

ABN AMRO HOLDING N V  
Form FWP  
May 07, 2009

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May 6, 2009

Relating to Preliminary Pricing Supplement No. 868 to

Registration Statement Nos. 333-137691, 333-137691-02  
Dated September 29, 2006

ABN AMRO Bank N.V. Reverse Exchangeable Securities

Preliminary Pricing Sheet – May 6, 2009

TWO OFFERINGS OF KNOCK-IN REXSM SECURITIES DUE MAY 28, 2010

OFFERING PERIOD: MAY 6, 2009 – MAY 26, 2009

SUMMARY  
INFORMATION

Issuer: ABN AMRO Bank N.V. (Senior Long Term Debt Rating: Moody's Aa2, S&P A+)\*\*

Lead Agent: ABN AMRO Incorporated

Offerings: This prospectus relates to two separate offerings of securities ("the Securities"). Each Security offered is linked to one, and only one, Underlying Stock. The Underlying Stocks are set forth in the table below. You may participate in either of the two Securities offerings or, at your election, in both of the offerings. This prospectus does not, however, allow you to purchase a Security linked to a basket of both of the Underlying Stocks described below.

Interest Payment Dates: Interest on the Securities is payable monthly in arrears on the last day of each month starting on June 30, 2009 and ending on the Maturity Date.

| Underlying Stock             | Ticker | Coupon<br>Rate Per<br>annum | Interest<br>Rate | Put<br>Premium | Knock-in<br>Level | CUSIP     | ISIN         |
|------------------------------|--------|-----------------------------|------------------|----------------|-------------------|-----------|--------------|
| CME Group Inc.               | CME    | 12.75%                      | 1.72%            | 11.03%         | 60%               | 00083JAS7 | US00083JAS78 |
| Valero Energy<br>Corporation | VLO    | 12.75%                      | 1.72%            | 11.03%         | 60%               | 00083JAT5 | US00083JAT51 |

Denomination/Principal: \$1,000

Issue Price: 100%

Payment at Maturity: The payment at maturity for each Security is based on the performance of the Underlying Stock linked to such Security:

- i) If the closing price of the Underlying Stock on the primary U.S. exchange or market for such Underlying Stock has not fallen below the Knock-In Level on any trading day from but not including the Pricing Date to and including the Determination Date, we will pay you the principal amount of each Security in cash.
- ii) If the closing price of the Underlying Stock on the primary U.S. exchange or market for such Underlying Stock has fallen below the Knock-In Level on any trading day from but not including the Pricing Date to and including the Determination Date:

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a) we will deliver to you a number of shares of the Underlying Stock equal to the Stock Redemption Amount, in the event that the closing price of the Underlying Stock on the Determination Date is below the Initial Price; or

b) We will pay you the principal amount of each Security in cash, in the event that the closing price of the Underlying Stock on the Determination Date is at or above the Initial Price.

You will receive cash in lieu of fractional shares. If due to events beyond our reasonable control, as determined by us in our sole discretion, shares of the Underlying Stock are not available for delivery at maturity we may pay you, in lieu of the Stock Redemption Amount, the cash value of the Stock Redemption Amount, determined by multiplying the Stock Redemption Amount by the Closing Price of the Underlying Stock on the Determination Date.

Initial Price: 100% of the Closing Price of the applicable Underlying Stock on the Pricing Date.

Stock Redemption Amount: For each \$1,000 principal amount of Security, a number of shares of the applicable Underlying Stock linked to such Security equal to \$1,000 divided by the applicable Initial Price.

Knock-In Level: A percentage of the applicable Initial Price as set forth in the table above.

Indicative Secondary Pricing: • Internet at: [www.s-notes.com](http://www.s-notes.com)  
Bloomberg at: REXS2 <GO>

Status: Unsecured, unsubordinated obligations of the Issuer

Trustee: Wilmington Trust Company

Securities Administrator: Citibank, N.A.

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|                           |  |
|---------------------------|--|
| Settlement:               | DTC, Book Entry, Transferable  |
| Selling Restrictions:     | Sales in the European Union must comply with the Prospectus Directive                      |
| Proposed Pricing Date:    | May 26, 2009 subject to certain adjustments as described in the related pricing supplement |
| Proposed Settlement Date: | May 29, 2009   |
| Determination Date:       | May 25, 2010 subject to certain adjustments as described in the related pricing supplement |
| Maturity Date:            | May 28, 2010 (One Year)  |

ABN AMRO has filed a registration statement (including a Prospectus and Prospectus Supplement) with the SEC for the offering to which this communication relates. Before you invest, you should read the Prospectus and Prospectus Supplement in that registration statement and other documents ABN AMRO has filed with the SEC for more complete information about ABN AMRO and the offering of the Securities.

You may get these documents for free by visiting EDGAR on the SEC website at <[www.sec.gov](http://www.sec.gov)> or by visiting ABN AMRO Holding N.V. on the SEC website at <<http://www.sec.gov/cgi-bin/browse-edgar?company=&CIK=abn&filenum=&State=&SIC=&owner=include&action=getcompany>>. Alternatively, ABN AMRO, any underwriter or any dealer participating in the offering will arrange to send you the Prospectus and Prospectus Supplement if you request it by calling toll free (866) 747-4332.

These Securities may not be offered or sold (i) to any person/entity listed on sanctions lists of the European Union, United States or any other applicable local competent authority; (ii) within the territory of Cuba, Sudan, Iran and Myanmar; (iii) to residents in Cuba, Sudan, Iran or Myanmar; or (iv) to Cuban Nationals, wherever located.

We reserve the right to withdraw, cancel or modify any offering and to reject orders in whole or in part.

\*\*A credit rating (1) is subject to revision, suspension or withdrawal at any time by the assigning rating organization, (2) does not take into account market risk or the performance related risks of investing in the Securities, and (3) is not a recommendation to buy, sell or hold the Securities.

## SUMMARY

This prospectus relates to two separate offerings of Securities. Each Security offered is linked to one, and only one, of the Underlying Stocks described on the cover page. The purchaser of any offering will acquire a Security linked to a single Underlying Stock, not to a basket or index of both of the Underlying Stocks. You may participate in either of the two offerings or, at your election, in both offerings.

The following summary does not contain all the information that may be important to you. You should read this summary together with the more detailed information that is contained in the related Pricing Supplement and in its accompanying Prospectus and Prospectus Supplement. You should carefully consider, among other things, the matters set forth in “Risk Factors” in the related Pricing Supplement, which are summarized on page 5 of this document. In addition, we urge you to consult with your investment, legal, accounting, tax and other advisors with respect to any investment in the Securities.

### What are the Securities?

The Securities are interest paying, non-principal protected securities issued by us, ABN AMRO Bank N.V., and are fully and unconditionally guaranteed by our parent company, ABN AMRO Holding N.V. The Securities are senior notes of ABN AMRO Bank N.V. These Securities combine certain features of debt and equity by offering a fixed interest rate on the principal amount while the payment at maturity is determined based on the performance of the Underlying Stock to which it is linked. Therefore your principal is at risk but you have no opportunity to participate in any appreciation of the Underlying Stock.

### What will I receive at maturity of the Securities?

The payment at maturity of each Security will depend on (i) whether or not the closing price of the Underlying Stock to which such Security is linked fell below the knock-in level on any trading day from but not including the pricing date to and including the determination date (such period, the “Knock-in Period”), and if so, (ii) the closing price of the applicable Underlying Stock on the determination date. To determine closing prices, we look at the prices quoted by the relevant exchange.

- If the closing price of the applicable Underlying Stock on the relevant exchange has not fallen below the applicable knock-in level on any trading day during the Knock-in Period, we will pay you the principal amount of each Security in cash.
- If the closing price of the applicable Underlying Stock on the relevant exchange has fallen below the applicable knock-in level on any trading day during the Knock-in Period, we will either:
- deliver to you the applicable stock redemption amount, in exchange for each Security, in the event that the closing price of the applicable Underlying Stock is below the applicable initial price on the determination date; or
- pay you the principal amount of each Security in cash, in the event that the closing price of the applicable Underlying Stock is at or above the applicable initial price on the determination date.

If due to events beyond our reasonable control, as determined by us in our sole discretion, shares of the applicable Underlying Stock are not available for delivery at maturity we may pay you, in lieu of the applicable Stock Redemption Amount, the cash value of the applicable Stock Redemption Amount, determined by multiplying the applicable Stock Redemption Amount by the Closing Price of the applicable Underlying Stock on the Determination Date.

