We recognize revenue using the proportional effort method based on the relationship of costs incurred to date to the total estimated cost 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.

l. *Warranty Reserves*

We estimate future costs associated with expected product failure rates, material usage and service costs in the development of our warranty obligations. Warranty reserves, included in other current liabilities and other long-term liabilities as applicable on our Consolidated Balance Sheets, are based on historical experience of warranty claims. In the event the actual results of these items differ from the estimates, an adjustment to the warranty obligation would be recorded.

m. *Shipping and Handling Costs*

Costs incurred by us related to shipping and handling are included in cost of products sold. Amounts charged to customers pertaining to these costs are reflected as revenue.

n. *Advertising Expenses*

Advertising costs are expensed as incurred and are included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations. Such expenses amounted to \$792, \$1,200, and \$1,090 for the years ended December 31, 2011, 2010 and 2009, respectively.

o. *Research and Development*

Research and development expenditures are charged to operations as incurred. The majority of research and development expenses pertain to salaries and benefits, developmental supplies, depreciation and other contracted services.

In 2011, we entered into a collaboration agreement with The New York State Energy Research and Development Authority (“NYSERDA”), to develop and demonstrate a large hybrid grid-connected energy storage system. As part of this agreement, we will construct and use a prototype energy storage system at our Corporate Headquarters in Newark, New York. Pursuant to the terms of the agreement, NYSERDA will reimburse us for certain construction and project research and development costs. During the year ended December 31, 2011, recoveries from NYSERDA for construction costs and project research and development costs were \$254 and \$56, respectively, and are reflected in the property, plant and equipment, net line on our Consolidated Balance Sheets as of December 31, 2011 and the research and development line on our Consolidated Statements of Operations for the year ended December 31, 2011, respectively.

p. *Environmental Costs*

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.

q. *Income Taxes*

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

A valuation allowance is required when it is more likely than not that the recorded value of a deferred tax asset will not be realized. As of December 31, 2011, we continued to recognize a valuation allowance on our net deferred tax asset to the extent they are not able to be offset by future reversing temporary differences, based on a consistent evaluation methodology that was used for 2009 and 2010. The assessment of the realizability of the U.S. NOL 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 2011. 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. For the years ended December 31, 2009 and 2010, we also recorded a valuation allowance on our net deferred tax asset. A valuation allowance was required for the years ended December 31, 2011, 2010 and 2009 related to our U.K. subsidiary due to the history of losses at that facility. A valuation allowance was required for the years ended December 31, 2010 and 2009 related to our ABLE subsidiary due to the history of losses at that facility. For the year ended December 31, 2011, we determined that it is more likely than not that we will fully utilize the NOL related to our ABLE subsidiary and therefore have removed the immaterial valuation allowance during 2011.

We have adopted the provisions of FASB’s guidance for the Accounting for Uncertainty in Income Taxes. We have recorded no liability for income taxes associated with unrecognized tax benefits during 2009 and 2010. In 2011, we had unrecognized tax benefits related to uncertain tax positions which have been recorded as a decrease in our NOL. We have not recorded any interest or penalty in regard to any unrecognized benefit. Interest and penalties would begin to

accrue in the period in which the NOL's related to the uncertain tax positions are utilized. Our policy regarding interest and/or penalties related to income tax matters is to recognize such items as a component of income tax expense (benefit).

r. *Concentration Related to Customers and Suppliers*

During the year ended December 31, 2011, we had one major customer, Harris Corporation which comprised 21% of our revenue. During the year ended December 31, 2010, we had two major customers, U.S. Department of Defense and Port Electronics Corp., which comprised 12% and 11% of our revenue, respectively. During the year ended December 31, 2009, we had two major customers, the U.S. Department of Defense and Harris Corporation, which comprised 29% and 11% of our revenue, respectively. There were no other customers that comprised greater than 10% of our total revenues during the years ended December 31, 2011, 2010 and 2009.

We have no customers that comprised greater than 10% of our trade accounts receivables as of December 31, 2011 and 2010.

Currently, we do not experience significant seasonal trends in our revenues. However, a downturn in the U.S. economy, such as the one that we recently experienced, or lower demand from the U.S., U.K. and other foreign governments could result in lower sales.

We generally do not distribute our products to a concentrated geographical area nor is there a significant concentration of credit risks arising from individuals or groups of customers engaged in similar activities, or who have similar economic characteristics. While sales to the U.S. Department of Defense have been substantial during 2011, 2010 and 2009, we do not consider this customer to be a significant credit risk. We do not normally obtain collateral on trade accounts receivable.

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. 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.

s. *Fair Value Measurements and Disclosures*

The FASB guidance for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. This accounting standard established a fair value hierarchy, which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required.

**Level 1:** Quoted prices in active markets for identical assets or liabilities.

**Level 2:** Observable inputs, other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or that we corroborate with observable market data for substantially the full term of the related assets or liabilities.

**Level 3:** Unobservable inputs supported by little or no market activity that are significant to the fair value of the assets or liabilities.

FASB's guidance for the disclosure regarding fair value of financial instruments requires disclosure of an estimate of the fair value of certain financial instruments. The fair value of financial instruments pursuant to FASB's guidance for the disclosure regarding fair value of financial instruments approximated their carrying values at December 31, 2011 and 2010. The fair value of cash, trade accounts receivable, trade accounts payable, accrued liabilities, and our revolving credit facility approximates carrying value due to the short-term nature of these instruments. The estimated fair value of other long-term debt and capital lease obligations approximates carrying value due to the variable nature of the interest rates or the stated interest rates approximating current interest rates that are available for debt with similar terms.

t. *Earnings (Loss) Per Share*

On January 1, 2009, we adopted the provisions of FASB’s guidance for determining whether instruments granted in share-based payment transactions are participating securities. The guidance requires that all outstanding unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (such as restricted stock awards granted by us) be considered participating securities. Because the 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”). The retrospective application of the provisions of FASB’s guidance did not change the prior period earnings per share (“EPS”) amount.

Basic EPS is determined using the Two-Class Method and is computed by dividing earnings attributable to Ultralife common shareholders by the weighted-average shares outstanding during the period. The Two-Class Method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Diluted EPS includes the dilutive effect of securities, if any, and reflects the more dilutive EPS amount calculated using the treasury stock method or the Two-Class Method. For the years ended December 31, 2011, 2010 and 2009, both the Two-Class Method and the treasury stock method calculations for diluted EPS yielded the same result.

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

	Years Ended December 31,		
	2011	2010	2009
Net Income (Loss) from continuing operations attributable to Ultralife	\$ 1,622	\$ 11,198	\$ (5,215)
Net Income (Loss) from continuing operations attributable to participating securities (unvested restricted stock awards) (3,000, 18,000 and -0-shares, respectively)	-	(12)	-
Net Income (Loss) from continuing operations attributable to Ultralife common shareholders (a)	1,622	11,186	(5,215)
Effect of Dilutive Securities:			
Convertible Notes Payable	-	-	-
Net Income (Loss) from continuing operations attributable to Ultralife common shareholders – Adjusted (b)	<u>\$ 1,622</u>	<u>\$ 11,186</u>	<u>\$ (5,215)</u>
Net Income (Loss) from discontinued operations attributable to Ultralife common shareholders (c)	\$ (3,702)	\$ (17,377)	\$ (4,026)
Effect of Dilutive Securities:			
Convertible Notes Payable	-	-	-
Net Income (Loss) from discontinued operations attributable to Ultralife common shareholders – Adjusted (d)	<u>\$ (3,702)</u>	<u>\$ (17,377)</u>	<u>\$ (4,026)</u>
Average Common Shares Outstanding – Basic (e)	17,304	17,157	16,989
Effect of Dilutive Securities:			
Stock Options / Warrants	32	9	-
Convertible Notes Payable	-	-	-
Average Common Shares Outstanding – Diluted (f)	<u>17,336</u>	<u>17,166</u>	<u>16,989</u>
EPS – Basic (a/e) – continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)
EPS – Basic (c/e) – discontinued operations	\$ (0.21)	\$ (1.01)	\$ (0.23)
EPS – Diluted (b/f) – continuing operations	\$ 0.09	\$ 0.65	\$ (0.31)
EPS – Diluted (d/f) – discontinued operations	\$ (0.21)	\$ (1.01)	\$ (0.23)

There were 2,105,228 outstanding stock options, warrants and restricted stock awards as of December 31, 2011, that were not included in EPS as the effect would be anti-dilutive. The dilutive effect of 252,218 outstanding stock options, warrants and restricted stock awards were included in the dilution computation for the year ended December 31, 2011.

There were 1,762,265 outstanding stock options, warrants and restricted stock awards as of December 31, 2010, that were not included in EPS as the effect would be anti-dilutive. The dilutive effect of 49,477 outstanding stock options, warrants and restricted stock awards were included in the dilution computation for the year ended December 31, 2010. There were 1,833,134 outstanding stock options, warrants and restricted stock awards as of December 31, 2009, that were not included in EPS as the effect would be anti-dilutive. We also had 236,919 shares of common stock at December 31, 2009 reserved under convertible notes payable, which were not included in EPS as the effect would be anti-dilutive. For the year ended December 31, 2009, diluted earnings (loss) per share was the equivalent of basic earnings (loss) per share due to the net loss.

u. *Stock-Based Compensation*

We have various stock-based employee compensation plans, which are described more fully in Note 7. 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).

v. *Segment Reporting*

We report segment information in accordance with FASB's guidance on Disclosures about Segments of an Enterprise and Related Information. We have two operating segments. The basis for determining our operating segments is the manner in which financial information is used by us in our operations. Management operates and organizes itself according to business units that comprise unique products and services across geographic locations.

On January 1, 2011, we began to report chargers in the Battery & Energy Products segment, to better align the portfolio of chargers with customers for those products and with how we manage our business operations. Previously, we had reported chargers in the Communications Systems segment.

On March 8, 2011, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business, which previously was a stand alone business segment. See Note 2 in these Notes to Condensed Consolidated Financial Statements for additional information.

w. *Recent Accounting Pronouncements*

In September 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-08, "Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment". ASU No. 2011-08 permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. An entity would not be required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for years beginning after December 15, 2011, with early adoption permitted. We adopted this standard during our annual impairment review process in the fourth quarter of 2011. Adoption of this standard did not have a material impact on our consolidated results of operations and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income". ASU No. 2011-05 requires entities to present the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements of net income and other comprehensive income. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, which is our current presentation. Further, in December 2011, the FASB issued ASU No. 2011-12 "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." This update defers the effective date of ASU No. 2011-05's requirement to present on the face of the financial statements reclassification adjustments for each component of accumulated other comprehensive income in both net income and other comprehensive income so that the FASB can reconsider those requirements during calendar 2012. These standards will be effective retrospectively for annual and interim reporting periods beginning after December 15, 2011, with early adoption permitted. The adoption of the standards will only impact the presentation of our consolidated financial statements and is not expected to result in a material impact on our consolidated results of operations and financial condition.

In December 2010, the FASB issued ASU No. 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations - a consensus of the FASB Emerging Issues Task

Force (“EITF”). ASU No. 2010-29 amends accounting guidance concerning disclosure of supplemental pro forma information for business combinations. If an entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred in the current year had occurred as of the beginning of the comparable prior annual reporting period only. The accounting guidance also requires additional disclosures to describe the nature and amount of material, nonrecurring pro forma adjustments. ASU No. 2010-29 became effective for fiscal years beginning on or after December 15, 2010 and applies to business combinations completed on or after that date. The adoption of this pronouncement did not have a significant impact on our financial statements. The future impact of adopting this pronouncement will depend on the future business combinations that we may pursue.

