ULTRALIFE CORP
Form 10-Q
August 09, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 2012

or

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

For the transition period from ________________ to ________________

Commission File Number: 000-20852

ULTRALIFE CORPORATION
(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes..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 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 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...

At July 29, 2012, there were 17,405,908 shares of common stock $0.10 par value outstanding, net of 1,372,757 treasury shares.

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements

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

ASSETS	(Unaudited) July 1, 2012	December 31, 2011
Current assets:		
Cash and cash equivalents	$ 4,016	$ 5,320
Restricted cash	162	166
Trade accounts receivable (less allowance for doubtful accounts of $620 at July 1, 2012 and $683 at December 31, 2011)	15,611	19,903
Inventories	33,692	34,967
Due from insurance company	726	1,730
Deferred tax asset - current	161	161
Income taxes receivable	118	220
Prepaid expenses and other current assets	2,020	1,766
Total current assets	56,506	64,233
Property, plant and equipment, net	12,714	12,588
Other assets:		
Goodwill	18,379	18,356
Intangible assets, net	5,290	5,533
Security deposits and other long-term assets	102	105
	23,771	23,994
Total Assets	$ 92,991	$ 100,815
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of debt	$ 357	$ -
Accounts payable	10,748	13,766
Income taxes payable	2	11
Deferred tax liability - current	73	187
Other current liabilities	7,849	9,194
Total current liabilities	19,029	23,158
Long-term liabilities:		
Deferred tax liability - long-term	4,303	4,170
Other long-term liabilities	214	261
Total long-term liabilities	4,517	4,431

Commitments and contingencies (Note 10)		
Shareholders' equity:		
Ultralife equity:		
Preferred stock, par value $0.10 per share, authorized 1,000,000 shares; none issued and outstanding	-	-
Common stock, par value $0.10 per share, authorized 40,000,000 shares; issued - 18,778,665 at July 1, 2012 and 18,716,921 at December 31, 2011	1,881	1,874
Capital in excess of par value	173,087	172,309
Accumulated other comprehensive loss	(862)	(985)
Accumulated deficit	(96,949)	(92,280)
	77,157	80,918
Less --Treasury stock, at cost -- 1,372,757 shares at July 1, 2012 and 1,372,757 shares at December 31, 2011 outstanding	7,658	7,658
Total Ultralife equity	69,499	73,260
Noncontrolling interest	(54)	(34)
Total shareholders' equity	69,445	73,226
Total Liabilities and Shareholders' Equity	$ 92,991	$ 100,815

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

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

	Three-Month Periods Ended		Six-Month Periods Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Revenues	$ 18,706	$ 43,112	$ 46,207	$ 71,027
Cost of products sold	14,239	31,552	35,147	55,053
Gross profit	4,467	11,560	11,060	15,974
Operating expenses:				
Research and development (including $65, $79, $130 and $157, respectively, of amortization of intangible assets)	1,970	2,114	4,109	4,619
Selling, general, and administrative (including $60, $78, $120 and $157, respectively, of amortization of intangible assets)	5,429	6,409	11,172	12,254
Total operating expenses	7,399	8,523	15,281	16,873
Operating income (loss)	(2,932)	3,037	(4,221)	(899)
Other income (expense):				
Interest income	2	1	3	2
Interest expense	(115)	(162)	(219)	(318)
Miscellaneous	(20)	(9)	32	290
Income (loss) from continuing operations before income taxes	(3,065)	2,867	(4,405)	(925)
Income tax provision-current	188	63	267	67
Income tax provision (benefit)-deferred	(17)	55	(5)	109
Total income taxes provision	171	118	262	176
Net income (loss) from continuing operations	(3,236)	2,749	(4,667)	(1,101)
Discontinued operations:				
Income (loss) from discontinued operations, net of tax	49	(2,325)	(22)	(4,178)
Net income (loss)	(3,187)	424	(4,689)	(5,279)
Net (income) loss attributable to noncontrolling interest	20	15	20	28
Net income (loss) attributable to Ultralife	$ (3,167)	$ 439	$ (4,669)	$ (5,251)
Other comprehensive income (loss):				