Why is the interest rate on the Securities higher than the interest rate payable on your conventional debt securities with the same maturity?

The Securities offer a higher interest rate than the yield that would be payable on a conventional debt security with the same maturity issued by us or an issuer with a comparable credit rating because you, the investor in the Securities, indirectly sell a put option to us on the shares of the applicable Underlying Stock. The premium due to you for this put option is combined with a market interest rate on our senior debt to produce the higher interest rate on the Securities. As explained below under "What are the consequences of the indirect put option that I have sold you?" you are being paid the premium for taking the risk that you may receive Underlying Stock with a market value less than the principal amount of your Securities at maturity, which would mean that you would lose some or all of your initial principal investment.

What are the consequences of the indirect put option that I have sold you?

The put option you indirectly sell to us creates the feature of exchangeability. This feature could result in the delivery of Underlying Stock to you, at maturity, with a market value which is less than the principal amount of \$1,000 per Security. If the closing price of the applicable Underlying Stock on the relevant exchange falls below the applicable Knock-In Level on any trading day during the Knock-In Period, and on the Determination Date the closing price of the applicable Underlying Stock is less than the applicable Initial Price, you will receive the applicable Stock Redemption Amount. The market value of the shares of such Underlying Stock on the Determination Date will be less than the principal amount of the Securities and could be zero. Therefore you are not guaranteed to receive any return of principal at maturity. If the price of the Underlying Stock rises above the initial price you

will not participate in any appreciation in the price of the Underlying Stock.

How is the Stock Redemption Amount determined?

The Stock Redemption Amount for each \$1,000 principal amount of any Security is equal to \$1,000 divided by the Initial Price of the Underlying Stock linked to such Security. The value of any fractional shares of such Underlying Stock that you are entitled to receive, after aggregating your total holdings of the Securities linked to such Underlying Stock, will be paid in cash based on the closing price of such Underlying Stock on the Determination Date.

What interest payments can I expect on the Securities?

The interest rate is fixed at issue and is payable in cash on each interest payment date, irrespective of whether the Securities are redeemed at maturity for cash or shares.

Can you give me an example of the payment at maturity?

If, for example, in a hypothetical offering, the interest rate was 10% per annum, the initial price of a share of underlying stock was \$45.00 and the knock-in level for such offering was 80%, then the stock redemption amount would be 22.222 shares of underlying stock, or \$1,000 divided by \$45.00, and the knock-in level would be \$36.00, or 80% of the initial price.

If the closing price of that hypothetical underlying stock fell below the knock-in level of \$36.00 on any trading day during the Knock-in Period, then the payment at maturity would depend on the closing price of the underlying stock on the determination date. In this case, if the closing price of the underlying stock on the determination date is \$30.00 per share at maturity, which is below the initial price level, you would receive 22.222 shares of underlying stock for each \$1,000 principal amount of the securities. (In actuality, because we cannot deliver fractions of a share, you would receive on the maturity date for each \$1,000 principal amount of the securities 22 shares of underlying stock plus \$6.66 cash in lieu of 0.222 fractional shares, determined by multiplying 0.222 by \$30.00, the closing price per shares of underlying stock on the determination date.) In addition, over the life of the securities you would have received interest payments at a rate of 10% per annum. In this hypothetical example, the market value of those 22 shares of underlying stock (including the cash paid in lieu of fractional shares) that we would deliver to you at maturity for each \$1,000 principal amount of security would be \$666.66, which is less than the principal amount of \$1,000, and you would have lost a portion of your initial investment. If, on the other hand, the closing price of the underlying stock on the determination date is \$50.00 per share, which is above the initial price level, you will receive \$1,000 in cash for each \$1,000 principal amount of the securities regardless of the knock-in level having been breached. In addition, over the life of the Securities you would have received interest payments at a rate of 10% per annum.

Alternatively, if the closing price of the underlying stock never falls below \$36.00, which is the knock-in level, on any trading day during the Knock-in Period, at maturity you will receive \$1,000 in cash for each security you hold regardless of the closing price of the underlying stock on the determination date. In addition, over the life of the securities you would have received interest payments at a rate of 10% per annum.

This example is for illustrative purposes only and is based on a hypothetical offering. It is not possible to predict the closing price of any of the Underlying Stocks on the determination date or at any time during the life of the Securities. For each offering, we will set the Initial Price, Knock-In Level and Stock Redemption Amount on the Pricing Date.

Do I benefit from any appreciation in the Underlying Stock over the life of the Securities?

No. The amount paid at maturity for each \$1,000 principal amount of the Securities will not exceed \$1,000.

What if I have more questions?

You should read “Description of Securities” in the related Pricing Supplement for a detailed description of the terms of the Securities. ABN AMRO has filed a registration statement (including a Prospectus and Prospectus Supplement) with the SEC for the offering to which this communication relates. Before you invest, you should read the Prospectus and Prospectus Supplement in that registration statement and other documents ABN AMRO has filed with the SEC for more complete information about ABN AMRO and the offering of the Securities. You may get these documents for free by visiting EDGAR on the SEC web site at [www.sec.gov](http://www.sec.gov). Alternatively, ABN AMRO, any underwriter or any dealer participating in the offering will arrange to send you the Prospectus and Prospectus Supplement if you request it by calling toll free (888) 644-2048.

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## RISK FACTORS

Investors should carefully consider the risks of the Securities to which this communication relates and whether these Securities are suited to their particular circumstances before deciding to purchase them. It is important that prior to investing in these Securities investors read the Pricing Supplement related to such Securities and the accompanying Prospectus and Prospectus Supplement to understand the actual terms of and the risks associated with the Securities. In addition, we urge investors to consult with their investment, legal, accounting, tax and other advisors with respect to any investment in the Securities.

### Credit Risk

The Securities are issued by ABN AMRO Bank N.V. and guaranteed by ABN AMRO Holding N.V., ABN AMRO's parent. As a result, investors assume the credit risk of ABN AMRO Bank N.V. and that of ABN AMRO Holding N.V. in the event that ABN AMRO defaults on its obligations under the Securities. Any obligations or Securities sold, offered, or recommended are not deposits on ABN AMRO Bank N.V. and are not endorsed or guaranteed by any bank or thrift, nor are they insured by the FDIC or any governmental agency.

### Principal Risk

The Securities are not ordinary debt securities: they are not principal protected. In addition, if the closing price of the applicable Underlying Stock falls below the applicable Knock-In Level on any trading day during the Knock-In Period, investors in the Securities will be exposed to any decline in the price of the applicable Underlying Stock below the closing price of such Underlying Stock on the date the Securities were priced. Accordingly, investors may lose some or all of their initial investment in the Securities.

### Limited Return

The amount payable under the Securities will never exceed the original principal amount of the Securities plus the applicable aggregate fixed coupon payment investors earn during the term of the Securities. This means that investors will not benefit from any price appreciation in the applicable Underlying Stock, nor will they receive dividends paid on the applicable Underlying Stock, if any. Accordingly, investors will never receive at maturity an amount greater than a predetermined amount per Security, regardless of how much the price of the applicable Underlying Stock increases during the term of the Securities or on the Determination Date. The return of a Security may be significantly less than the return of a direct investment in the Underlying Stock to which the Security is linked during the term of the Security.

### Liquidity Risk

The Securities will not be listed on any securities exchange. Accordingly, there may be little or no secondary market for the Securities and information regarding independent market pricing of the Securities may be very limited or non-existent. The value of the Securities in the secondary market, if any, will be subject to many unpredictable factors, including then prevailing market conditions.

It is important to note that many factors will contribute to the secondary market value of the Securities, and investors may not receive their full principal back if the Securities are sold prior to maturity. Such factors include, but are not limited to, time to maturity, the price of the applicable Underlying Stock, volatility and interest rates.

In addition, the price, if any, at which we or another party are willing to purchase Securities in secondary market transactions will likely be lower than the issue price, since the issue price included, and secondary market prices are likely to exclude, commissions, discounts or mark-ups paid with respect to the Securities, as well as the cost of

hedging our obligations under the Securities.

#### Tax Risk

Pursuant to the terms of the Knock-in Reverse Exchangeable Securities, we and every investor agree to characterize the Securities as consisting of a Put Option and a Deposit of cash with the issuer. Under this characterization, a portion of the stated interest payments on each Security is treated as interest on the Deposit, and the remainder is treated as attributable to a sale by the investor of the Put Option to ABN AMRO (referred to as Put Premium). Receipt of the Put Premium will not be taxable upon receipt.