In December 2010, the FASB issued ASU No. 2010-28, “Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts”. ASU No. 2010-28 modifies Step 1 of the goodwill impairment test so that for those reporting units with zero or negative carrying amounts, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not based on an assessment of qualitative indicators that a goodwill impairment exists. In determining whether it is more likely than not that goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. ASU No. 2010-28 became effective for annual and interim reporting periods beginning after December 15, 2010, and any impairment identified at the time of adoption was recognized as a cumulative-effect adjustment to beginning retained earnings. The adoption of this pronouncement did not have a significant impact on our financial statements.

In April 2010, the FASB issued ASU No. 2010-17, “Revenue Recognition - Milestone Method (Topic 605): Milestone Method of Revenue Recognition - a consensus of the FASB EITF”. ASU No. 2010-17 is limited to research or development arrangements and requires that this ASU be met for an entity to apply the milestone method (record the milestone payment in its entirety in the period received) of recognizing revenue. However, the FASB clarified that, even if the requirements in this ASU are met, entities would not be precluded from making an accounting policy election to apply another appropriate policy that results in the deferral of some portion of the arrangement consideration. The guidance in this ASU will apply to milestones in both single-deliverable and multiple-deliverable arrangements involving research or development transactions. ASU No. 2010-17 became effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. The adoption of this pronouncement did not have a significant impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements”, which provides additional guidance to improve disclosures regarding fair value measurements. ASU No. 2010-06 amends Accounting Standards Codification (“ASC”) 820-10 to add two new disclosures: (1) transfers in and out of Level 1 and 2 measurements and the reasons for the transfers, and (2) a gross presentation of activity within the Level 3 roll forward. ASU 2010-06 also includes clarifications to existing disclosure requirements on the level of disaggregation and disclosures regarding inputs and valuation techniques. ASU 2010-06 applies to all entities required to make disclosures about recurring and nonrecurring fair value measurements. ASU No. 2010-06 became effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which became effective for fiscal years beginning after December 15, 2010. The partial adoption of ASU 2010-06, as of January 1, 2010, did not have a material impact on our financial statements. The adoption of the deferred portions of ASU 2010-06, as of January 1, 2011, did not have a material impact on our financial statements.

In October 2009, the FASB issued ASU No. 2009-13, “Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements - a consensus of the FASB EITF”. ASU No. 2009-13 eliminates the residual method of accounting for revenue on undelivered products and instead, requires companies to allocate revenue to each of the deliverable products based on their relative selling price. In addition, this ASU expands the disclosure requirements surrounding multiple-deliverable arrangements. ASU No. 2009-13 became effective for revenue arrangements entered into for fiscal years beginning on or after June 15, 2010. The adoption of this pronouncement did not have a significant impact on our financial statements.

## Note 2- Acquisitions and Dispositions & Exit Activities

### 2011 Activity

#### Ultralife Energy Services Corporation

On March 8, 2011, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business, which included standby power and systems design, installation and maintenance activities. As a result of management's ongoing 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 over the last several years, 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 segment resulted in the elimination of approximately 40 jobs and the closing of five facilities, primarily in California, Florida and Texas, over several months. As of the end of the second quarter of 2011, all exit activities with respect to our Energy Services segment were completed. As a result, the presentation of results herein excludes the Energy Services segment from the results of continuing operations. The following amounts have been reported as discontinued operations for the years ended December 31, 2011, 2010 and 2009:

	Years Ended December 31,		
	2011	2010	2009
Net sales	\$ 3,891	\$ 11,758	\$ 17,814
Loss from discontinued operations	(3,702)	(17,748)	(3,837)
(Provision) Benefit for income taxes	-	371	(189)
Loss from discontinued operations, net of tax	(3,702)	(17,377)	(4,026)

Included in the Loss from discontinued operations described above, we recorded the following exit charges:

	Year Ended December 31, 2011
Inventory and fixed asset write-downs	\$ 941
Employee related, including termination benefits	703
Lease termination costs	250
Other costs	1,030
Total Exit Costs	\$ 2,924
Cash Component	\$ 1,984

### 2009 Activity

We accounted for the following acquisition in accordance with the purchase method of accounting provisions of the revised FASB guidance for 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.

#### AMTI™ Brand

On March 20, 2009, we acquired substantially all of the assets and assumed substantially all of the liabilities of the tactical communications products business of Science Applications International Corporation. The tactical communications products business ("AMTI"), located in Virginia Beach, Virginia, designs, develops and manufactures tactical communications products including amplifiers, man-portable systems, cables, power solutions and ancillary communications equipment that are sold by Ultralife Corporation under the brand name of AMTI.

Under the terms of the asset purchase agreement for AMTI, the purchase price consisted of \$5,717 in cash.

The results of operations of AMTI and the estimated fair value of assets acquired and liabilities assumed were included in our Condensed Consolidated Financial Statements beginning on the acquisition date. For the year ended December 31, 2010, AMTI contributed net sales of \$14,001 and net income of \$2,134. From the date of acquisition through



December 31, 2009, AMTI contributed net sales of \$11,354 and net income of \$1,744. Pro forma information has not been presented, as it would not be materially different from amounts reported. The estimated excess of the purchase price over the net tangible and intangible assets acquired of \$4,684 was recorded as goodwill in the amount of \$1,033. The acquired goodwill has been assigned to the Communications Systems segment 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:

<b>ASSETS</b>	
Current assets:	
Cash	\$ -
Trade accounts receivable, net	693
Inventories	2,534
Total current assets	<u>3,227</u>
Property, plant and equipment, net	339
Goodwill	1,033
Intangible Assets:	
Trademarks	450
Patents and Technology	800
Customer Relationships	970
Total assets acquired	<u>6,819</u>
<b>LIABILITIES</b>	
Current liabilities:	
Accounts payable	801
Other current liabilities	301
Total current liabilities	<u>1,102</u>
Long-term liabilities:	
Other long-term liabilities	-
Total liabilities assumed	<u>1,102</u>
Total Purchase Price	<u>\$ 5,717</u>

Trademarks have an indefinite life and are not being amortized. The intangible assets related to patents and technology and customer relationships are being amortized as the economic benefits of the intangible assets are being utilized over their weighted-average estimated useful life of thirteen years.

### Note 3 - Supplemental Balance Sheet Information

a. *Inventory*

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:

	<b>December 31,</b>	
	<b><u>2011</u></b>	<b><u>2010</u></b>
Raw materials .....	\$20,097	\$18,250
Work in process.....	4,770	6,649
Finished products .....	10,100	8,223
	<u>\$34,967</u>	<u>\$33,122</u>

b. *Property, Plant and Equipment*

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

	<b>December 31,</b>	
	<b><u>2011</u></b>	<b><u>2010</u></b>
Land .....	\$ 123	\$ 123
Buildings and Leasehold Improvements.....	7,000	6,188
Machinery and Equipment .....	44,770	45,714
Furniture and Fixtures .....	1,894	1,702
Computer Hardware and Software.....	3,815	3,652
Construction in Progress .....	641	582
	<hr/>	<hr/>
	58,243	57,961
Less: Accumulated Depreciation .....	45,655	43,476
	<hr/>	<hr/>
	\$ 12,588	\$ 14,485

Estimated costs to complete construction in progress as of December 31, 2011 and 2010 was approximately \$1,032 and \$372, respectively.

Depreciation expense was \$3,629, \$3,768, and \$3,929 for the years ended December 31, 2011, 2010, and 2009, respectively.

c. *Impairment of Goodwill, Intangible Assets and Long-Lived Assets*

We applied the provisions of FASB ASC Topic 820, including the early adoption of ASU 2011-08 described in Note 1, during the annual goodwill impairment analysis performed in October 2011. The first, optional, step of the goodwill analysis is to determine if it is more likely than not that the fair value of the identified reporting units exceeds the respective carrying value. This qualitative analysis 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. We performed the qualitative assessment on four out of five of the identified reporting units noting that no further testing was indicated. If a reporting unit does not pass or is not subjected to the qualitative assessment, the fair value of the reporting unit is determined when performing the quantitative assessment. The fair value for our one reporting unit subjected to this quantitative test could not be determined using readily available quoted Level 1 inputs or Level 2 inputs that were observable in active markets. Therefore, we used an income approach, to estimate the fair value of the reporting unit, using Level 3 inputs. To estimate the fair value of the reporting unit, we used significant estimates and judgmental factors. The key estimates and factors used in the valuation model included revenue growth rates and profit margins based on internal forecasts, as well as industry and market based terminal growth rates, inputs to the weighted-average cost of capital used to discount future cash flows, and earnings multiples. As a result of the goodwill impairment test performed during 2011, no impairment was indicated. The fair value measurements of the reporting units included unobservable inputs defined above that are classified as Level 3 inputs.

During 2011, we also evaluated our indefinite lived intangible assets for impairment utilizing valuation methods that are classified as Level 3 inputs. Based upon the results of this evaluation, no impairment was indicated.

During 2011, we also evaluated certain fixed assets for impairment utilizing valuation methods that are classified as Level 3 inputs. Based upon the results of this evaluation, no material impairment was indicated.

In the fourth quarter of 2010, we completed an impairment analysis of the goodwill, intangible assets, and other long-lived assets associated with the standby power business included in the Energy Services segment. As a result of this analysis, in connection with the overall decrease in revenues in 2010 compared to 2009 and the declining gross margins over the last two years for the standby power business, we recognized a non-cash impairment charge of \$13,793 in the fourth quarter of 2010 to fully write off the goodwill and intangible assets and partially write off certain fixed assets. In conjunction with the non-cash impairment charge, we impaired goodwill of \$7,974, trademarks of \$1,300, patents and technology of \$431, customer relationships of \$3,819 and fixed assets of \$269.

During 2010, we also recognized non-cash impairments to indefinite lived and amortizable intangible assets. The impairment charges were calculated by determining the fair value of these assets. The fair value measurements were calculated using unobservable inputs including discounted cash flow analyses classified as Level 3 inputs.

We also recognized non-cash impairments of certain fixed assets during the year ended December 31, 2010. The impairment charges were calculated by determining the fair value of the fixed assets using unobservable inputs including market data for transactions involving similar assets. These inputs were classified as Level 3 inputs.

d. *Goodwill*

The following table summarizes the goodwill activity by segment for the years ended December 31, 2011 and 2010:

	<b>Battery &amp; Energy Products</b>	<b>Communications Systems</b>	<b>Discontinued Operations</b>	<b>Total</b>
Balance at December 31, 2009	\$ 4,687	\$ 13,701	\$ 7,048	\$ 25,436
Adjustments to purchase price allocation	-	(183)	926	743
Impairment charge	-	-	(7,974)	(7,974)
Effect of foreign currency translations	71	-	-	71
Balance at December 31, 2010	4,758	13,518	-	18,276
Effect of foreign currency translations	80	-	-	80
Balance at December 31, 2011	\$ 4,838	\$ 13,518	\$ -	\$ 18,356

e. *Other Intangible Assets*

The composition of intangible assets was:

	<b><u>December 31, 2011</u></b>		
	<b><u>Gross Assets</u></b>	<b><u>Accumulated Amortization</u></b>	<b><u>Net</u></b>
Trademarks	\$ 3,563	\$ -	\$ 3,563
Patents and technology	4,492	3,440	1,052
Customer relationships	3,993	3,143	850
Distributor relationships	378	310	68
Non-compete agreements	396	396	-
Total intangible assets	\$ 12,822	\$ 7,289	\$ 5,533
	<b><u>December 31, 2010</u></b>		
	<b><u>Gross Assets</u></b>	<b><u>Accumulated Amortization</u></b>	<b><u>Net</u></b>
Trademarks	\$ 3,559	\$ -	\$ 3,559
Patents and technology	4,474	3,108	1,366
Customer relationships	3,955	2,820	1,135
Distributor relationships	364	274	90
Non-compete agreements	395	395	-
Total intangible assets	\$ 12,747	\$ 6,597	\$ 6,150

Amortization expense for intangible assets was \$627, \$1,428, and \$1,683 for the years ended December 31, 2011, 2010 and 2009, respectively.