Foreign currency translation adjustments	(25)	60	123	287
Comprehensive income (loss) attributable to Ultralife	$ (3,192)	$ 499	$ (4,546)	$ (4,964)
Net income (loss) attributable to Ultralife common shareholders - basic				
Continuing operations	$ (0.18)	$ 0.16	$ (0.27)	$ (0.06)
Discontinued operations	$ 0.00	$ (0.13)	$ (0.00)	$ (0.24)
Total	$ (0.18)	$ 0.03	$ (0.27)	$ (0.30)
Net income (loss) attributable to Ultralife common shareholders - diluted				
Continuing operations	$ (0.18)	$ 0.16	$ (0.27)	$ (0.06)
Discontinued operations	$ 0.00	$ (0.13)	$ (0.00)	$ (0.24)
Total	$ (0.18)	$ 0.03	$ (0.27)	$ (0.30)
Weighted average shares outstanding - basic	17,396	17,296	17,376	17,286
Weighted average shares outstanding - diluted	17,396	17,308	17,376	17,286

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

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

	Six-Month Periods Ended July 1, 2012	Six-Month Periods Ended July 3, 2011
OPERATING ACTIVITIES		
Net income (loss)	$ (4,689)	$ (5,279)
Loss from discontinued operations, net of tax	22	4,178
Adjustments to reconcile net income (loss) from continuing operations to net cash provided from operating activities:		
Depreciation and amortization of financing fees	1,717	1,830
Amortization of intangible assets	250	314
(Gain) loss on long-lived asset disposal and write-offs	5	-
Foreign exchange gain	(22)	(283)
Non-cash stock-based compensation	670	532
Changes in deferred income taxes	(5)	109
Changes in operating assets and liabilities:		
Accounts receivable	5,190	9,169
Inventories	1,273	(1,062)
Income taxes receivable	104	-
Prepaid expenses and other current assets	(284)	280
Insurance receivable relating to fires	1,022	(1,225)
Income taxes payable	(9)	(24)
Accounts payable and other liabilities	(5,536)	(3,766)
Net cash provided from (used in) operating activities from continuing operations	(292)	4,773
Net cash provided from operating activities from discontinued operations	-	90
Net cash provided from (used in) operating activities	(292)	4,863
INVESTING ACTIVITIES		
Purchase of property and equipment	(1,546)	(1,525)
Payments for acquired companies, net of cash acquired	-	(50)
Net cash used in investing activities from continuing operations	(1,546)	(1,575)
Net cash provided from investing activities from discontinued operations	-	91
Net cash used in investing activities	(1,546)	(1,484)
FINANCING ACTIVITIES		
Net change in revolving credit facility	357	(4,884)
Proceeds from issuance of common stock	115	53
Net cash provided from (used in) financing activities from continuing operations	472	(4,831)
Net cash used in financing activities from discontinued operations	-	(110)
Net cash provided from (used in) financing activities	472	(4,941)
Effect of exchange rate changes on cash	62	472
Change in cash and cash equivalents	(1,304)	(1,090)

Cash and cash equivalents at beginning of period	5,320	4,641
Cash and cash equivalents at end of period	$ 4,016	$ 3,551
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	$ 174	$ 91
Cash paid for interest	$ 146	$ 282

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

ULTRALIFE CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar Amounts in Thousands – Except Share and Per Share Amounts)
(unaudited)

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1. BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements of Ultralife Corporation and our subsidiaries have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the Condensed Consolidated Financial Statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the Consolidated Financial Statements contained in our Form 10-K for the twelve-month period ended December 31, 2011.

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

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

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

2. DISPOSITIONS AND EXIT ACTIVITIES

RedBlack Communications, Inc.

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 business 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 Communications Systems. Since 2008, our RedBlack Communications business has incurred significant operating losses. We are actively seeking to sell our RedBlack business as a going concern and have engaged appropriate professionals to assist in that effort. We have received non-binding letters of intent and interest from several interested parties and have executed one of them. 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. We expect the RedBlack divestiture to occur within the next nine months. Commencing with the first quarter of 2012 and concluding with the ultimate closing of the transaction, the results of the RedBlack operations and related divestiture costs will be reported as a discontinued operation.

As a result, the Condensed Consolidated Statements of Comprehensive Income (Loss) herein exclude the RedBlack operations from the results of continuing operations. The following amounts have been reported as discontinued operations for the three- and six-month periods ended July 1, 2012 and July 3, 2011:

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	Three-Month Periods Ended		Six-Month Periods Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Net sales	$ 951	$ 443	$ 2,137	$ 984
Income (Loss) from discontinued operations	68	(174)	56	(358)
Provision for income taxes	12	12	23	24
Income (Loss) from discontinued operations, net of tax	56	(186)	33	(382)

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.