If the Put Option expires unexercised (i.e., a cash payment of the principal amount of the Securities is made to the investor at maturity), the investor will recognize short-term capital gain equal to the total Put Premium received. If the Put Option is exercised (i.e., the final payment on the Securities is paid in the applicable Underlying Stock), the investor will not recognize any gain or loss in respect of the Put Option, but the investor's tax basis in the applicable Underlying Stock received will be reduced by the Put Premium received.

Significant aspects of the U.S. federal income tax treatment of the Securities are uncertain, and no assurance can be given that the Internal Revenue Service will accept, or a court will uphold, the tax treatment described above.

This summary is limited to the federal tax issues addressed herein. Additional issues may exist that are not addressed in this summary and that could affect the federal tax treatment of the transaction. This tax summary was written in connection with the promotion or marketing by ABN AMRO Bank N.V. and the placement agent of the Knock-in Reverse Exchangeable Securities, and it cannot be used by any investor for the purpose of avoiding penalties that may be asserted against the investor under the Internal Revenue Code. Investors should seek their own advice based on their particular circumstances from an independent tax advisor.

On December 7, 2007, the U.S. Treasury and the Internal Revenue Service released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. While it is not entirely clear whether the Securities are among the instruments described in the notice, it is possible that any Treasury regulations or other guidance issued after consideration of the issues raised in the notice could materially and adversely affect the tax consequences of ownership and disposition of the Securities, possibly on a retroactive basis.

The notice indicates that it is possible the IRS may adopt a new position with respect to how the IRS characterizes income or loss (including, for example, whether the option premium might be currently included as ordinary income) on the Securities for U.S. holders of the Securities.

You should consult your tax advisor regarding the notice and its potential implications for an investment in the Securities.

Reverse Exchangeable is a Service Mark of ABN AMRO Bank N.V.

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Principal payments on debt and capital lease obligations  
(1,468) (1,669)  
Purchase of treasury stock  
(3,326)

Net cash provided from (used in) financing activities

22,817 (10,597)

Effect of exchange rate changes on cash

269 59

Change in cash and cash equivalents

(181) 3,272

Cash and cash equivalents at beginning of period

1,878 2,245

Cash and cash equivalents at end of period

\$1,697 \$5,517

#### SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for income taxes

\$605 \$

Cash paid for interest

\$823 \$787

Noncash investing and financing activities:

Purchase of property and equipment via notes payable

\$102 \$66

Conversion of convertible notes into shares of common stock

\$ \$10,500

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

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

**1. BASIS OF PRESENTATION**

The accompanying unaudited Condensed Consolidated Financial Statements of Ultralife Corporation and our subsidiaries have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the Condensed Consolidated Financial Statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the Consolidated Financial Statements contained in our Form 10-K for the twelve-month period ended December 31, 2008.

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 5/4/4 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.

We have evaluated subsequent events through November 6, 2009, which is the date these financial statements were issued.

**2. ACQUISITIONS AND JOINT VENTURES**

**2009 Activity**

We accounted for the following acquisitions in accordance with the purchase method of accounting provisions of the revised Financial Accounting Standards Board ( 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.

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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 are included in our Condensed Consolidated Financial Statements beginning on the acquisition date. 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 \$4,320 was recorded as goodwill in the amount of \$1,397. We are in the process of completing the valuations of certain tangible and intangible assets acquired with the new business. The final allocation of the excess of the purchase price over the net assets acquired is subject to revision based upon our final review of valuation assumptions. The acquired goodwill will be assigned to the Communications Systems segment and is expected to be fully deductible for income tax purposes.

As a result of revisions to the preliminary asset valuations during the third quarter of 2009, values assigned to the tangible assets have been revised. The adjustments to the values for tangible assets from those reported for the second quarter of 2009 were as follows: other current liabilities increased by \$136. These adjustments resulted in an increase to goodwill of \$136.

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

**ASSETS**

## Current assets:

|                                    |    |       |
|------------------------------------|----|-------|
| Cash                               | \$ |       |
| Trade accounts receivable, net     |    | 696   |
| Inventories                        |    | 2,350 |
| Total current assets               |    | 3,046 |
| Property, plant and equipment, net |    | 206   |
| Goodwill                           |    | 1,397 |
| Intangible Assets:                 |    |       |
| Trademarks                         |    | 450   |
| Patents and Technology             |    | 800   |
| Customer Relationships             |    | 920   |
| Total assets acquired              |    | 6,819 |

**LIABILITIES**

## Current liabilities:

|                             |  |       |
|-----------------------------|--|-------|
| Accounts payable            |  | 801   |
| Other current liabilities   |  | 301   |
| Total current liabilities   |  | 1,102 |
| Long-term liabilities:      |  |       |
| Other long-term liabilities |  |       |
| Total liabilities assumed   |  | 1,102 |

|                      |    |       |
|----------------------|----|-------|
| Total Purchase Price | \$ | 5,717 |
|----------------------|----|-------|

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.

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**2008 Activity**

We accounted for the following acquisitions, including the establishment of a joint venture, in accordance with the purchase method of accounting provisions of the pre-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.

**Ultralife Batteries India Private Limited**

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 \$86 in cash into the India JV, as consideration for our 51% ownership stake in the India JV.

**U.S. Energy Systems, Inc. and U.S. Power Services, Inc.**

On November 10, 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. USE is located in Riverside, California. The acquired assets of USE have been incorporated into our Stationary Power Services, Inc. subsidiary.

Under the terms of the asset purchase agreements for USE, the initial purchase price consisted of \$2,865 in cash. In addition, on the achievement of certain annual post-acquisition financial milestones during the period ending December 31, 2012, we will issue up to an aggregate of 200,000 unregistered shares of our common stock. The unregistered shares of common stock will be issued after the first occasion annual sales for a calendar year exceed \$10,000 (30,000 shares), \$15,000 (40,000 shares), \$20,000 (60,000 shares), and \$25,000 (70,000 shares). The contingent stock issuances will be recorded as an addition to the purchase price when the financial milestones are attained. We incurred \$65 in acquisition related costs, which are included in the initial cost of the USE investment of \$2,930. During the third quarter of 2009, \$3 of additional acquisition costs were incurred, which resulted in an increase to goodwill of \$3.

The results of operations of USE and the estimated fair value of assets acquired and liabilities assumed are included in our Condensed Consolidated Financial Statements beginning on the acquisition date. 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 \$1,499 was recorded as goodwill in the amount of \$1,431. The acquired goodwill has been assigned to the Design and Installation Services segment and is expected to be fully deductible for income tax purposes.

Values assigned to the intangible assets were revised and finalized during the third quarter of 2009. The adjustments to the values for intangible assets from those reported for the second quarter of 2009 were as follows: patents and technology decreased by \$40 and customer relationships decreased by \$20. These adjustments resulted in an increase to goodwill of \$60.

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

**ASSETS**

## Current assets:

|                                    |    |       |
|------------------------------------|----|-------|
| Cash                               | \$ |       |
| Total current assets               |    |       |
| Property, plant and equipment, net |    | 306   |
| Goodwill                           |    | 1,431 |
| Intangible Assets:                 |    |       |
| Patents and Technology             |    | 220   |
| Customer Relationships             |    | 1,300 |
| Total assets acquired              |    | 3,257 |

**LIABILITIES**

## Current liabilities:

|                                   |  |     |
|-----------------------------------|--|-----|
| Current portion of long-term debt |  | 56  |
| Other current liabilities         |  | 43  |
| Total current liabilities         |  | 99  |
| Long-term liabilities:            |  |     |
| Debt                              |  | 228 |
| Total liabilities assumed         |  | 327 |

|                      |    |       |
|----------------------|----|-------|
| Total Purchase Price | \$ | 2,930 |
|----------------------|----|-------|

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 fifteen years.