The change in the cost value of total intangible assets is a result of the effect of foreign currency translations.

#### Note 4 - Operating Leases

We lease various buildings, machinery, land, automobiles and office equipment. Rental expenses for all operating leases were approximately \$1,494, \$1,479 and \$1,334 for the years ended December 31, 2011, 2010 and 2009, respectively. Future minimum lease payments under non-cancelable operating leases as of December 31, 2011 are as follows:

<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016 and beyond</u>
\$ 855	\$ 490	\$ 335	\$ 258	\$ 65

#### Note 5 - Debt and Capital Leases

##### *Credit Facilities*

On February 17, 2010, we entered into a new senior secured asset based revolving credit facility (“Credit Facility”) of up to \$35,000 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 has a maturity date of February 17, 2013 (“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 amounts of eligible accounts receivable and eligible inventory. Available borrowings under the Credit Facility equals the lesser of (1) \$35,000 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:

<u>Excess Availability</u>	<u>LIBOR Rate Plus</u>
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%

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.

In addition to paying interest on the outstanding principal under the Credit Facility, we are required to pay an unused line fee of 0.50% on the unused portion of the \$35,000 Credit Facility. 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, 2011, our fixed charge ratio was 3.41 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, 2011, we had \$-0- outstanding under the Credit Facility. At December 31, 2011, the interest rate on the asset based revolver component of the Credit Facility was 3.27%. As of December 31, 2011, the revolver arrangement had approximately \$14,078 of borrowing capacity, including outstanding letters of credit. At December 31, 2011, we had \$413 of outstanding letters of credit related to this facility.

#### *Convertible Notes Payable*

On November 16, 2007, under the terms of the stock purchase agreement for Stationary Power Services, Inc. (“SPS”), we issued a \$4,000 subordinated convertible promissory note to be held by the previous owner of SPS for partial consideration of the purchase price. The \$4,000 subordinated convertible promissory note carried a three-year term, bore interest at the rate of 5% per year and was convertible at \$15.00 per share into 266,667 shares of our common stock, with a forced conversion feature at \$17.00 per share. We evaluated the terms of the conversion feature under applicable accounting literature, including FASB’s guidance in accounting for derivative instruments and hedging activities and accounting for derivative financial instruments indexed to, and potentially settled in, a company’s own stock, and concluded that this feature should not be separately accounted for as a derivative. Effective March 28, 2009, we entered into Amended and Restated Subordinated Convertible Promissory Note (“Amended Note”) with William Maher, the former owner of SPS. The Amended Note reduced the principal amount under the original subordinated convertible promissory note (“Original Note”), as issued in connection with the SPS acquisition in November 2007, by \$580 to \$3,420. This reduction was an offset of amounts owed to SPS from WMSP Holdings, LLC (an entity wholly owned by William Maher). There were no other revisions to any of the other terms of the Original Note. In February 2010, in connection with the closing on the new credit facility with RBS, we made a prepayment of \$129 on the outstanding principal balance of the Amended Note. In April 2010, we changed the name of Stationary Power Services, Inc. to Ultralife Energy Services Corporation. The Amended Note matured on November 16, 2010, with principal and accrued interest due in full, totaling \$3,312. We paid the \$3,312 amount primarily from cash on hand and cash generated from operations, in addition to borrowing from our credit facility.

#### **Note 6 - Commitments and Contingencies**

##### a. *Indemnity*

The Delaware General Corporation Law provides that directors or officers will be reimbursed for all expenses, to the fullest extent permitted by law arising out of their performance as our agents or trustees.

##### b. *Purchase Commitments*

As of December 31, 2011, we have made commitments to purchase approximately \$849 of production machinery and equipment.

##### c. *Royalty Agreements*

Technology underlying certain of our products is based in part on non-exclusive transfer agreements. 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 2011, 2010 and 2009 was \$5, \$242 and \$19, respectively. This agreement expires in the year 2017.

d. *Government Grants/Loans*

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

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

e. *Employment Contracts*

We have an employment contract with Michael D. Popielec, our President and Chief Executive Officer, which stays in effect until terminated by either party. This agreement provides for a base salary of \$450,000, as adjusted for increases at the discretion of our Board of Directors, and includes incentive bonuses based upon attainment of specified quantitative and qualitative performance goals. This agreement also provides for severance payments in the event of specified events of termination of employment. In addition, this agreement provides for a lump sum payment in the event of termination of employment in association with a change in control.

We have an employment contract with Peter F. Comerford, our Vice-President of Administration & General Counsel and Secretary, with automatic one-year renewals unless terminated by either party. This agreement provides for a minimum salary, as adjusted for annual increases, and may include incentive bonuses based upon attainment of specified management goals. This agreement also provides for severance payments in the event of specified termination of employment. In addition, this agreement provides for a lump sum payment in the event of termination of employment in association with a change in control.

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.

f. *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 years ended December 31, 2011, 2010 and 2009 were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year	\$1,314	\$1,211	\$1,026
Accruals for warranties issued	591	602	436
Settlements made	(1,066)	(499)	(251)
Balance at end of year	\$ 839	\$1,314	\$1,211

g. *Post Audits of Government Contracts*

We had certain “exigent”, non-bid contracts with the U.S. government, which were subject to audit and final price adjustment, which resulted in decreased margins compared with the original terms of the contracts. As of December 31, 2011, there were no outstanding exigent contracts with the U.S. government. As part of its due diligence, the U.S. government has conducted post-audits of the completed exigent contracts to ensure that information used in supporting the pricing of exigent contracts did not differ materially from actual results. In September 2005, the Defense Contracting Audit Agency (“DCAA”) presented its findings related to the audits of three of the exigent contracts, suggesting a potential pricing adjustment of approximately \$1,400 related to reductions in the cost of materials that occurred prior to the final negotiation of these contracts. In addition, in June 2007, we received a request from the Office of Inspector General of the Department of Defense (“DoD IG”) seeking certain information and documents relating to our business with the Department of Defense. We cooperated with the DCAA audit and DoD IG inquiry by making available to government auditors and investigators our personnel and furnishing the requested information and documents. The DCAA Audit and DoD IG inquiry were consolidated and the US Attorney’s Office represented the government in connection with these matters. Under applicable federal law, we may have been subject up to treble damages and penalties associated with the potential pricing adjustment. In light of the uncertainty, we decided to enter into discussions with the U.S. Attorney’s Office in April 2011 to negotiate a settlement that would be in the best interests of our customers, employees and shareholders. On April 21, 2011, we were advised by the government that there was a \$2,730 settlement-in-principle to resolve all claims related to the contracts, subject to final approval by the Department of Justice. As a result, we recorded a \$2,730 charge as a reduction in revenues for the first quarter of 2011. On June 1, 2011, we entered into a Settlement Agreement with the United States of America, acting through the United States Department of Justice and on behalf of the Department of Defense that provides that we shall pay the U.S. \$2,700 plus accrued interest thereon at the rate of 2.625% per annum from May 6, 2011, with principal payments of \$1,000, \$567, \$567 and \$566 being due on June 8, 2011, December 1, 2011, June 1, 2012 and December 1, 2012, respectively. Each principal payment will be accompanied by a payment of accrued interest. As of December 31, 2011, we have made the first two required payments.

h. *Legal Matters*

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 Complaint, we allege 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 allege that, as a result of actions by Arista and Modeen: (i) Modeen has breached the terms of his Employee Confidentiality, Non-Disclosure, Non-Compete, Non-Disparagement and Assignment Agreement with us; (ii) Modeen has breached certain agreements, duties and obligations he owed us, including to protect and refrain from disclosing our trade secrets and confidential and proprietary information; (iii) Arista’s employment of Modeen will inevitably lead to the disclosure and use of our trade secrets by Arista, in violation of Modeen’s duties and obligations to us; (iv) Arista unlawfully induced Modeen to breach his agreements with and duties and obligations to us; and (v) Arista’s recruitment and employment of Modeen has breached a subcontract between Arista and us. We seek damages as determined at trial and preliminary and permanent injunctive relief. The defendants have answered the allegations set forth in the Complaint, without asserting any counterclaims. Discovery has commenced and is ongoing.

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. We and our officers, directors and employee named in the Complaint have yet to answer the allegations set forth in the Complaint.

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 dismissing 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.

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

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

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

#### *Energy Services Litigation*

In May 2010, we were served with a summons and complaint by a customer of one of our subsidiaries that performed energy services. The complaint sought damages in an amount of at least \$1,500 and included claims of breach of contract, negligent installation, and breach of warranty against us and breach of warranty against the manufacturer of the installed batteries. In January 2011, we settled all claims related to the litigation. Pursuant to the settlement, we agreed to pay the customer \$1,100, of which, \$1,075 was paid by our insurance providers.

#### *9-Volt Battery Litigation*

In July 2010, we were served with a summons and complaint filed in Japan by one of our 9-volt battery customers. The complaint alleges damages associated with claims of breach of warranty in an amount of approximately \$1,100. We dispute the customer's allegations against us and intend to vigorously defend the lawsuit. At this time, we have no basis for assessing whether we may incur any liability as a result of the lawsuit and no accrual has been made or reflected in the consolidated financial statements as of December 31, 2011.

#### *Communications Systems Litigation*

In October 2008, we filed a summons and complaint against one of our vendors seeking to recover at least \$3,600 in damages, plus interest resulting from the vendor's breach of contract and failure to perform by failing to timely deliver product and delivering product that failed to conform to the contractual requirements. The vendor filed an answer and counterclaim in November 2008 denying liability to us for breach of contract and asserting various counterclaims for non-payment, fraud, unjust enrichment, unfair and deceptive trade practices, breach of covenant of good faith and fair dealing, negligent misrepresentation, and tortious interference with contract and prospective economic advantage. In its



answer and counterclaims, the vendor claims damages in excess of \$3,500 plus interest and other incidental, consequential and punitive damages. In September 2009, we settled all claims related to the litigation. Pursuant to the settlement, we agreed to pay the vendor \$1,500 of the \$3,556 that we had previously reflected in the accounts payable line of our Consolidated Balance Sheets relating to this matter. We further agreed to issue an \$800 credit on future purchases to our customer in this matter. This \$800 credit was utilized in full during the fourth quarter of 2009. As a result, we have recognized a net gain on litigation settlement of \$1,256, and which has been reflected in the cost of products sold line on our Consolidated Statements of Operations for the year ended December 31, 2009.

#### *Battery & Energy Products Litigation*

In January 2008, we filed a summons and complaint against one of our customers seeking to recover \$162 in unpaid invoices, plus interest for product supplied to the customer under a Master Purchase Agreement (“MPA”). The customer filed an answer and counterclaim in March 2008 alleging that the product did not conform with a material requirement of the MPA. The customer claims restitution, cost of cover, and incidental and consequential damages in an approximate amount of \$2,800. In June 2009, we received a jury verdict in our favor awarding us \$162 in damages on our claim and finding no liability on the customer’s counterclaim. We received full payment from the customer on the award in June 2009, and in July 2009, the parties reached an agreement in which the customer agreed not to pursue an appeal from the jury verdict.