Energy Services Business

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 review of our business segments and products, and taking into account the lack of growth and profitability potential of the Energy Services segment as well as its sizeable operating losses, we determined it was appropriate to refocus our operations on profitable growth opportunities presented in our other segments, Battery & Energy Products and Communications Systems. In the fourth quarter of 2010, we recorded a non-cash impairment charge of $13,793 to write-off the goodwill and intangible assets and certain fixed assets associated with the standby power portion of our Energy Services business.

The actions taken to exit our Energy Services 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 three- and six-month periods ended July 1, 2012 and July 3, 2011:

	Three-Month Periods Ended		Six-Month Periods Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Net sales	$ -	$ 1,607	$ -	$ 3,895
Loss from discontinued operations	(7)	(2,139)	(55)	(3,796)
Provision for income taxes	-	-	-	-
Loss from discontinued operations, net of tax	(7)	(2,139)	(55)	(3,796)

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

	Three-Month Periods Ended		Six-Month Periods Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Inventory and fixed asset write-downs	$ -	$ 472	$ -	$ 941
Employee related, including termination benefits	-	437	-	703
Lease termination costs	-	250	-	250
Other costs	-	980	-	1,030
Total Exit Costs	$ -	$ 2,139	$ -	$ 2,924
Cash Component	$ -	$ 1,666	$ -	$ 1,984

3. INVENTORIES

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

	July 1, 2012	December 31, 2011
Raw materials	$ 18,355	$ 20,097
Work in process	3,780	4,770
Finished goods	11,557	10,100
	$ 33,692	$ 34,967

4. PROPERTY, PLANT AND EQUIPMENT

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

	July 1, 2012	December 31, 2011
Land	$ 123	$ 123
Buildings and leasehold improvements	7,254	7,000
Machinery and equipment	45,751	44,770
Furniture and fixtures	1,933	1,894
Computer hardware and software	4,149	3,815
Construction in progress	942	641
	60,152	58,243
Less: Accumulated depreciation	47,438	45,655
	$ 12,714	$ 12,588

Depreciation expense for property, plant and equipment was $824 and $1,660 for the three- and six-month periods ended July 1, 2012, respectively, and $891 and $1,798 for the three- and six-month periods ended July 3, 2011, respectively.

5. GOODWILL AND INTANGIBLE ASSETS

a. Goodwill

The following table summarizes the goodwill activity by segment for the six-month periods ended July 1, 2012 and July 3, 2011:

	Battery & Energy Products	Communications Systems	Discontinued Operations	Total
Balance at December 31, 2010	$ 4,758	$ 11,493	$ 2,025	$18,276
Effect of foreign currency translations	42	-	-	42
Balance at July 3, 2011	4,800	11,493	2,025	18,318
Effect of foreign currency translations	38	-	-	38
Balance at December 31, 2011	4,838	11,493	2,025	18,356
Effect of foreign currency translations	23	-	-	23
Balance at July 1, 2012	$ 4,861	$ 11,493	$ 2,025	$18,379

b. Intangible Assets

The composition of intangible assets was:

	July 1, 2012		
	Gross Assets	Accumulated Amortization	Net
Trademarks	$3,564	$ -	$3,564
Patents and technology	4,497	3,574	923
Customer relationships	4,003	3,260	743
Distributor relationships	382	322	60
Non-compete agreements	397	397	-
Total intangible assets	$12,843	$ 7,553	$5,290

	December 31, 2011		
	Gross Assets	Accumulated Amortization	Net
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

Amortization expense for intangible assets was $125 and $250 for the three- and six-month periods ended July 1, 2012, respectively, and $157 and $314 for the three- and six-month periods ended July 3, 2011, respectively.

The change in the cost value of total intangible assets from December 31, 2011 to July 1, 2012 is a result of the effect of foreign currency translations.

6. DEBT

On February 17, 2010, we entered into a 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 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 into a First Amendment to the Credit Agreement (“First Amendment”) with RBS. The First Amendment amended the Credit Facility as follows:

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

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

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

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 coverage ratio of 1.20 to 1.00 or greater at all times as of and after March 28, 2010. As of July 1, 2012, our fixed charge coverage ratio was 2.00 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 July 1, 2012, we had $357 outstanding under the Credit Facility. At July 1, 2012, the interest rate on the asset based revolver component of the Credit Facility was 3.24%. As of July 1, 2012, the revolver arrangement had approximately $9,796 of additional borrowing capacity, including outstanding letters of credit. At July 1, 2012, we had $413 of outstanding letters of credit under the Credit Facility.