**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:

|                                | September 27,<br>2009 | December 31,<br>2008 |
|--------------------------------|-----------------------|----------------------|
| Raw materials                  | \$ 27,477             | \$ 29,352            |
| Work in process                | 7,476                 | 9,087                |
| Finished goods                 | 11,761                | 4,876                |
|                                | 46,714                | 43,315               |
| Less: Reserve for obsolescence | 3,807                 | 2,850                |
|                                | \$ 42,907             | \$ 40,465            |



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

|                                      | September 27,<br>2009 | December 31,<br>2008 |
|--------------------------------------|-----------------------|----------------------|
| Land                                 | \$ 123                | \$ 123               |
| Buildings and leasehold improvements | 5,982                 | 5,274                |
| Machinery and equipment              | 43,844                | 42,172               |
| Furniture and fixtures               | 1,823                 | 1,669                |
| Computer hardware and software       | 3,387                 | 2,808                |
| Construction in progress             | 1,181                 | 2,023                |
|                                      | 56,340                | 54,069               |
| Less: Accumulated depreciation       | 39,049                | 35,604               |
|                                      | \$ 17,291             | \$ 18,465            |

Depreciation expense for property, plant and equipment was \$1,016 and \$2,910 for the three- and nine-month periods ended September 27, 2009, respectively, and \$943 and \$2,822 for the three- and nine-month periods ended September 27, 2008, respectively.

**5. GOODWILL AND INTANGIBLE ASSETS****a. Goodwill**

The following table summarizes the goodwill activity by segment for the nine-month periods ended September 27, 2009 and 2008:

|  | <b>Non-<br/>Rechargeable<br/>Products</b> | <b>Rechargeable<br/>Products</b> | <b>Communications<br/>Systems</b> | <b>Design<br/>and<br/>Installation<br/>Services</b> | <b>Total</b> |
|--|---|----------------------------------|-----------------------------------|---|--------------|
| Balance at December 31, 2007             | \$ 1,703                                  | \$ 4,287                         | \$ 10,460                         | \$ 4,730  | \$ 21,180    |
| Adjustments to purchase price allocation | 250                                       | 30                               |                                   | 233   | 513          |
| Effect of foreign currency translations  | 114                                       |                                  |                                   |   | 114          |
| Balance at September 27, 2008            | 2,067                                     | 4,317                            | 10,460                            | 4,963   | 21,807       |
| Adjustments to purchase price allocation |   | 19                               |                                   | 1   | 20           |
| Acquisition of US Energy                 |   |                                  |                                   | 1,111   | 1,111        |
| Effect of foreign currency translations  | 5   |                                  |                                   |   | 5            |
| Balance at December 31, 2008             | 2,072                                     | 4,336                            | 10,460                            | 6,075   | 22,943       |
|  |   | 111                              |                                   | 1,158   | 1,269        |

|  |  |  |  |       |  |  |       |
|--|--|--|--|-------|--|--|-------|
| Adjustments to purchase price allocation |  |  |  |       |  |  |       |
| Acquisition of AMTI                      |  |  |  | 1,397 |  |  | 1,397 |
| Effect of foreign currency translations  |  |  |  |       |  |  |       |

Balance at September 27, 2009    \$     2,072    \$     4,447    \$     11,857    \$     7,233    \$    25,609

On February 9, 2009, we entered into Amendment No. 1 to the RedBlack Communications, Inc. stock purchase agreement, which eliminated the up to \$2,000 in additional cash consideration contingent on the achievement of certain sales milestones provision, in exchange for a one time final payment of \$1,020. The one time final payment of \$1,020 was made in February 2009, and resulted in an increase to goodwill of \$838 (net of the \$182 amount that was accrued during the third quarter of 2008) in the Design and Installation Services segment, in the first quarter of 2009, and a revised total cost of the investment of \$2,104.

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Through September 27, 2009, we have accrued \$111 for the 2009 portion of the contingent cash consideration in connection with the purchase price for RPS Power Systems, Inc., which is included in the other current liabilities line on our Condensed Consolidated Balance Sheet. This accrual resulted in an increase to goodwill of \$111 in the Rechargeable Products segment.

## b. Intangible Assets

The composition of intangible assets was:

|                           | September 27, 2009 |                             |           |
|---------------------------|--------------------|-----------------------------|-----------|
|                           | Gross<br>Assets    | Accumulated<br>Amortization | Net       |
| Trademarks                | \$ 4,856           | \$                          | \$ 4,856  |
| Patents and technology    | 5,119              | 2,710                       | 2,409     |
| Customer relationships    | 9,772              | 3,696                       | 6,076     |
| Distributor relationships | 352                | 206                         | 146       |
| Non-compete agreements    | 393                | 388                         | 5         |
| <br>                      |                    |                             |           |
| Total intangible assets   | \$ 20,492          | \$ 7,000                    | \$ 13,492 |

|                           | December 31, 2008 |                             |           |
|---------------------------|-------------------|-----------------------------|-----------|
|                           | Gross<br>Assets   | Accumulated<br>Amortization | Net       |
| Trademarks                | \$ 4,789          | \$                          | \$ 4,789  |
| Patents and technology    | 4,229             | 2,313                       | 1,916     |
| Customer relationships    | 8,906             | 2,934                       | 5,972     |
| Distributor relationships | 352               | 180                         | 172       |
| Non-compete agreements    | 393               | 317                         | 76        |
| <br>                      |                   |                             |           |
| Total intangible assets   | \$ 18,669         | \$ 5,744                    | \$ 12,925 |

Amortization expense for intangible assets was \$449 and \$1,256 for the three- and nine-month periods ended September 27, 2009, respectively, and \$517 and \$1,563 for the three- and nine-month periods ended September 27, 2008, respectively.

The change in the cost value of total intangible assets from December 31, 2008 to September 27, 2009 is a result of the 2009 acquisition, changes in the valuation of tangible and intangible assets in connection with the 2008 acquisition and the effect of foreign currency translations.

## 6. DEBT

Our primary credit facility consists of both a term loan component and a revolver component, and the facility is collateralized by essentially all of our assets, including those of our subsidiaries. The lenders of the credit facility are JP Morgan Chase Bank, N.A. and Manufacturers and Traders Trust Company (together, the Lenders ), with JP Morgan Chase Bank acting as the administrative agent ( Agent ). The current revolver loan commitment is \$35,000. Availability under the revolving credit component is subject to meeting certain financial covenants, including a debt to earnings ratio and a fixed charge coverage ratio. In addition, we are required to meet certain non-financial covenants. The rate

of interest, in general, is based upon either the Prime Rate plus 200 basis points or LIBOR plus 500 basis points.

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On June 30, 2004, we drew down on a \$10,000 term loan under the credit facility. The term loan was repaid in equal monthly installments of \$167 over five years. On July 1, 2004, we entered into an interest rate swap arrangement in the notional amount of \$10,000 to be effective on August 2, 2004, related to the \$10,000 term loan, in order to take advantage of historically low interest rates. We received a fixed rate of interest in exchange for a variable rate. The swap rate received was 3.98% for five years. The total rate of interest paid by us was equal to the swap rate of 3.98% plus the applicable Eurodollar spread associated with the term loan. During the full year of 2008, the adjusted rate ranged from 5.73% to 6.48%. During the first nine months of 2009, the adjusted rate was 6.48%. Derivative instruments are accounted for in accordance with FASB's guidance in accounting for derivative instruments and hedging activities, which requires that all derivative instruments be recognized in the financial statements at fair value. In July 2009, we paid the final monthly installment for the term loan under the credit facility and have no further obligations relating to the term loan portion of the credit facility. Correspondingly, the interest rate swap arrangement we entered into in connection with the term loan under the credit facility has expired and we have no further obligations under the interest rate swap arrangement.

There have been several amendments to the credit facility during the past few years, including amendments to authorize acquisitions and modify financial covenants. Effective April 23, 2008, we entered into Amendment Number Ten to Credit Agreement ( Amendment Ten ) with the Lenders. Amendment Ten increased the amount of the revolving credit facility from \$15,000 to \$22,500, an increase of \$7,500. Additionally, Amendment Ten amended the applicable revolver and term rates under the Credit Agreement from a variable pricing grid based on quarterly financial ratios to a set interest rate structure based on either the current prime rate, or a LIBOR rate plus 250 basis points.