#### *Environmental Matter*

In conjunction with our purchase/lease of our Newark, New York facility in 1998, we entered into a payment-in-lieu of tax agreement, which provided us with real estate tax concessions upon meeting certain conditions. In connection with this agreement, a consulting firm performed a Phase I and II Environmental Site Assessment, which revealed the existence of contaminated soil and ground water around one of the buildings. We retained an engineering firm, which estimated that the cost of remediation should be in the range of \$230. In February 1998, we entered into an agreement with a third party, which provides that we and this third party will retain an environmental consulting firm to conduct a supplemental Phase II investigation to verify the existence of the contaminants and further delineate the nature of the environmental concern. The third party agreed to reimburse us for fifty percent (50%) of the cost of correcting the environmental concern on the Newark property. We have fully reserved for our portion of the estimated liability. Test sampling was completed in the spring of 2001, and the engineering report was submitted to the New York State Department of Environmental Conservation (“NYSDEC”) for review. The NYSDEC reviewed the report and, in January 2002, recommended additional testing. We responded by submitting a work plan to the NYSDEC, which was approved in April 2002. We sought proposals from engineering firms to complete the remedial work contained in the work plan. A firm was selected to undertake the remediation and in December 2003 the remediation was completed, and was overseen by the NYSDEC. The report detailing the remediation project, which included the test results, was forwarded to the NYSDEC and to the New York State Department of Health (“NYSDOH”). The NYSDEC, with input from the NYSDOH, requested that we perform additional sampling. A work plan for this portion of the project was written and delivered to the NYSDEC and approved. In November 2005, additional soil, sediment and surface water samples were taken from the area outlined in the work plan, as well as groundwater samples from the monitoring wells. We received the laboratory analysis and met with the NYSDEC in March 2006 to discuss the results. On June 30, 2006, the Final Investigation Report was delivered to the NYSDEC by our outside environmental consulting firm. In November 2006, the NYSDEC completed its review of the Final Investigation Report and requested additional groundwater, soil and sediment sampling. A work plan to address the additional investigation was submitted to the NYSDEC in January 2007 and was approved in April 2007. Additional investigation work was performed in May 2007. A preliminary report of results was prepared by our outside environmental consulting firm in August 2007 and a meeting with the NYSDEC and NYSDOH took place in September 2007. As a result of this meeting, the NYSDEC and NYSDOH requested additional investigation work. A work plan to address this additional investigation was submitted to and approved by the NYSDEC in November 2007. Additional investigation work was performed in December 2007. Our environmental consulting firm prepared and submitted a Final Investigation Report in January 2009 to the NYSDEC for review. The NYSDEC reviewed and approved the Final Investigation Report in June 2009 and requested the development of a Remedial Action Plan. Our environmental consulting firm developed and submitted the requested plan for review and approval by the NYSDEC. In October 2009, we received comments back from the NYSDEC regarding the content of the remediation work plan. Our environmental consulting firm incorporated the requested changes and submitted a revised work plan to the NYSDEC in January 2010 for review and approval. Upon approval from the NYSDEC, environmental remediation work was completed in July and August 2010. Our environmental consulting firm prepared a Final Engineering report which was submitted to the NYSDEC for review and approval in October 2010. Comments on the Final Engineering report and associated documents were received from the NYSDEC in December 2010. Our environmental consulting firm revised the Final Engineering report and submitted the report and associated documents to the NYSDEC for review and approval in January 2011. In May 2011, the NYSDEC administratively closed remedial activities associated with the

approved work plan. In September 2011, the NYSDEC issued an Assignable Release and Covenant Not to Sue document. As a result, anticipated costs are not expected to exceed those currently reserved. Through December 31, 2011, total costs incurred have amounted to approximately \$383, none of which has been capitalized. At December 31, 2011 and December 31, 2010, we had \$8 and \$22, respectively, reserved for this matter.

i. *Workers' Compensation Self-Insured Trust*

From August 2002 through August 2006, we participated in a self-insured trust to manage our workers' compensation activity for our employees in New York State. All members of this trust had, by design, joint and several liability during the time they participated in the trust. In August 2006, we left the self-insured trust and obtained alternative coverage for our workers' compensation program through a third-party insurer. In the third quarter of 2006, we confirmed that the trust was in an underfunded position (i.e. the assets of the trust were insufficient to cover the actuarially projected liabilities associated with the members in the trust). In the third quarter of 2006, we recorded a liability and an associated expense of \$350 as an estimate of our potential future cost related to the trust's underfunded status based on our estimated level of participation. On April 28, 2008, we, along with all other members of the trust, were served by the State of New York Workers' Compensation Board ("Compensation Board") with a Summons with Notice that was filed in Albany County Supreme Court, wherein the Compensation Board put all members of the trust on notice that it would be seeking approximately \$1,000 in previously billed and unpaid assessments and further assessments estimated to be not less than \$25,000 arising from the accumulated estimated under-funding of the trust. The Summons with Notice did not contain a complaint or a specified demand. We timely filed a Notice of Appearance in response to the Summons with Notice. On June 16, 2008, we were served with a Verified Complaint. Subject to the results of a deficit reconstruction that was pending, the Verified Complaint estimated that the trust was underfunded by \$9,700 during the period of December 1, 1997 – November 30, 2003 and an additional \$19,400 for the period December 1, 2003 – August 31, 2006. The Verified Complaint estimated our pro-rata share of the liability for the period of December 1, 1997 – November 30, 2003 to be \$195. The Verified Complaint did not contain a pro-rata share liability estimate for the period of December 1, 2003-August 31, 2006. Further, the Verified Complaint stated that all estimates of the underfunded status of the trust and the pro-rata share liability for the period of December 1, 1997-November 30, 2003 were subject to adjustment based on a forensic audit of the trust that was being conducted on behalf of the Compensation Board by a third-party audit firm. We timely filed our Verified Answer with Affirmative Defenses on July 24, 2008. In November 2009, the New York Attorney General's office presented the results of the deficit reconstruction of the trust. As a result of the deficit reconstruction, the State of New York has determined that the trust was underfunded by \$19,100 instead of \$29,100 during the period December 1, 1997 to August 31, 2006. Our pro-rata share of the liability was determined to be \$452. The Attorney General's office proposed a settlement by which we could avoid joint and several liability in exchange for a settlement payment of \$520. Under the terms of the settlement agreement, we could satisfy our obligations by either paying (i) a lump sum of \$468, representing a 10% discount, (ii) paying the entire amount in twelve monthly installments of \$43 commencing the month following execution of the settlement agreement, or (iii) paying the entire amount in monthly installments over a period of up to five years, with interest of 6.0, 6.5, 7.0, and 7.5% for the two, three, four and five year periods, respectively. We elected the twelve monthly installments option and on May 3, 2010, we received written notice from the Attorney General's office that the Compensation Board had decided to proceed with the settlement, as proposed, and that payments would commence in June 2010. As of December 31, 2011, we have made all payments under this settlement and have no further obligations outstanding relating to this matter. On October 11, 2011, an order was filed with the Albany County Clerk wherein this lawsuit was discontinued against us.

**Note 7 - Shareholders' Equity**

a. *Preferred Stock*

We have authorized 1,000,000 shares of preferred stock, with a par value of \$0.10 per share. At December 31, 2011, no preferred shares were issued or outstanding.

b. *Common Stock*

We have authorized 40,000,000 shares of common stock, with a par value of \$0.10 per share.

In February 2009, we issued 4,388 unrestricted shares of common stock to our non-employee directors, valued at \$37. In May 2009, we issued 10,725 unrestricted shares of common stock to our non-employee directors, valued at \$76. In August 2009, we issued 11,881 unrestricted shares of common stock to our non-employee directors, valued at \$76. In November 2009, we issued 19,345 unrestricted shares of common stock to our non-employee directors, valued at \$77.

In September 2009, we issued 21,340 shares of common stock to four members of the AMTI management team in accordance with the asset purchase agreement for AMTI, valued at \$136.

In February 2010, we issued 19,346 unrestricted shares of common stock to our non-employee directors, valued at \$76. In May 2010, we issued 18,528 unrestricted shares of common stock to our non-employee directors, valued at \$87. In August 2010, we issued 16,616 unrestricted shares of common stock to our non-employee directors, valued at \$76. In November 2010, we issued 11,811 unrestricted shares of common stock to our non-employee directors, valued at \$76.

On April 27, 2010, we entered into Amendment No. 2 to the USE asset purchase agreement. Under the terms of Amendment No. 2, we agreed to issue an aggregate of 200,000 shares of our unregistered common stock, valued at approximately \$858, in full satisfaction of our outstanding obligations to the Selling Shareholders under the USE asset purchase agreement. Amendment No. 2 did not change our original assessment that the contingent payout of shares of common stock was related to the acquisition of the assets of USE. Accordingly, we reflected the payment as additional purchase price. This adjustment resulted in an increase to goodwill of \$858.

In February 2011, we issued 11,276 unrestricted shares of common stock to our non-employee directors, valued at \$77. In May 2011, we issued 17,036 unrestricted shares of common stock to our non-employee directors, valued at \$76. In August 2011, we issued 15,981 unrestricted shares of common stock to our non-employee directors, valued at \$77. In November 2011, we issued 17,350 unrestricted shares of common stock to our non-employee directors, valued at \$76.

c. *Treasury Stock*

At December 31, 2011 and 2010, we had 1,372,757 and 1,371,900 shares, respectively, of treasury stock outstanding, valued at \$7,658 and \$7,652, respectively. The increase in treasury shares related to the vesting of restricted stock awards for certain key employees, a portion of which were withheld as treasury shares to cover estimated individual income taxes, since the vesting of such awards is a taxable event for the individuals.

In October 2008, the Board of Directors authorized a share repurchase program of up to \$10,000 to be implemented over the course of a six-month period. In April 2009, this share repurchase program expired. Repurchases were made from time to time at management's discretion, either in the open market or through privately negotiated transactions. The repurchases were made in compliance with Securities and Exchange Commission guidelines and were subject to market conditions, applicable legal requirements, and other factors. We had no obligation under the program to repurchase shares and the program could have been suspended or discontinued at any time without prior notice. We funded the purchase price for shares acquired primarily with current cash on hand and cash generated from operations, in addition to borrowing from our credit facility, as necessary. Under this repurchase program, we made the following share repurchases:

<u>Years Ended December 31,</u>	<u>2009</u>		<u>2008</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
First Quarter	416,305	\$ 3,326	-	\$ -
Second Quarter	-	-	-	-
Third Quarter	-	-	-	-
Fourth Quarter	-	-	<u>212,108</u>	<u>1,815</u>
Total	<u>416,305</u>	<u>\$ 3,326</u>	<u>212,108</u>	<u>\$ 1,815</u>

d. *Stock Options*

We have various stock-based employee compensation plans, for which 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).

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

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

Stock options granted under the LTIP are either Incentive Stock Options (“ISOs”) or Non-Qualified Stock Options (“NQSOs”). Key employees are eligible to receive ISOs and NQSOs; however, directors and consultants are eligible to receive only NQSOs. Most ISOs vest over a three- or five-year period and expire on the sixth or seventh anniversary of the grant date. All NQSOs issued to non-employee directors vest immediately and expire on either the sixth or seventh anniversary of the grant date. Some NQSOs issued to non-employees vest immediately and expire within three years; others have the same vesting characteristics as options given to employees. As of December 31, 2011, there were 2,258,228 stock options outstanding under the LTIP.

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

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

On June 9, 2009, in connection with his becoming employed by us, we granted our former Vice-President of Finance and Chief Financial Officer, John C. Casper, an option to purchase 30,000 shares of common stock at \$7.18 per share outside of any of our equity-based compensation plans. The option was to vest in annual increments of 10,000 shares over a three-year period commencing June 9, 2010. As a result of his resignation in November 2009, this option was forfeited.