7. SHAREHOLDERS' EQUITY

a. Common Stock

In February 2012, we issued 16,271 shares of common stock to our non-employee directors, valued at $76.

In May 2012, we issued 17,473 shares of common stock to our non-employee directors, valued at $77.

b. Treasury Stock

At July 1, 2012 and December 31, 2011, we had 1,372,757 shares of treasury stock outstanding, valued at $7,658.

c. Stock Options

We have various stock-based employee compensation plans, for which we follow the provisions of the Financial Accounting Standards Board's ("FASB") 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 certain grants 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 shares 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 issued to employees. As of July 1, 2012, there were 2,265,928 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 stock option is fully vested and expires on March 7, 2015.

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 $252 and $516 for the three- and six-month periods ended July 1, 2012, respectively, and $162 and $401 for the three- and six-month periods ended July 3, 2011, respectively. As of July 1, 2012, there was $1,417 of total unrecognized compensation cost related to outstanding stock options, which is expected to be recognized over a weighted average period of 1.97 years.

We use the Black-Scholes option-pricing model to estimate the fair value of non-market performance stock-based awards. The following weighted average assumptions were used to value non-market performance stock options granted during the six-month periods ended July 1, 2012 and July 3, 2011.

	Six-Month Periods Ended			
	July 1, 2012		July 3, 2011	
Risk-free interest rate	0.59	%	1.22	%
Volatility factor	62.88	%	60.63	%
Dividends	0.00	%	0.00	%
Weighted average expected life (years)	3.91		3.82	

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 six-month period ended July 3, 2011. There were no market performance stock options granted during the six-months ended July 1, 2012.

	Six-Month Period Ended July 3, 2011	
Risk-free interest rate	2.74	%
Volatility factor	63.79	%
Dividends	0.00	%
Weighted average expected life (years)	5.51	

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.

Stock option activity for the first six months of 2012 is summarized as:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Shares under option at January 1, 2012	2,356,228	$ 8.34		
Options granted	156,000	4.02		
Options exercised	(28,000)	4.09		
Options forfeited	(52,816)	7.15		
Options expired	(67,484)	13.78		
Shares under option at July 1, 2012	2,363,928	$ 8.03	4.67 years	$ -
Vested and expected to vest as of July 1, 2012	2,087,864	$ 8.40	4.52 years	$ -
Options exercisable at July 1, 2012	996,070	$ 9.09	2.55 years	$ -

The total intrinsic value of stock 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 six-month period ended July 1, 2012 was $29.

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 stock options in excess of the deferred tax asset attributable to stock compensation costs for such stock options. We did not record any excess tax benefits in the first six months of 2012 and 2011. Cash received from stock option exercises under our stock-based compensation plans for the six-month periods ended July 1, 2012 and July 3, 2011 was $115 and $53, respectively.

d. Restricted Stock Awards

No restricted stock was awarded during the six-month periods ended July 1, 2012 and July 3, 2011.

The activity of restricted stock awards for the six months of 2012 is summarized as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2011	1,218	$ 11.33
Granted	-	-
Vested	(1,218)	11.33
Forfeited	-	-
Unvested at July 1, 2012	-	$ -

We recorded compensation cost related to restricted stock awards of $-0- and $1 for the three- and six-month periods ended July 1, 2012, respectively, and $10 and $(22) for the three- and six-month periods ended July 3, 2011, respectively. As of July 1, 2012, we had $-0- of total unrecognized compensation cost related to restricted stock awards. The total fair value of these grants that vested during the six-month period ended July 1, 2012 was $5.

8. INCOME TAXES

The asset and liability method, prescribed by FASB's guidance on 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.

For the three- and six-month periods ended July 1, 2012, we recorded $183 and $285, respectively, in income tax expense. For the three- and six-month periods ended July 3, 2011, we recorded $130 and $200, respectively, in income tax expense. The expense is primarily due to (a) the recognition of deferred tax liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods, and (b) the income reported for our China operations during the periods.

Our effective consolidated tax rate for the three- and six-month periods ended July 1, 2012 and July 3, 2011 was:

Three-Month Periods Ended		Six-Month Periods Ended	
July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011