Effective January 27, 2009, we entered into an Amended and Restated Credit Agreement (the Restated Credit Agreement ) with the Lenders. The Restated Credit Agreement reflects the previous ten amendments to the original Credit Agreement dated June 30, 2004 between us and the Lenders and modifies certain of those provisions. The Restated Credit Agreement among other things (i) increased the revolver loan commitment from \$22,500 to \$35,000, (ii) extended the maturity date of the revolving credit component from January 31, 2009 to June 30, 2010, (iii) modified the interest rate, and (iv) modified certain covenants. The rate of interest is based, in general, upon either a LIBOR rate plus a Eurodollar spread or an Alternate Base Rate plus an ABR spread, as that term is defined in the Restated Credit Agreement, within a predetermined grid, which is dependent upon whether Earnings Before Interest and Taxes for the most recently completed fiscal quarter is greater than or less than zero. Generally, borrowings under the Restated Credit Agreement bear interest based primarily on the Prime Rate plus 50 to 200 basis points or LIBOR plus 300 to 500 basis points. Additionally, among other covenant modifications, the Restated Credit Agreement modified the financial covenants by (i) revising the debt to earnings ratio and fixed charge coverage ratio and (ii) deleting the current assets to total liabilities ratio.

Effective June 28, 2009, we entered into Waiver and Amendment Number One to Amended and Restated Credit Agreement ( Waiver and Amendment ) with the Lenders and Agent. The Waiver and Amendment provided that the Lenders and Agent would waive their right to exercise their respective rights and remedies under the credit facility arising from our failure to comply with the financial covenants in the credit facility with respect to the fiscal quarter ended June 28, 2009. In addition to a number of revisions to non-financial covenants, the Waiver and Amendment revised the applicable revolver rate under the Restated Credit Agreement to an interest rate structure based on the Prime Rate plus 200 basis points or LIBOR plus 500 basis points.

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As stated in the Restated Credit Agreement, as amended by the Waiver and Amendment, we are required to maintain a debt to earnings ratio at or below 2.75 to 1 and a fixed charge ratio at or above 1.25 to 1. As of September 27, 2009, our debt to earnings ratio was (34.37) to 1 and our fixed charge ratio was (0.07) to 1. Accordingly, we were not in compliance with the financial covenants of our credit facility. This constitutes an event of default under the terms of our existing credit facility which would entitle our Lenders to provide us with notice that they were exercising their rights under the credit facility. Although we have not received such a notice from our Lenders, there are no constraints on their ability to do so. If we were to receive a notice of default from our Lenders, we would not be able to cure our default, and our Lenders would be able to exercise their rights and remedies as secured creditors of our indebtedness. Our Lenders would be able to terminate any commitment to lend additional funds to us and demand payment in full of the outstanding indebtedness under our credit facility, which indebtedness totaled \$15,500 as of the date of this Quarterly Report on Form 10-Q. We currently do not have sufficient liquidity to satisfy such payment demand, were it to occur. Unless we were able to obtain additional capital resources, or appropriate waivers and forbearances from our Lenders, we would not be able to continue to fund our operations in the ordinary course or continue our business as currently conducted.

We are seeking to change our existing revolving credit line to an asset-based credit facility that will more closely match our operating needs and provide funding for our future operations and have evaluated proposals from our existing Lenders as well as other potential lenders. We have accepted a proposal for an asset-based credit facility which, if and when completed, would result in full payment of all of our obligations under our existing credit facility. In connection with that proposal, we are in active discussions with our current Lenders to secure a forbearance agreement. If we do not succeed in securing that agreement, our current Lenders could demand payment in full of the current outstanding indebtedness upon providing notice of default. We can provide no assurance that we will be able to obtain the forbearance agreement that we are currently discussing. Nor can we assure that we will succeed in obtaining any commitments to secure the asset-based credit facility that we are currently seeking. If we do not succeed in negotiating a forbearance agreement with our Lenders, they would be able to commence foreclosure on some or all of our assets that serve as collateral for the debt owed our Lenders, or exercise other rights and remedies given them under our current credit facility. Substantially all of our assets, tangible and intangible, serve as collateral for the debt that is owed our Lenders. In that event, we would likely be compelled to seek protection under Chapter 11 of the United States Bankruptcy Code. If this were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

As of September 27, 2009, we had \$-0- outstanding under the term loan component of our credit facility with our primary lending bank and \$26,550 was outstanding under the revolver component. At September 27, 2009, the interest rate on the revolver component was 5.25%. As of September 27, 2009, the revolver arrangement provided for up to \$35,000 of borrowing capacity, including outstanding letters of credit. At September 27, 2009, we had \$325 of outstanding letters of credit related to this facility, leaving \$8,125 of additional borrowing capacity.

Our relations with our Lenders have become strained due to our recent operating results and our failure to meet the financial covenants of our existing credit facility. We have received waivers as necessary in the past, and we are in active discussions with our current Lenders to secure a forbearance agreement. There can be no assurance, however, that such discussions will result in the execution and delivery of an appropriate forbearance agreement. Similarly, there can be no assurance that waivers or forbearances will always be obtained when needed in the future. If we are unable to obtain the forbearance agreement from our Lenders, we may need to implement alternative plans to provide us with sufficient levels of liquidity and working capital. 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. Our ability to refinance our current credit facility, if necessary, or to secure additional capital resources to fund our operational and growth strategies will depend, in large part, on our ability to access the credit markets. The recent disruption in credit markets and our recent operating losses make it uncertain whether we will be able to access the credit markets when necessary or desirable. If we are not able to access credit markets and obtain financing on commercially reasonable terms when needed, our business could be materially harmed and our results of operations could be adversely affected.



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On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell Research, Ltd. relating to various operational issues that arose during the first several months following the July 2006 acquisition that significantly reduced our profit margins. The settlement agreement amount was approximately \$7,900. The settlement agreement reduced the principal amount on the convertible notes initially issued in that transaction from \$20,000 to \$14,000, and eliminated a \$1,889 liability related to a purchase price adjustment. In addition, the interest rate on the convertible notes was increased from 4% to 5% and we made prepayments totaling \$3,500 on the convertible notes. Upon payment of the \$3,500 in November 2007, we reported a one-time, non-operating gain of approximately \$7,550 to account for the settlement, net of certain adjustments related to the change in the interest rate on the convertible notes. Based on the facts and circumstances surrounding the settlement agreement, there was not a clear and direct link to the acquisition's purchase price; therefore, we recorded the settlement as an adjustment to income in accordance with the pre-revised FASB guidance for business combinations. In January 2008, the remaining \$10,500 principal balance on the convertible notes was converted in full into 700,000 shares of our common stock, and the remaining \$313 that pertained to the change in the interest rate on the notes was recorded in other income as a gain on debt conversion.

**7. SHAREHOLDERS' EQUITY****a. Common Stock**

In February 2009, we issued 4,388 shares of common stock to our non-employee directors, valued at \$37.

In May 2009, we issued 10,725 shares of common stock to our non-employee directors, valued at \$76.

In August 2009, we issued 11,881 shares of common stock to our non-employee directors, valued at \$76.

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.

**b. Treasury Stock**

At September 27, 2009 and December 31, 2008, we had 1,358,507 and 942,202 shares, respectively, of treasury stock outstanding, valued at \$7,558 and \$4,232, respectively. The increase in treasury shares related to shares that were repurchased under our share repurchase program.

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.

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c. 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 options, restricted stock and other equity-based awards. In addition, our shareholders on occasion have approved the grant of options outside of these plans.

In December 2000, our shareholders approved a 2000 stock option plan for grants to key employees, directors and consultants. The shareholders approved reservation of 500,000 shares of common stock for grant under the plan. In December 2002, the shareholders approved an amendment to the plan increasing the number of shares of common stock reserved by 500,000, to a total of 1,000,000 shares.

In June 2004, our 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. In June 2006, the shareholders approved an amendment to the LTIP, increasing the number of shares of common stock by an additional 750,000, bringing the total shares authorized under the LTIP to 1,500,000. In June 2008, the shareholders approved another amendment to the LTIP, increasing the number of shares of common stock by an additional 500,000, bringing the total shares authorized under the LTIP to 2,000,000 shares.

Stock options granted under the amended 2000 stock option plan and 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 September 27, 2009, there were 1,618,976 stock options outstanding under the amended 2000 stock option plan and the LTIP.

On December 19, 2005, we granted our President and Chief Executive Officer, John D. Kavazanjian, an option to purchase 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 option to purchase 48,000 shares of common stock is fully vested. The option expires on June 8, 2013.

On March 7, 2008, in connection with his becoming employed with us, we granted our Vice-President of Business Development, 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 vests in annual increments of 16,667 shares over a three-year period which commenced March 7, 2009. The option expires on March 7, 2015.