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

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

In conjunction with FASB’s guidance for share-based payments, we recorded compensation cost related to stock options of \$946, \$670 and \$964 for the years ended December 31, 2011, 2010 and 2009, respectively. As of December 31, 2011, there was \$1,730 of total unrecognized compensation costs related to outstanding stock options, which is expected to be recognized over a weighted average period of 2.25 years.

We use the Black-Scholes option-pricing model to estimate fair value of stock-based awards. The following weighted average assumptions were used to value options granted during the years ended December 31, 2011, 2010 and 2009:

	Years Ended December 31,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Risk-free interest rate	0.97%	1.67%	1.69%
Volatility factor	61.62%	80.61%	67.75%
Dividends	0.00%	0.00%	0.00%
Weighted average expected life (years)	3.78	3.56	3.55
Forfeiture rate	15.00%	14.00%	10.00%

We use a Monte Carlo simulation option-pricing model to estimate the fair value of market performance stock-based awards. The following weighted average assumptions were used to value market performance stock options granted during the year ended December 31, 2011. There were no market performance stock options granted during the years ended December 31, 2010 or 2009.

	<u>Year Ended</u> <u>December 31,</u> <u>2011</u>
Risk-free interest rate	2.74%
Volatility factor	63.78%
Dividends	0.00%
Weighted average expected life (years)	5.51
Forfeiture rate	0.00%

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. Forfeiture rates are calculated by dividing unvested shares forfeited by beginning shares outstanding. The pre-vesting forfeiture rate is calculated yearly and is determined using a historical twelve-quarter rolling average of the forfeiture rates.

The following table summarizes data for the stock options issued by us:

	<u>Year Ended December 31, 2011</u>			
	<u>Number</u> <u>of Shares</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u> <u>Per Share</u>	<u>Weighted</u> <u>Average</u> <u>Remaining</u> <u>Contractual</u> <u>Term</u>	<u>Aggregate</u> <u>Intrinsic</u> <u>Value</u>
Shares under option at beginning of year .....	1,794,694	\$ 9.71		
Options granted.....	1,113,900	7.96		
Options exercised .....	(18,500)	3.94		
Options cancelled .....	(533,866)	12.30		
Shares under option at end of year	<u>2,356,228</u>	<u>\$ 8.34</u>	<u>5.02 years</u>	<u>\$ 25</u>
Vested and expected to vest as end of year	2,077,030	\$ 8.74	4.89 years	\$ 22
Options exercisable at end of year	989,972	\$9.62	2.97 years	\$ 16

<u>Year Ended December 31,</u>	<u>2010</u>		<u>2009</u>	
	<u>Number</u>	<u>Weighted</u>	<u>Number</u>	<u>Weighted</u>
	<u>of Shares</u>	<u>Average</u>	<u>of Shares</u>	<u>Average</u>
		<u>Exercise</u>		<u>Exercise</u>
		<u>Price</u>		<u>Price</u>
		<u>Per Share</u>		<u>Per Share</u>
Shares under option at beginning of year .....	1,805,107	\$10.99	1,651,007	\$12.33
Options granted.....	468,250	5.41	620,070	5.71
Options exercised .....	(14,000)	3.91	(103,860)	4.59
Options cancelled .....	(464,663)	10.51	(362,110)	9.86
Shares under option at end of year	1,794,694	\$ 9.71	1,805,107	\$10.99
Options exercisable at end of year	1,103,100	\$12.28	1,697,301	\$11.22

The following table represents additional information about stock options outstanding at December 31, 2011:

<u>Options Outstanding</u>				<u>Options Exercisable</u>	
<u>Range of Exercise Prices</u>	<u>Number of Outstanding at December 31, 2011</u>	<u>Weighted-Average Remaining Contractual Life</u>	<u>Weighted-Average Exercise Price</u>	<u>Number Exercisable at December 31, 2011</u>	<u>Weighted-Average Exercise Price</u>
\$ 3.91-\$ 3.91	224,500	4.68	\$ 3.91	144,167	\$ 3.91
\$ 4.41-\$ 4.41	169,584	5.12	\$ 4.41	58,753	\$ 4.41
\$ 4.42-\$ 4.42	318,000	6.94	\$ 4.42	-0-	\$ 0.00
\$ 4.70-\$ 6.37	122,800	5.84	\$ 5.28	13,501	\$ 5.00
\$ 6.42-\$ 6.42	300,000	6.00	\$ 6.42	75,000	\$ 6.42
\$ 6.58-\$ 9.70	225,166	4.94	\$ 7.64	114,002	\$ 8.46
\$ 9.84-\$12.00	410,283	4.23	\$10.22	210,283	\$10.42
\$12.18-\$12.96	269,395	1.85	\$12.79	257,766	\$12.81
\$13.22-\$16.15	295,000	6.23	\$14.67	95,000	\$13.97
\$17.12-\$17.12	21,500	0.25	\$17.12	21,500	\$17.12
\$ 3.91-\$17.12	2,356,228	5.02	\$ 8.34	989,972	\$ 9.62

The weighted average fair value of options granted during the years ended December 31, 2011, 2010 and 2009 was \$2.04, \$3.06 and \$2.77. The total intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the years ended December 31, 2011, 2010 and 2009 was \$45, \$43 and \$390.

FASB's guidance for share-based payments requires cash flows from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. We did not record any excess tax benefits in 2011, 2010 or 2009. Cash received from option exercises under our stock-based compensation plans for the years ended December 31, 2011, 2010 and 2009 was \$73, \$55 and \$226, respectively.

e. *Warrants*

On May 19, 2006, in connection with our acquisition of ABLE New Energy Co., Ltd., we granted warrants to acquire 100,000 shares of common stock. The exercise price of the warrants was \$12.30 per share and the warrants had a five-year term. In January 2008, 82,000 warrants were exercised, for total proceeds received of \$1,009. In January 2009, 10,000 warrants were exercised, for total proceeds received of \$123. In May 2011, the remaining outstanding warrants to acquire 8,000 shares of common stock expired without being exercised.

f. *Restricted Stock Awards*

No restricted stock was awarded during the years ended December 31, 2011 and 2010.

During 2009, we issued 16,286 time-vested restricted stock awards to our executive officers. The restrictions will lapse over a three-year period in equal installments, commencing on the first anniversary of the grant date (January 14, 2009). As of December 31, 2011, 7,364 of these shares had vested, and 7,704 of these shares were forfeited.

During 2009, we issued 6,000 time-vested restricted stock awards to our former Vice-President of Finance and Chief Financial Officer, John C. Casper. The restrictions were to lapse over a two-year period in equal installments, commencing on the first anniversary of the grant date (June 9, 2009). As a result of his resignation in November 2009, this restricted stock award was forfeited.

During 2009, we issued 2,500 performance-vested restricted stock awards to our former Vice-President of Finance and Chief Financial Officer, John C. Casper. The restrictions were to lapse only if we met or exceeded the same predetermined target for our operating performance for 2009 as used for determining cash awards pursuant to the non-equity incentive plan. As a result of his resignation in November 2009, this restricted stock award was forfeited.

Restricted stock grants awarded during the years ended December 31, 2011, 2010 and 2009 had the following values:

	<b>Years Ended December 31,</b>		
	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
Number of shares awarded	-	-	24,786
Weighted average fair value per share	\$ 0.00	\$ 0.00	\$ 7.44
Aggregate total value	\$ -	\$ -	\$ 185

The activity of restricted stock grants of common stock for the years ended December 31, 2011, 2010 and 2009 is summarized as follows:

	<b><u>Number of Shares</u></b>	<b><u>Weighted Average Grant Date Fair Value</u></b>
Unvested at December 31, 2008	76,664	\$ 11.47
Granted	24,786	7.44
Vested	(31,093)	11.60
Forfeited	(23,830)	9.81
Unvested at December 31, 2009	46,527	\$ 11.42
Granted	-	0.00
Vested	(9,944)	12.69
Forfeited	(27,535)	10.80
Unvested at December 31, 2010	9,048	\$ 11.94
Granted	-	0.00
Vested	(4,925)	12.01
Forfeited	(2,905)	12.07
Unvested at December 31, 2011	1,218	\$ 11.33

We recorded compensation cost related to restricted stock grants of \$(27), \$92 and \$100 for the years ended December 31, 2011, 2010 and 2009, respectively. During the third quarter of 2009, we determined that the performance measures for certain performance-based restricted stock grants would not be achieved. Therefore, these restricted stock grants did not vest, and we reversed the prior period recognized expense of \$301 for these performance-based restricted stock grants. As of December 31, 2011, we had \$1 of total unrecognized compensation expense related to restricted stock grants, which is expected to be recognized over the remaining weighted average period of approximately 0.04 years. The total fair value of these grants that vested during the years ended December 31, 2011, 2010 and 2009 was \$32, \$44 and \$209, respectively.

g. *Reserved Shares*

We have reserved 2,939,723, 2,065,366, and 2,106,617 shares of common stock under the various stock option plans, warrants and restricted stock awards as of December 31, 2011, 2010, and 2009, respectively.

**Note 8 - Income Taxes**

The provision for income taxes expense (benefit) consists of:

	December 31, <u>2011</u>	December 31, <u>2010</u>	December 31, <u>2009</u>
Current – Continuing Operations:			
Federal	\$ -	\$ (582)	\$ 17
State	32	25	14
Foreign	<u>-</u>	<u>-</u>	<u>-</u>
	<u>32</u>	<u>(557)</u>	<u>31</u>
Current – Discontinued Operations:			
Federal	\$ -	\$ -	\$ -
State	<u>-</u>	<u>2</u>	<u>-</u>
	<u>-</u>	<u>2</u>	<u>-</u>
Deferred – Continuing Operations:			
Federal	277	258	171
State	-	-	-
Foreign	<u>219</u>	<u>-</u>	<u>-</u>
	<u>496</u>	<u>258</u>	<u>171</u>
Deferred – Discontinued Operations:			
Federal	-	(373)	189
State	<u>-</u>	<u>-</u>	<u>-</u>
	<u>-</u>	<u>(373)</u>	<u>189</u>
Total	<u>\$ 528</u>	<u>\$ (670)</u>	<u>\$ 391</u>

We reflected a tax expense of \$528 for the year ended December 31, 2011. The 2011 tax provision is principally a result of the increase in the net deferred tax liability related to liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. In addition, we incurred state and foreign income taxes in 2011.

We reflected a tax benefit of \$670 for the year ended December 31, 2010. The 2010 tax benefit is principally a result of our realization of a current tax benefit related to our election in 2010 to carry back the 2009 net operating loss to the prior five tax years. This amount was partially offset by state income taxes due for 2010. This election resulted in us receiving a refund of any alternative minimum taxes paid in the prior five years. In addition, we realized a deferred tax benefit as a result of the reassessment of the net required deferred tax liability. This reassessment was required due to the impairment of certain goodwill and other intangible assets by us in 2010.

We reflected a tax provision of \$391 for the year ended December 31, 2009. The 2009 tax provision is principally a result of the increase in the net deferred tax liability related to liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. The current federal tax provision relates to additional 2008 income tax that was paid in 2009. We were not subject to the alternative minimum tax in the U.S. in 2009.



Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Significant components of our deferred tax liabilities and assets are as follows:

	December 31, <u>2011</u>	December 31, <u>2010</u>
Deferred tax liabilities:		
Property, plant and equipment	\$ 763	\$ 661
Intangible assets and other	<u>4,437</u>	<u>3,789</u>
Total deferred tax liabilities	<u>5,200</u>	<u>4,450</u>
Deferred tax assets:		
Net operating loss carryforwards	17,578	16,146
Intangible assets	5,079	5,423
Accrued expenses, reserves and other	4,531	5,101
Investments	<u>342</u>	<u>342</u>
Total deferred tax assets	27,530	27,012
Valuation allowance for deferred tax assets	<u>(26,526)</u>	<u>(26,260)</u>
Net deferred tax assets	<u>1,004</u>	<u>752</u>
Net deferred tax liability	<u>\$ (4,196)</u>	<u>\$ (3,698)</u>

The \$4,196 net deferred tax liability for the year ended December 31, 2011 is comprised of a current deferred tax liability of \$187 and a long-term deferred tax liability of \$4,170, offset in part by a current deferred tax asset of \$161. The \$3,698 net deferred tax liability for the year ended December 31, 2010 is comprised of a long-term deferred tax liability of \$3,906, offset in part by a current deferred tax asset of \$208.

In 2011, 2010 and 2009, 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 2011. 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. In 2010 and 2009, we reported a valuation allowance for our deferred tax assets in China. As a result of our assessment at December 31, 2011, there is no longer a need to record a valuation allowance for the Chinese deferred tax assets as we determined that it is more likely than not that they will be realized. We are more likely than not to fully utilize the NOL in China and therefore have removed the immaterial valuation allowance during 2011. We continually assess the carrying value of this asset based on relevant accounting standards.

As of December 31, 2011, we have foreign and domestic NOL's totaling approximately \$57,977 available to reduce future taxable income. Foreign loss carryforwards of approximately \$11,479 can be carried forward indefinitely. The domestic NOL carryforward of \$46,498 expires from 2019 through 2031. The domestic NOL carryforward includes approximately \$2,949 for which a benefit will be recorded in capital in excess of par value when realized.

We have determined that a change in ownership, as defined under Internal Revenue Code Section 382, occurred during 2005 and 2006. As such, the domestic 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. 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 2011, 2010 and 2009. 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.

For financial reporting purposes, income (loss) from continuing operations before income taxes is as follows:

	December 31, <u>2011</u>	December 31, <u>2010</u>	December 31, <u>2009</u>
United States	\$ 3,747	\$ 12,295	\$ (2,353)
Foreign	<u>(1,655)</u>	<u>(1,426)</u>	<u>(2,650)</u>
Total	<u>\$ 2,092</u>	<u>\$ 10,869</u>	<u>\$ (5,003)</u>

There are no undistributed earnings of our foreign subsidiaries, at December 31, 2011 or December 31, 2010.

We have been granted a tax holiday in China. As a result of new legislation effective for 2008, ABLE's corporate income rate increased to 9%, which was 50% of the 2008 tax rate of 18%. For 2009, ABLE's corporate income rate increased to 10%, which was 50% of the normal 20% tax rate for the jurisdiction in which we operate. Thereafter, our tax rate in China will be phased in until ultimately reaching a rate of 25% in 2012. During the years ended December 31, 2011, 2010 and 2009, we realized no tax benefits from the tax holiday due to taxable losses.

The provision for income taxes differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to income (loss) from continuing operations before income taxes as follows:

	December 31, <u>2011</u>	December 31, <u>2010</u>	December 31, <u>2009</u>
Provision/(benefit) computed using the statutory rate	34.0%	34.0%	(34.0)%
Increase (reduction) in taxes resulting from:			
State tax, net of federal benefit	1.0	(0.1)	0.2
Foreign	26.8	4.4	11.0
Valuation allowance/deferred impact	(46.5)	(42.8)	17.0
Compensation	8.7	1.7	7.3
Other	<u>1.2</u>	<u>0.1</u>	<u>2.5</u>
Provision (benefit) for income taxes	<u>25.2%</u>	<u>(2.7)%</u>	<u>4.0%</u>

In 2011, the provision for income taxes was higher than what would be expected if the statutory rate were applied to pretax income. This is due to the continuation of reflecting a full valuation allowance for our U.S. and U.K. deferred tax assets, and as a result of the mix of earnings in foreign jurisdictions.

In 2010, the benefit for income taxes was lower than what would be expected if the statutory rate were applied to pretax income. This is due primarily to three factors. The first factor is the continuation of reflecting a full valuation allowance for our U.S, U.K. and China deferred tax assets, resulting generally in no recognition of a tax benefit for the losses in 2010. The second factor is principally a result of our realization of a current tax benefit related to our election in 2010 to carry back the 2009 net operating loss to the prior five tax years. This election resulted in us receiving a refund of alternative minimum taxes paid in the prior five years. The third factor was that we realized a deferred tax benefit as a result of the reassessment of the net required deferred tax liability. This reassessment was required due to the impairment of certain goodwill and other intangible assets for us in 2010.

In 2009, the provision for income taxes was higher than what would be expected if the statutory rate were applied to pretax income. This is due to the continuation of reflecting a full valuation allowance for our U.S, U.K. and China deferred tax assets.

#### Accounting for Uncertainty in Income Taxes

We have adopted FASB's guidance for the Accounting for Uncertainty in Income Taxes. As a result of the implementation of this guidance, there was no cumulative effect adjustment for unrecognized tax benefits, which would have been accounted for as an adjustment to the January 1, 2007 balance of retained earnings.

Our unrecognized tax benefits related to uncertain tax positions at December 31, 2011 relate to Federal and various state jurisdictions. The following table summarizes the activity related to our unrecognized tax benefits:

	<b>Years ended December 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Balance at beginning of the year	\$ -	\$ -	\$ -
Increases related to the current year tax positions	6,779	-	-
Increases related to prior year tax positions	-	-	-
Decreases related to prior year tax positions	-	-	-
Expiration of statute of limitations for assessment of taxes	-	-	-
Settlements	-	-	-
Balance at the end of the year	-	-	-
	<u>\$ 6,779</u>	<u>\$ -</u>	<u>\$ -</u>

The total unrecognized tax benefit balance at December 31, 2011 is comprised of tax benefits that, if recognized, would result in a deferred tax asset and a corresponding increase in our valuation allowance. As a result, because the benefit would be offset by an increase in the valuation allowance, there would be no effect on the effective tax rate.

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

As a result of our operations, we file income tax returns in various jurisdictions including U.S. federal, U.S. State and foreign jurisdictions. We are routinely subject to examination by taxing authorities in these various jurisdictions. Our U.S. tax matters for the years 1999 through 2011 remain subject to examination by the Internal Revenue Service ("IRS") due to our NOL carryforwards. Our U.S. tax matters for the years 1999 through 2011 remain subject to examination by various state and local tax jurisdictions due to our NOL carryforwards. Our tax matters for the years 2006 through 2011 remain subject to examination by the respective foreign tax jurisdiction authorities. The IRS has completed the examination of our 2009 US Federal income tax return, with no resulting material effect to our financial position or results of operations.

#### **Note 9 - 401(k) Retirement Benefit Plan**

We maintain a defined contribution 401(k) plan covering substantially all employees. Employees can contribute a portion of their salary or wages as prescribed under Section 401(k) of the Internal Revenue Code and, subject to certain limitations, we may, at the Board of Directors discretion, authorize an employer contribution based on a portion of the employees' contributions. Effective February 2004, the Board of Directors approved our matching of employee contributions at the rate of 50% of the first 4% contributed by an employee, or a maximum of 2% of the employee's income. In November 2005, the employer match was suspended in an effort to conserve cash. In October 2007, the employer match was reinstated at the rate of 50% of the first 4% contributed by an employee, or a maximum of 2% of the employee's income. During the fourth quarter of 2009, the employer match was temporarily suspended in an effort to conserve cash and control costs. In January 2010, the employer match was reinstated at the rate of 50% of the first 4% contributed by an employee, or a maximum of 2% of the employee's income. For 2011, 2010, and 2009 we contributed \$381, \$379, and \$333, respectively.

#### **Note 10 - Business Segment Information**

On January 1, 2011, we began to report chargers in the Battery & Energy Products segment, to better align the portfolio of chargers with customers for those products and with how we manage our business operations. Previously, we had reported chargers in the Communications Systems segment.

On March 8, 2011, our senior management, as authorized by our Board of Directors, decided to exit our Energy Services business, which previously was a stand alone business segment. See Note 2 in these Notes to Condensed Consolidated Financial Statements for additional information.

Segment information previously reported has been reclassified to conform to the current year presentation.

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

## 2011

	<b>Battery &amp; Energy Products</b>	<b>Communications Systems</b>	<b>Discontinued Operations</b>	<b>Corporate</b>	<b>Total</b>
Revenues	\$ 108,203	\$ 31,183	\$ -	\$ -	\$ 139,386
Segment contribution	25,169	10,224	-	(32,918)	2,475
Interest expense, net				(554)	(554)
Miscellaneous				171	171
Income taxes-current				(32)	(32)
Income taxes-deferred				(496)	(496)
Loss from discontinued operations			(3,702)		(3,702)
Noncontrolling interest				58	58
Net income attributable to Ultralife					<u>(2,080)</u>
Total assets	51,351	38,833	23	10,608	100,815
Capital expenditures	1,209	1,026	-	127	2,362
Depreciation and amortization	2,471	191	93	1,657	4,412
Stock-based compensation	70	6	1	1,148	1,225

## 2010

	<b>Battery &amp; Energy Products</b>	<b>Communications Systems</b>	<b>Discontinued Operations</b>	<b>Corporate</b>	<b>Total</b>
Revenues	\$ 105,126	\$ 61,693	\$ -	\$ -	\$ 166,819
Segment contribution	24,844	21,812	-	(34,794)	11,862
Interest expense, net				(1,138)	(1,138)
Miscellaneous				145	145
Income taxes-current				557	557
Income taxes-deferred				(258)	(258)
Loss from discontinued operations			(17,377)		(17,377)
Noncontrolling interest				30	30
Net income attributable to Ultralife					<u>(6,179)</u>
Total assets	59,790	38,898	6,184	9,963	114,835
Capital expenditures	1,182	195	54	384	1,815
Depreciation and amortization	2,537	115	211	2,487	5,350
Stock-based compensation	107	7	20	943	1,077

**2009**

	<b>Battery &amp; Energy Products</b>	<b>Communications Systems</b>	<b>Discontinued Operations</b>	<b>Corporate</b>	<b>Total</b>
Revenues	\$ 107,165	\$ 47,130	\$ -	\$ -	\$ 154,295
Segment contribution	21,379	13,930	-	(38,858)	(3,549)
Interest expense, net				(1,431)	(1,431)
Miscellaneous				(23)	(23)
Income taxes-current				(31)	(31)
Income taxes-deferred				(171)	(171)
Loss from discontinued operations			(4,026)		(4,026)
Noncontrolling interest				(10)	(10)
Net income attributable to Ultralife					(9,241)
Total assets	54,559	48,305	18,341	9,961	131,166
Capital expenditures	1,042	163	215	615	2,035
Depreciation and amortization	2,540	189	170	2,828	5,727
Stock-based compensation	36	-	18	1,276	1,330

**Geographical Information**

	<b>Revenues</b>			<b>Long-Lived Assets</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
United Kingdom	\$11,727	\$19,507	\$ 8,765	\$ 334	\$ 515	\$ 730
China	8,748	5,706	2,604	1,370	1,413	1,479
Hong Kong	484	1,255	1,242	-	-	-
India	104	356	384	52	65	65
Europe, excluding United Kingdom	8,091	11,665	9,389	-	-	-
Japan	1,440	1,232	1,190	-	-	-
Singapore	567	1,011	362	-	-	-
Canada	5,245	8,441	5,328	-	-	-
Australia	1,815	1,086	1,193	-	-	-
Other	5,357	4,980	3,337	-	-	-
Total Non-U.S.	43,578	55,239	33,794	1,756	1,993	2,274
United States	95,808	111,580	120,501	10,832	12,492	14,374
Total	\$139,386	\$166,819	\$154,295	\$12,588	\$14,485	\$16,648

Long-lived assets represent the sum of the net book value of property, plant and equipment.