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On June 9, 2009, in connection with his becoming employed with us, we granted our current Vice-President of Finance and Chief Financial Officer, John C. Casper, an option to purchase 30,000 shares of common stock at \$7.1845 per share outside of any of our equity-based compensation plans. The option vests in annual increments of 10,000 shares over a three-year period commencing June 9, 2010. The option expires on June 9, 2016.

In conjunction with FASB's guidance for share-based payments, we recorded compensation cost related to stock options of \$53 and \$797 for the three- and nine-month periods ended September 27, 2009, respectively, and \$418 and \$1,330 for the three- and nine-month periods ended September 27, 2008, respectively. As of September 27, 2009, there was \$494 of total unrecognized compensation costs related to outstanding stock options, which is expected to be recognized over a weighted average period of 1.18 years.

We use the Black-Scholes option-pricing model to estimate the fair value of stock-based awards. The following weighted average assumptions were used to value options granted during the nine-month periods ended September 27, 2009 and 2008:

|  | <b>Nine-Month Periods Ended</b>   |                                   |
|--|-----------------------------------|-----------------------------------|
|  | <b>September<br/>27,<br/>2009</b> | <b>September<br/>27,<br/>2008</b> |
| Risk-free interest rate                | 1.44%                             | 2.33%                             |
| Volatility factor                      | 68.58%                            | 59.46%                            |
| Dividends                              | 0.00%                             | 0.00%                             |
| Weighted average expected life (years) | 3.51                              | 3.55                              |

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 nine months of 2009 is summarized as:

|  | <b>Number<br/>of Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>Per Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|--|-----------------------------|--|--|--|
| Shares under option at January 1, 2009               | 1,651,007                   | \$ 12.33   |  |  |
| Options granted                                      | 250,820                     | 8.35   |  |  |
| Options exercised                                    | (89,355)                    | 4.87   |  |  |
| Options forfeited                                    | (39,319)                    | 11.40  |  |  |
| Options expired                                      | (26,177)                    | 16.44  |  |  |
| Shares under option at September 27, 2009            | 1,746,976                   | \$ 12.10   | 3.63 years   | \$ 71                                    |
| Vested and expected to vest as of September 27, 2009 | 1,667,983                   | \$ 12.17   | 3.55 years   | \$ 70                                    |
| Options exercisable at September 27, 2009            | 1,229,546                   | \$ 12.85   | 2.84 years   | \$ 69                                    |

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 nine-month period ended September 27, 2009 was \$371.

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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 the first nine months of 2009 and 2008. Cash received from option exercises under our stock-based compensation plans for the nine-month periods ended September 27, 2009 and 2008 was \$187 and \$1,267, respectively.

**d. 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 is \$12.30 per share and the warrants have 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. At September 27, 2009, there were 8,000 warrants outstanding.

**e. Restricted Stock Awards**

Restricted stock grants awarded during the nine-month periods ended September 27, 2009 and 2008 had the following values:

|                                       | <b>Nine-Month Period<br/>Ended<br/>September 27, 2009</b> | <b>Nine-Month Period<br/>Ended<br/>September 27, 2008</b> |
|---------------------------------------|---|---|
| Number of shares awarded              | 24,786  | 6,800   |
| Weighted average fair value per share | \$ 10.58  | \$ 12.59  |
| Aggregate total value                 | \$ 246  | \$ 86   |

The activity of restricted stock awards of common stock for the first nine months of 2009 is summarized as follows:

|                                | <b>Number of<br/>Shares</b> | <b>Weighted Average<br/>Grant Date Fair<br/>Value</b> |
|--------------------------------|-----------------------------|---|
| Unvested at December 31, 2008  | 76,664                      | \$ 11.47  |
| Granted                        | 24,786                      | 7.44  |
| Vested                         | (26,100)                    | 11.64   |
| Forfeited                      | (4,722)                     | 11.31   |
| Unvested at September 27, 2009 | 70,628                      | \$ 10.00  |

We recorded compensation cost related to restricted stock grants of \$(211) and \$9 for the three- and nine-month periods ended September 27, 2009, respectively, and \$77 and \$361 for the three- and nine-month periods ended September 27, 2008, respectively. During the third quarter of 2009, we have determined that the 2009 performance measure for certain performance-based restricted stock grants will not be achieved. Therefore, these restricted stock grants will not vest, and we have reversed the prior period recognized expense of \$301 for these performance-based restricted stock grants.

As of September 27, 2009, we had \$308 of total unrecognized compensation expense related to restricted stock grants, which is expected to be recognized over the remaining weighted average period of approximately 1.03 years. The total fair value of these grants that vested during the nine-month period ended September 27, 2009 was \$183.

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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 bases 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 nine-month periods ended September 27, 2009, we recorded \$105 and \$291, respectively, in income tax expense. The expense is primarily due to the recognition of deferred tax liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods.

For the three- and nine-month periods ended September 27, 2008, we recorded \$213 and \$3,617, respectively, in income tax expense. The second quarter of 2008 tax provision included an approximate \$3,100 non-cash charge to record a deferred tax liability for liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. Substantially all of this adjustment related to book/tax differences that occurred during 2007 and were identified during the second quarter of 2008. In connection with this adjustment, we reviewed the illustrative list of qualitative considerations provided in SEC Staff Accounting Bulletin No. 99 and other qualitative factors in our determination that this adjustment was not material to the 2007 consolidated financial statements or this quarterly report on Form 10-Q. The remaining expense was primarily due to the income reported for U.S. operations during the period.

The effective tax rate for the total consolidated company for the three- and nine-month periods ended September 27, 2009 and 2008 was:

|  | Three-Month Periods Ended<br>September 27, |          | Nine-Month Periods Ended<br>September 27, |           |
|--|--|----------|---|-----------|
|  | 2009                                       | 2008     | 2009                                      | 2008      |
| Income (Loss) before Incomes Taxes (a) | \$ (508)                                   | \$ 4,880 | \$ (9,816)                                | \$ 17,085 |
| Total Income Tax Provision (b)         | \$ 105                                     | \$ 213   | \$ 291                                    | \$ 3,617  |
| Effective Tax Rate (b/a)               | 20.7%                                      | 4.4%     | 3.0%                                      | 21.2%     |

The overall effective rate is the result of the combination of income and losses in each of our tax jurisdictions, which is particularly influenced by the fact that we have not recognized a deferred tax asset pertaining to cumulative historical losses for our U.S. operations and our U.K. subsidiary, as management does not believe, at this time, it is more likely than not that we will realize the benefit of these losses. We have substantial net operating loss carryforwards which offset taxable income in the United States. However, we remain subject to the alternative minimum tax in the United States. The alternative minimum tax limits the amount of net operating loss available to offset taxable income to 90% of the current year income. This limitation did have an impact on income taxes determined for 2008, and we incurred \$151 and \$469 in alternative minimum tax for the three- and nine-month periods ended September 27, 2008, respectively. However, we expect the alternative minimum tax will not have an impact on income taxes to be determined for 2009, and accordingly, have not recorded any alternative minimum tax for the three- and nine-month periods ended September 27, 2009. The tax provision for 2008 includes a provision for the U.S. alternative minimum tax as well as state income taxes, for states in which we do not have the ability to utilize net operating loss carryforwards. Normally, the payment of the alternative minimum tax results in the establishment of a deferred tax asset. However, we have established a valuation allowance for our net U.S. deferred tax asset. Therefore, the expected payment of the alternative minimum tax does not result in a net deferred tax asset.

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As of December 31, 2008, we have foreign and domestic net operating loss carryforwards totaling approximately \$58,403 available to reduce future taxable income. Foreign loss carryforwards of approximately \$8,963 can be carried forward indefinitely. The domestic net operating loss carryforwards of \$49,440 expire from 2018 through 2027. The domestic net operating loss carryforwards include approximately \$2,687 of the net operating loss carryforwards for which a benefit will be recorded in capital in excess of par value when realized.

During the fiscal quarter ended December 31, 2006, we recorded a full valuation allowance on our net deferred tax asset, due to the determination, at that time, that it was more likely than not that we would not be able to utilize our U.S. and U.K. net operating loss carryforwards ( NOL s ) that had accumulated over time. At September 27, 2009, we continue to recognize a valuation allowance on our U.S. deferred tax asset, to the extent that we believe, that it is more likely than not that we will not be able to utilize that portion of our U.S. NOL s that had accumulated over time. A U.S. valuation allowance is not required for the portion of the deferred tax asset that will be realized by the reversal of temporary differences related to deferred tax liabilities to the extent those temporary differences are expected to reverse in our carryforward period. At September 27, 2009, we continue to recognize a full valuation allowance on our U.K. net deferred tax asset, as we believe, at this time, that it is more likely than not that we will not be able to utilize our U.K. NOL s that had accumulated over time. We continually monitor the assumptions and performance results to assess the realizability of the tax benefits of the U.S. and U.K. net operating losses and other deferred tax assets. 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 2008 and 2009, and as such, have not recorded any interest or penalty in regard to any unrecognized benefit. 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). We file a consolidated income tax return in the U.S. federal jurisdiction and consolidated and separate income tax returns in many state and foreign jurisdictions. Our U.S. tax matters for the years 2006 through 2008 remain subject to examination by the Internal Revenue Service ( IRS ). Our U.S. tax matters for the years 2004 through 2008 remain subject to examination by various state and local tax jurisdictions. Our tax matters for the years 2004 through 2008 remain subject to examination by the respective foreign tax jurisdiction authorities.

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 and \$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 2009. However, this limitation did have an impact of \$151 and \$469 on income taxes determined for the three- and nine-month periods ended September 27, 2008, respectively. 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.

**Table of Contents****9. EARNINGS 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 changed the prior period earnings per share (EPS) amount for the three-month period ended September 27, 2008. Diluted EPS was decreased from \$0.27 per share to \$0.26 per share. The remaining prior period EPS amounts did not change from the retrospective application of the provisions of FASB's guidance.

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 three- and nine-month periods ended September 27, 2009 and for the nine-month period ended September 27, 2008, both the Two-Class Method and the treasury stock method calculations for diluted EPS yielded the same result. For the three-month period ended September 27, 2008, the Two-Class Method calculation for diluted EPS yielded \$0.26, while the treasury stock method calculation for diluted EPS yielded \$0.27. The computation of basic and diluted earnings per share is summarized as follows:

|   | Three-Month Periods Ended<br>September 27, |            | Nine-Month Periods Ended<br>September 27, |            |
|---|--|------------|---|------------|
|   | 2009                                       | 2008       | 2009                                      | 2008       |
| Net Income (Loss) attributable to Ultralife   | \$ (605)                                   | \$ 4,657   | \$ (10,081)                               | \$ 13,486  |
| Net Income (Loss) attributable to participating securities (unvested restricted stock awards) (-0-, 81,000, -0-, and 85,000 shares, respectively) |  | (22)       |   | (66)       |
| Net Income (Loss) attributable to Ultralife common shareholders (a)   | (605)                                      | 4,635      | (10,081)                                  | 13,420     |
| Effect of Dilutive Securities:  |  |            |   |            |
| Convertible Notes Payable   |  | 50         |   | 165        |
| Net Income (Loss) attributable to Ultralife common shareholders Adjusted (b)  | \$ (605)                                   | \$ 4,685   | \$ (10,081)                               | \$ 13,585  |
| Average Common Shares Outstanding Basic (c)   | 16,921,000                                 | 17,366,000 | 16,996,000                                | 17,220,000 |
| Effect of Dilutive Securities:  |  |            |   |            |
| Stock Options / Warrants  |  | 89,000     |   | 185,000    |
| Convertible Notes Payable   |  | 267,000    |   | 337,000    |
| Average Common Shares Outstanding Diluted (d)   | 16,921,000                                 | 17,722,000 | 16,996,000                                | 17,742,000 |
| EPS Basic (a/c)   | \$ (0.04)                                  | \$ 0.27    | \$ (0.59)                                 | \$ 0.78    |

|                   |    |        |    |      |    |        |    |      |
|-------------------|----|--------|----|------|----|--------|----|------|
| EPS Diluted (b/d) | \$ | (0.04) | \$ | 0.26 | \$ | (0.59) | \$ | 0.77 |
|-------------------|----|--------|----|------|----|--------|----|------|

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There were 1,805,776 and 1,438,001 outstanding stock options, warrants and restricted stock awards for the three-month periods ended September 27, 2009 and 2008, respectively, that were not included in EPS as the effect would be anti-dilutive. We also had 227,995 shares of common stock for the three-month period ended September 27, 2009 reserved under convertible notes payable, which were not included in EPS as the effect would be anti-dilutive. The dilutive effect of -0- and 390,957 outstanding stock options, warrants and restricted stock awards were included in the dilution computation for the three-month periods ended September 27, 2009 and 2008, respectively. We also had 266,667 shares of common stock reserved under convertible notes payable, which were included in the dilution computation for the three-month period ended September 27, 2008.

There were 1,805,776 and 1,048,435 outstanding stock options, warrants and restricted stock awards for the nine-month periods ended September 27, 2009 and 2008, respectively, that were not included in EPS as the effect would be anti-dilutive. We also had 239,597 shares of common stock for the nine-month period ended September 27, 2009 reserved under convertible notes payable, which were not included in EPS as the effect would be anti-dilutive. The dilutive effect of -0- and 781,123 outstanding stock options, warrants and restricted stock awards were included in the dilution computation for the nine-month periods ended September 27, 2009 and 2008, respectively. We also had 336,667 shares of common stock reserved under convertible notes payable, which were included in the dilution computation for the nine-month period ended September 27, 2008.

**10. COMPREHENSIVE INCOME**

The components of our total comprehensive income (loss) were:

|   | Three-Month Periods Ended |          | Nine-Month Periods Ended |           |
|---|---------------------------|----------|--------------------------|-----------|
|   | September 27,             |          | September 27,            |           |
|   | 2009                      | 2008     | 2009                     | 2008      |
| Net income (loss) attributable to Ultralife | \$ (605)                  | \$ 4,657 | \$ (10,081)              | \$ 13,486 |
| Foreign currency translation adjustments    | (201)                     | (628)    | 661                      | (447)     |
| Change in fair value of derivatives         | 1                         | 9        | 12                       | (10)      |
| Total comprehensive income (loss)           | \$ (805)                  | \$ 4,038 | \$ (9,408)               | \$ 13,029 |

**11. COMMITMENTS AND CONTINGENCIES****a. Purchase Commitments**

As of September 27, 2009, we have made commitments to purchase approximately \$346 of production machinery and equipment.

**b. Product Warranties**

We estimate future costs associated with expected product failure rates, material usage and service costs in the development of our warranty obligations. Warranty reserves are based on historical experience of warranty claims and generally will be estimated as a percentage of sales over the warranty period. In the event the actual results of these items differ from the estimates, an adjustment to the warranty obligation would be recorded. Changes in our product warranty liability during the first nine months of 2009 were as follows:

|                                |          |
|--------------------------------|----------|
| Balance at December 31, 2008   | \$ 1,010 |
| Accruals for warranties issued | 228      |
| Settlements made               | (193)    |
| Balance at September 27, 2009  | \$ 1,045 |

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## c. Contingencies and 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.

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, the parties 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 on our Condensed Consolidated Balance Sheets relating to this matter. We further agreed to issue an \$800 credit on future purchases to our customer in this matter. 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 Condensed Consolidated Statements of Operations.

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) between the parties. 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 claimed 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. Accordingly, no accrual has been made or reflected in the Condensed Consolidated Financial Statement as of September 27, 2009.

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. NYSDEC reviewed the report and, in January 2002, recommended additional testing. We responded by submitting a work plan to 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 NYSDEC and to the New York State Department of Health (NYSDOH). The NYSDEC, with input from the NYSDOH, requested that we perform additional

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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, 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 is working to incorporate the requested changes and will submit a revised work plan for review and approval. The final Remedial Action Plan selected may increase the estimated remediation costs modestly. Through September 27, 2009, total costs incurred have amounted to approximately \$247, none of which has been capitalized. At September 27, 2009 and December 31, 2008, we had \$39 and \$52, respectively, reserved for this matter.

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 have, by design, joint and several liability during the time they participate in the trust. In August 2006, we left the self-insured trust and have 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. The Verified Complaint estimates 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 estimates our pro-rata share of the liability for the period of December 1, 1997 - November 30, 2003 is \$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 states 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 are subject to adjustment based on a forensic audit of the trust that is currently 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. While the potential of joint and several liability exists, we have paid all assessments that have been levied against us to date during our participation in the trust. In addition, our liability is limited to the extent that the trust was underfunded for the years of our participation. As of September 27, 2009, we have determined that our \$350 reserve for this potential liability continues to be reasonable. The final amount may be more or less, depending upon the ultimate settlement of claims that remain in the trust for the period of time we were a member. It may take several years before resolution of outstanding workers' compensation claims are finally settled. We will continue to review this liability periodically and make adjustments

accordingly as new information is collected.