**Note 11 - Fire at Manufacturing Facility**

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

The total amount of the loss pertaining to assets and the related expenses was approximately \$1,573. The majority of the insurance claim is related to the recovery of damaged inventory. As of December 31, 2011, we reflect a receivable from the insurance company relating to this claim of \$1,441, which is net of our deductible of approximately \$132. The deductible charge was expensed in the second quarter of 2011 and reflected as a component of cost of products sold in the Condensed Consolidated Statements of Operations.

## Note 12 – Subsequent Events

On February 15, 2012, our senior management, as authorized by our Board of Directors, decided to divest our RedBlack Communications business. As a result of management's ongoing review of our business portfolio, management had determined that RedBlack offers limited opportunities to achieve the operating margin thresholds of our new business model and decided to refocus our operations on profitable growth opportunities presented in the other product lines that comprise our business segments, Battery & Energy Products and Communication Systems. Since 2008, our RedBlack Communications business has incurred significant operating losses. We are seeking to sell our RedBlack business as a going concern and will be engaging appropriate professionals to assist in that effort. We anticipate that the actions taken to divest the RedBlack Communications business will result in the elimination of approximately 30 jobs and the transfer of the RedBlack facility located in Hollywood, Maryland in connection the divestiture. We cannot predict at this time when the closing of any divestiture transaction will occur. Commencing with the first quarter of 2012 and concluding with the ultimate closing of the transaction, the results of RedBlack operations and related divestiture costs will be reported as a discontinued operation.

We cannot at this time determine an estimate or a range of estimates of the extent of the restructuring charges we will incur in connection with the RedBlack divestiture.

## Note 13 - Selected Quarterly Information (unaudited)

The following table presents reported net revenues, gross margin (net sales less cost of products sold), net income (loss) attributable to Ultralife – continuing operations, net income (loss) attributable to Ultralife – discontinued operations, net income (loss) attributable to Ultralife common share – continuing operations, basic and diluted, and net income (loss) attributable to Ultralife common share – discontinued operations, basic and diluted, for each quarter during the past two years:

2011	Quarter ended				Full Year
	April 3, 2011	July 3, 2011	Oct 2, 2011	Dec 31, 2011	
Revenues	\$ 28,456	\$ 43,555	\$ 36,006	\$ 31,369	\$ 139,386
Gross profit	4,538	11,797	9,639	9,419	35,393
Net income (loss) attributable to					
Ultralife - continuing operations	(4,033)	2,578	1,388	1,689	1,622
Net income (loss) attributable to					
Ultralife - discontinued operations	(1,657)	(2,139)	-	94	(3,702)
Net income (loss) attributable to					
Ultralife common shares -					
continuing operations - basic	(0.23)	0.15	0.08	0.10	0.09
Net income (loss) attributable to					
Ultralife common shares -					
discontinued operations - basic	(0.10)	(0.12)	0.00	0.00	(0.21)
Net income (loss) attributable to					
Ultralife common shares -					
continuing operations - diluted	(0.23)	0.15	0.08	0.10	0.09
Net income (loss) attributable to					
Ultralife common shares -					
discontinued operations - diluted	(0.10)	(0.12)	0.00	0.00	(0.21)

2010	Quarter ended				Full Year
	March 28, 2010	June 27, 2010	Sept 26, 2010	Dec 31, 2010	
Revenues	\$ 36,469	\$ 33,647	\$ 50,812	\$ 45,891	\$ 166,819
Gross profit	9,839	9,006	15,125	12,686	46,656
Net income (loss) attributable to Ultralife - continuing operations	1,232	583	5,992	3,391	11,198
Net income (loss) attributable to Ultralife - discontinued operations	(945)	(563)	(1,466)	(14,403)	(17,377)
Net income (loss) attributable to Ultralife common shares - continuing operations - basic	0.07	0.03	0.35	0.20	0.65
Net income (loss) attributable to Ultralife common shares - discontinued operations - basic	(0.05)	(0.03)	(0.09)	(0.84)	(1.01)
Net income (loss) attributable to Ultralife common shares - continuing operations - diluted	0.07	0.03	0.35	0.20	0.65
Net income (loss) attributable to Ultralife common shares - discontinued operations - diluted	(0.05)	(0.03)	(0.09)	(0.83)	(1.01)

Our current 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. Prior to January 1, 2011, we utilized a 5/4/4 weekly-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.

Quarterly and year-to-date computations of per share amounts are made independently; therefore, the sum of per share amounts for the quarters may not equal per share amounts for the year.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

#### ITEM 9A. CONTROLS AND PROCEDURES

**Evaluation Of Disclosure Controls And Procedures** – Our president and chief executive officer (principal executive officer) and our chief financial officer and treasurer (principal financial officer) have evaluated our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of the end of the period covered by this annual report. Based on this evaluation, our president and chief executive officer and chief financial officer and treasurer concluded that our disclosure controls and procedures were effective as of such date.

**Changes In Internal Controls Over Financial Reporting** – There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) that occurred during the fourth quarter of the fiscal year covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Management’s Report on Internal Control over Financial Reporting** – Our management team is responsible for establishing and maintaining adequate internal control over our financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of the inherent limitations of internal control systems, our internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control-Integrated Framework. Based on our assessment, we concluded that, as of December 31, 2011, our internal control over financial reporting was effective based on those criteria.

BDO USA, LLP, an independent registered public accounting firm that audited the financial statements included in this report, has issued a report on the operating effectiveness of our internal control over financial reporting. A copy of the report follows:

**Report of Independent Registered Public Accounting Firm on Internal Controls Over Financial Reporting**

Board of Directors and Shareholders  
Ultralife Corporation  
Newark, New York

We have audited Ultralife Corporation’s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Ultralife Corporation’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Item 9A, Management’s Report on Internal Control Over Financial Reporting”. Our responsibility is to express an opinion on the company’s internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Ultralife Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.



We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Ultralife Corporation as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity and accumulated other comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 13, 2012 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Troy, Michigan  
March 13, 2012

**ITEM 9B. OTHER INFORMATION**

None.

### PART III

The information required by Part III, other than as set forth in Item 12, and each of the following items is omitted from this report and will be presented in our definitive proxy statement ("Proxy Statement") to be filed pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report, in connection with our 2012 Annual Meeting of Shareholders, which information included therein is incorporated herein by reference.

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The sections entitled "Election of Directors", "Executive Officers", "Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance" in the Proxy Statement are incorporated herein by reference.

#### ITEM 11. EXECUTIVE COMPENSATION

The sections entitled "Executive Compensation", "Directors' Compensation", "Employment Arrangements" and "Compensation and Management Committee Report" in the Proxy Statement are incorporated herein by reference.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The section entitled "Security Ownership of Certain Beneficial Owners" and "Security Ownership of Management" in the Proxy Statement is incorporated herein by reference.

##### Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,307,446	\$ 8.25	598,995
Equity compensation plans not approved by security holders	<u>50,000</u>	<u>12.74</u>	<u>-</u>
Total	2,357,446	\$ 8.34	598,995

See Note 7 in Notes to Consolidated Financial Statements for additional information.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The section entitled "Corporate Governance - General" in the Proxy Statement is incorporated herein by reference.

#### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The section entitled "Proposal to Ratify the Selection of Independent Registered Accounting Firm - Principal Accountant Fees and Services" in the Proxy Statement is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

1. Financial Statements

The financial statements and schedules required by this Item 15 are set forth in Part II, Item 8 of this report.

2. Financial Statement Schedules

Schedule II – Valuation and Qualifying Accounts

See Item 15 (c)

(b) Exhibits. The following exhibits are filed as a part of this report:

Exhibit Index	Description of Document	Incorporated By Reference from:
3.1	Restated Certificate of Incorporation	Exhibit 3.1 of the Form 10-K for the year ended December 31, 2008, filed March 13, 2009
3.2	Amended and Restated By-laws	Exhibit 3.2 of the Form 8-K filed December 9, 2011
4.1	Specimen Stock Certificate	Exhibit 4.1 of the Form 10-K for the year ended December 31, 2008, filed March 13, 2009
10.1*	Technology Transfer Agreement relating to Lithium Batteries	Exhibit 10.19 of our Registration Statement on Form S-1 filed on October 7, 1994, File No. 33-84888 (the “1994 Registration Statement”)
10.2*	Technology Transfer Agreement relating to Lithium Batteries	Exhibit 10.20 of the 1994 Registration Statement
10.3*	Amendment to the Agreement relating to rechargeable batteries	Exhibit 10.24 of our Form 10-K for the fiscal year ended June 30, 1996 (this Exhibit may be found in SEC File No. 0-20852)
10.4†	Ultralife Batteries, Inc. 2000 Stock Option Plan	Exhibit 99.1 of our Registration Statement on Form S-8 filed on May 15, 2001, File No. 333-60984 (the “2001 Registration Statement”)
10.5†	Ultralife Batteries, Inc. Amended and Restated 2004 Long-Term Incentive Plan	Exhibit 99.2 of our Registration Statement on Form S-8 filed on July 26, 2004, File No. 333-117662
10.6	Agreement on Transfer of Shares in ABLE New Energy Co., Limited dated January 25, 2006	Exhibit 10.1 of the Form 10-Q for the fiscal quarter ended April 1, 2006 (the “March 2006 10-Q”)
10.7	First Amendment to Agreement on Transfer of Shares in ABLE New Energy Co., Limited	Exhibit 10.2 of the March 2006 10-Q
10.8	Agreement on Transfer of Equity Shares in ABLE New Energy Co., Ltd dated January 25, 2006	Exhibit 10.3 of the March 2006 10-Q
10.9†	Amendment No. 1 to Ultralife Batteries, Inc. Amended and Restated 2004 Long-Term Incentive Plan	Exhibit 99.3 of our Registration Statement on Form S-8 filed August 18, 2006, File No. 333-136737

10.10	Stock Purchase Agreement by and among Innovative Solutions Consulting, Inc., Michele A. Aloisio, Marc DeLaVergne, Thomas R. Knowlton, Kenneth J. Wood, W. Michael Cooper, and the Registrant, dated September 12, 2007	Exhibit 10.1 of the Form 10-Q for the fiscal quarter ended September 29, 2007, filed November 7, 2007
10.11	Stock Purchase Agreement by and among Stationary Power Services, Inc., William Maher, and the Registrant dated October 30, 2007	Exhibit 10.48 of the Form 10-K for the year ended December 31, 2007, filed March 19, 2008
10.12	Subordinated Convertible Promissory Note with William Maher	Exhibit 10.49 of the Form 10-K for the year ended December 31, 2007, filed March 19, 2008
10.13	Stock Purchase Agreement by and among Reserve Power Systems, Inc., William Maher, Edward Bellamy, and the Registrant dated October 30, 2007	Exhibit 10.50 of the Form 10-K for the year ended December 31, 2007, filed March 19, 2008
10.14	Amended and Restated Subordinated Promissory Note with William Maher effective March 28, 2009	Exhibit 10.3 of the Form 10-Q for the fiscal quarter ended March 29, 2009, filed May 7, 2009
10.15†	Amendment No. 2 to Ultralife Batteries, Inc. Amended and Restated 2004 Long-Term Incentive Plan	Exhibit 99.4 of our Registration Statement on Form S-8 filed November 13, 2008, File No. 333-155349
10.16†	Amendment No. 3 to Ultralife Batteries, Inc. Amended and Restated 2004 Long-Term Incentive Plan	Exhibit 99.5 of our Registration Statement on Form S-8 filed November 13, 2008, File No. 333-155349
10.17	Asset Purchase Agreement by and among U.S. Energy Systems, Inc., Ken Cotton, Shawn O'Connell, Simon Baitler, and the Registrant and Stationary Power Services, Inc. dated October 31, 2008	Exhibit 10.34 of the Form 10-K for the year ended December 31, 2008, filed March 13, 2009
10.18	Asset Purchase Agreement by and among U.S. Power Services, Inc., Ken Cotton, Shawn O'Connell, Simon Baitler, and the Registrant and Stationary Power Services, Inc. dated October 31, 2008	Exhibit 10.35 of the Form 10-K for the year ended December 31, 2008, filed March 13, 2009
10.19	Amendment No.1 to the Stock Purchase Agreement by and among Innovative Solutions Consulting, Inc., Michele A. Aloisio, Marc DeLaVergne, Thomas R. Knowlton, Kenneth J. Wood, W. Michael Cooper, and the Registrant, dated September 12, 2007	Exhibit 99.1 of the Form 8-K filed on February 13, 2009
10.20†	Employment Agreement between the Registrant and John D. Kavazanjian	Exhibit 99.1 of the Form 8-K filed on July 9, 2009
10.21†	Employment Agreement between the Registrant and Peter F. Comerford	Exhibit 10.30 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.22	Credit Agreement with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.33 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.23	Revolving Credit Note with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.34 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010

10.24	Form of Security Agreement between RBS Business Capital, a division of RBS Asset Finance, Inc. and each of Ultralife Corporation, McDowell Research Co., Inc., RedBlack Communications, Inc. and Stationary Power Services, Inc. dated as of February 17, 2010	Exhibit 10.35 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.25	Pledge and Security Agreement in favor of RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.36 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.26	Negative Pledge – Real Property with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.37 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.27	Patents Security Agreement with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.38 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.28	Trademark Security Agreement with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.39 of the Form 10-K for the year ended December 31, 2009, filed March 16, 2010
10.29	Amendment No. 2 to the Asset Purchase Agreement dated October 31, 2008 by and among U.S. Energy Systems, Inc., Ken Cotton, Shawn O’Connell, Simon Baitler, and the Registrant and Stationary Power Services, Inc. dated April 27, 2010	Exhibit 10.9 of the Form 10-Q for the fiscal quarter ended March 28, 2010, filed May 7, 2010
10.30†	Addendum to Employment Agreement between the Registrant and John D. Kavazanjian	Exhibit 99.1 of Form 8-K filed on May 27, 2010
10.31†	Employment Agreement between the Registrant and Michael D. Popielec dated December 6, 2010	Exhibit 10.40 of the Form 10-K for the year ended December 31, 2010, filed March 15, 2011
10.32	First Amendment to Credit Agreement with RBS Business Capital, a division of RBS Asset Finance, Inc. dated as of February 17, 2010	Exhibit 10.1 of the Form 8-K filed on January 21, 2011
10.33†	Revised definition of “Change in Control” for Ultralife Corporation Amended and Restated 2004 Long-Term Incentive Plan	Exhibit 10.1 of the Form 8-K filed on May 26, 2011
10.34	Settlement Agreement between the Registrant and the United States of America dated June 1, 2011	Exhibit 10.1 of the Form 8-K filed on June 2, 2011
10.35†	Agreement, Release and Waiver of all Claims with Patrick R. Hanna, Jr. dated July 15, 2011	Filed herewith
10.36†	Amendment No. 4 to Ultralife Corporation Amended and Restated Long-Term Incentive Plan	Exhibit 4.5 of the Registration Statement on Form S-8 filed on January 30, 2012, File No. 333-179235
21	Subsidiaries	Filed herewith
23.1	Consent of BDO USA, LLP	Filed herewith
31.1	CEO 302 Certifications	Filed herewith
31.2	CFO 302 Certifications	Filed herewith

32	906 Certifications	Filed herewith
100.INS	XBRL Instance Document	Filed herewith
100.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
100.CAL	XBRL Taxonomy Calculation Linkbase Document	Filed herewith
100.LAB	XBRL Taxonomy Label Linkbase Document	Filed herewith
100.PRE	XBRL Taxonomy Presentation Linkbase Document	Filed herewith
100.DEF	XBRL Taxonomy Definition Document	Filed herewith

\* Confidential treatment has been granted as to certain portions of this exhibit.

† Management contract or compensatory plan or arrangement.

(c) Financial Statement Schedules.

The following financial statement schedules of the Registrant are filed herewith:

Schedule II – Valuation and Qualifying Accounts

	<u>December 31,</u> <u>2010</u>	<u>Additions</u> Charged to			<u>December 31,</u> <u>2011</u>
		<u>Charged to</u> <u>Expense</u>	<u>Other</u> <u>Accounts</u>	<u>Deductions</u>	
Allowance for doubtful accounts	\$ 490	\$ 237	\$ (2)	\$ 42	\$ 683
Inventory reserves	3,781	1,537	1,074	1,233	5,159
Warranty reserves	1,314	591	-	1,066	839
Deferred tax valuation allowance	26,260	496	-	231	26,525

	<u>December 31,</u> <u>2009</u>	<u>Additions</u> Charged to			<u>December 31,</u> <u>2010</u>
		<u>Charged to</u> <u>Expense</u>	<u>Other</u> <u>Accounts</u>	<u>Deductions</u>	
Allowance for doubtful accounts	\$ 1,024	\$ (216)	\$ (7)	\$ 311	\$ 490
Inventory reserves	3,990	387	(10)	586	3,781
Warranty reserves	1,211	602	-	499	1,314
Deferred tax valuation allowance	25,775	(115)	-	(600)	26,260

	<u>December 31,</u> <u>2008</u>	<u>Additions</u> Charged to			<u>December 31,</u> <u>2009</u>
		<u>Charged to</u> <u>Expense</u>	<u>Other</u> <u>Accounts</u>	<u>Deductions</u>	
Allowance for doubtful accounts	\$ 1,086	\$ 188	\$ (42)	\$ 208	\$ 1,024
Inventory reserves	2,850	1,123	17	-	3,990
Warranty reserves	1,026	436	-	251	1,211
Deferred tax valuation allowance	23,605	360	-	(1,810)	25,775

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### ULTRALIFE CORPORATION

Date: March 12, 2012

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: March 12, 2012

/s/ Michael D. Popielec  
Michael D. Popielec  
President, Chief Executive Officer and Director  
(Principal Executive Officer)

Date: March 12, 2012

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

Date: March 12, 2012

/s/ Steven M. Anderson  
Steven M. Anderson (Director)

Date: March 12, 2012

/s/ Patricia C. Barron  
Patricia C. Barron (Director)

Date: March 12, 2012

/s/ James A. Croce  
James A. Croce (Director)

Date: March 12, 2012

/s/ Thomas L. Saeli  
Thomas L. Saeli (Director)

Date: March 12, 2012

/s/ Robert W. Shaw II  
Robert W. Shaw II (Director)

Date: March 12, 2012

/s/ Ranjit C. Singh  
Ranjit C. Singh (Director)

Date: March 12, 2012

/s/ Bradford T. Whitmore  
Bradford T. Whitmore (Director)

## Index to Exhibits

10.35	Agreement, Release and Waiver of all Claims with Patrick R. Hanna, Jr. dated July 15, 2011
21	Subsidiaries
23.1	Consent of BDO USA, LLP
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
101.DEF	XBRL Taxonomy Definition Document



**SUBSIDIARIES**

We have a 100% ownership interest in Ultralife Batteries (UK) Ltd., incorporated in the United Kingdom.

We have a 100% ownership interest in ABLE New Energy Co., Limited, incorporated in Hong Kong, which has a 100% ownership interest in ABLE New Energy Co., Ltd, incorporated in the People's Republic of China.

We have a 100% ownership interest in RedBlack Communications, Inc., incorporated in Maryland.

We have a 100% ownership interest in Ultralife Energy Services Corporation, incorporated in Florida.

We have a 51% ownership interest in Ultralife Batteries India Private Limited, incorporated in India.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-3 (Nos. 333-67808, 333-90984, 333-110426 and 333-136742) and Forms S-8 (Nos. 333-31930, 333-60984, 333-114271, 333-117662, 333-136737, 333-136738, 333-155347, 333-155349 and 333-179235) of Ultralife Corporation of our reports dated March 13, 2012 relating to the consolidated financial statements and financial statement schedule, and the effectiveness of Ultralife Corporation's internal control over financial reporting, which appear in this Form 10-K.

/s/ BDO USA, LLP

Troy, Michigan  
March 13, 2012

I, Michael D. Popielec, certify that:

1. I have reviewed this annual report on Form 10-K of Ultralife Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2012

/s/ Michael D. Popielec

Michael D. Popielec,  
President and Chief Executive Officer

I, Philip A. Fain, certify that:

1. I have reviewed this annual report on Form 10-K of Ultralife Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2012

/s/ Philip A. Fain

Philip A. Fain,  
Chief Financial Officer and Treasurer

Section 1350 Certification

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (“Section 906”), Michael D. Popielec and Philip A. Fain, the President and Chief Executive Officer and Chief Financial Officer and Treasurer, respectively, of Ultralife Corporation, certify that (i) the Annual Report on Form 10-K for the year ended December 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Ultralife Corporation.

A signed original of this written statement required by Section 906 has been provided to Ultralife Corporation and will be retained by Ultralife Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Date: March 12, 2012

/s/ Michael D. Popielec  
Michael D. Popielec,  
President and Chief Executive Officer

Date: March 12, 2012

/s/ Philip A. Fain  
Philip A. Fain,  
Chief Financial Officer and Treasurer

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## CORPORATE & SHAREHOLDER INFORMATION

### Board of Directors

Bradford T. Whitmore	Board Chair, Managing Partner, Grace Brothers, Ltd.
Steven M. Anderson	Brigadier General (Ret.) U.S. Army; Senior Vice President, Relyant LLC
Patricia C. Barron	Retired Clinical Associate Professor at the Leonard N. Stern School of Business of New York University
James A. Croce	President, Greenlark Energy Partners, LLC
Michael D. Popielec	President and Chief Executive Officer, Ultralife Corporation
Thomas L. Saeli	Chief Executive Officer, JRB Enterprises, Inc.
Robert W. Shaw II	President, Hornblower Yachts, Inc.
Ranjit C. Singh	Chief Executive Officer, CSR Consulting Group

### Corporate Officers

Michael D. Popielec	President and Chief Executive Officer
Peter F. Comerford	Vice President of Administration, Secretary and General Counsel
Philip A. Fain	Chief Financial Officer and Treasurer

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### Stock Exchange Listing

NASDAQ

### Stock Symbol

ULBI

### Stock Transfer Agent

American Stock Transfer & Trust Company  
59 Maiden Lane  
Plaza Level  
New York, NY 10038-4502

### Annual Meeting

June 5, 2012  
9:00 AM Eastern Time  
Crystal City Marriot at Reagan National Airport  
1999 Jefferson Davis Highway  
Arlington, VA 22202-3526

### Form 10-K

Shareholders may obtain a copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 by going to the Investor Info page at [www.ultralifecorp.com](http://www.ultralifecorp.com) or by calling us at 1-315-332-7100. This information is also available at no charge by sending a request to Shareholder Services at the following address:

Ultralife Corporation  
2000 Technology Parkway  
Newark, NY 14513  
Attn: Philip A. Fain



Ultralife Corporation • 2000 Technology Parkway • Newark, NY 14513 • 315-332-7100  
[www.ultralifecorp.com](http://www.ultralifecorp.com)

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