**Table of Contents****d. Post-Audits of Government Contracts**

We have had certain exigent, non-bid contracts with the U.S. government, which have been subject to an audit and final price adjustment, which have resulted in decreased margins compared with the original terms of the contracts. As of September 27, 2009, there were no outstanding exigent contracts with the government. As part of its due diligence, the 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. We have reviewed these audit reports, have submitted our response to these audits and believe, taken as a whole, the proposed audit adjustments can be offset with the consideration of other compensating cost increases that occurred prior to the final negotiation of the contracts. While we believe that potential exposure exists relating to any final negotiation of these proposed adjustments, we cannot reasonably estimate what, if any, adjustment may result when finalized. 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 continue to cooperate 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. At this time we have no basis for assessing whether we might face any penalties or liabilities on account of the DoD IG inquiry. The aforementioned DCAA-related adjustments could reduce margins and, along with the aforementioned DoD IG inquiry, could have an adverse effect on our business, financial condition and results of operations.

**e. Government Grants/Loans**

We have been able to obtain certain grants/loans from government agencies to assist with various funding needs. In November 2001, we received approval for a \$300 grant/loan from New York State. The grant/loan was to fund capital expansion plans that we expected would lead to job creation. In this case, we were to be reimbursed after the full completion of the particular project. This grant/loan also required us to meet and maintain certain levels of employment. During 2002, since we did not meet the initial employment threshold, it appeared unlikely at that time that we would be able to gain access to these funds. However, during 2006, our employment levels had increased to a level that exceeded the minimum threshold, and we received these funds in April 2007. This grant/loan required us to not only meet, but maintain, our employment levels for a pre-determined time period. Our employment levels met the specified levels as of December 31, 2007 and 2008. As a result of meeting the employment levels as of December 31, 2008, we have satisfied all of the requirements for the grant/loan, and no amounts are owed on such grant/loan. 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 September 27, 2009, approximately \$480 has been distributed under the grant. Under an agreement with the City of West Point, we have agreed to employ at least 30 full-time employees at the facility, of which 51% of the jobs must be filled or made available to low or moderate income families, within three years of completion of the CDBG improvement activities. In addition, we have 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. In the event we fail to honor these commitments, we are obligated to reimburse all amounts received under the CDBG to the City of West Point, Mississippi.

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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 September 27, 2009, approximately \$150 has been distributed under the grant. Under an agreement with Clay County, we have agreed to employ at least 30 full-time employees at the facility, of which 51% of the jobs must be filled or made available to low or moderate income families, within two years of completion of the RIFG improvement activities. In addition, we have 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. In the event we fail to honor these commitments, we are obligated to reimburse all amounts received under the RIFG to Clay County, Mississippi.

**12. BUSINESS SEGMENT INFORMATION**

We report our results in four operating segments: Non-Rechargeable Products, Rechargeable Products, Communications Systems and Design and Installation Services. The Non-Rechargeable Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries. The Rechargeable Products segment includes: rechargeable batteries, charging systems, uninterruptable power supplies and accessories, such as cables. The Communications Systems segment includes: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication system kits. The Design and Installation Services segment includes: standby power and communications and electronics systems design, installation and maintenance activities and revenues and related costs associated with various development contracts. We look at our segment performance at the gross margin level, and we do not allocate research and development or selling, general and administrative costs against the segments. All other items that do not specifically relate to these four segments and are not considered in the performance of the segments are considered to be Corporate charges.

**Three-Month Period Ended September 27, 2009**

|                                       | <b>Non-<br/>Rechargeable<br/>Products</b> | <b>Rechargeable<br/>Products</b> | <b>Communications<br/>Systems</b> | <b>Design<br/>and<br/>Installation<br/>Services</b> | <b>Corporate</b> | <b>Total</b> |
|---------------------------------------|---|----------------------------------|-----------------------------------|---|------------------|--------------|
| Revenues                              | \$ 18,358                                 | \$ 8,484                         | \$ 9,565                          | \$ 5,956  | \$               | \$ 42,363    |
| Segment contribution                  | 3,357                                     | 2,001                            | 3,745                             | 1,261   | (10,768)         | (404)        |
| Interest expense, net                 |   |                                  |                                   |   | (454)            | (454)        |
| Miscellaneous                         |   |                                  |                                   |   | 350              | 350          |
| Income taxes-current                  |   |                                  |                                   |   | (17)             | (17)         |
| Income taxes-deferred                 |   |                                  |                                   |   | (88)             | (88)         |
| Non controlling interest              |   |                                  |                                   |   | 8                | 8            |
| Net loss attributable to<br>Ultralife |   |                                  |                                   |   |                  | \$ (605)     |
| Total assets                          | \$ 42,996                                 | \$ 24,165                        | \$ 44,106                         | \$ 22,463   | \$ 5,870         | \$ 139,600   |

**Table of Contents****Three-Month Period Ended September 27, 2008**

|                                      | Non-Rechargeable Products |        | Rechargeable Products | Communications Systems | Design and Installation Services | Corporate | Total |        |    |          |            |
|--------------------------------------|---------------------------|--------|-----------------------|------------------------|----------------------------------|-----------|-------|--------|----|----------|------------|
| Revenues                             | \$                        | 15,741 | \$                    | 8,020                  | \$                               | 40,675    | \$    | 3,557  | \$ | 67,993   |            |
| Segment contribution                 |                           | 1,906  |                       | 1,738                  |                                  | 11,371    |       | 671    |    | (10,388) | 5,298      |
| Interest expense, net                |                           |        |                       |                        |                                  |           |       |        |    | (243)    | (243)      |
| Miscellaneous                        |                           |        |                       |                        |                                  |           |       |        |    | (175)    | (175)      |
| Income taxes-current                 |                           |        |                       |                        |                                  |           |       |        |    | (151)    | (151)      |
| Income taxes-deferred                |                           |        |                       |                        |                                  |           |       |        |    | (62)     | (62)       |
| Non controlling interest             |                           |        |                       |                        |                                  |           |       |        |    | (10)     | (10)       |
| Net income attributable to Ultralife |                           |        |                       |                        |                                  |           |       |        |    |          | \$ 4,657   |
| Total assets                         | \$                        | 43,527 | \$                    | 22,212                 | \$                               | 44,559    | \$    | 16,081 | \$ | 9,965    | \$ 136,344 |

**Nine-Month Period Ended September 27, 2009**

|                                    | Non-Rechargeable Products |        | Rechargeable Products | Communications Systems | Design and Installation Services | Corporate | Total |        |    |          |             |
|------------------------------------|---------------------------|--------|-----------------------|------------------------|----------------------------------|-----------|-------|--------|----|----------|-------------|
| Revenues                           | \$                        | 52,855 | \$                    | 32,645                 | \$                               | 20,402    | \$    | 15,857 | \$ | 121,759  |             |
| Segment contribution               |                           | 9,536  |                       | 7,426                  |                                  | 5,960     |       | 2,003  |    | (33,911) | (8,986)     |
| Interest expense, net              |                           |        |                       |                        |                                  |           |       |        |    | (982)    | (982)       |
| Miscellaneous                      |                           |        |                       |                        |                                  |           |       |        |    | 152      | 152         |
| Income taxes-current               |                           |        |                       |                        |                                  |           |       |        |    | (19)     | (19)        |
| Income taxes-deferred              |                           |        |                       |                        |                                  |           |       |        |    | (272)    | (272)       |
| Non controlling interest           |                           |        |                       |                        |                                  |           |       |        |    | 26       | 26          |
| Net loss attributable to Ultralife |                           |        |                       |                        |                                  |           |       |        |    |          | \$ (10,081) |
| Total assets                       | \$                        | 42,996 | \$                    | 24,165                 | \$                               | 44,106    | \$    | 22,463 | \$ | 5,870    | \$ 139,600  |

**Nine-Month Period Ended September 27, 2008**

|                          | Non-Rechargeable Products |        | Rechargeable Products | Communications Systems | Design and Installation Services | Corporate | Total |        |    |          |           |
|--------------------------|---------------------------|--------|-----------------------|------------------------|----------------------------------|-----------|-------|--------|----|----------|-----------|
| Revenues                 | \$                        | 48,056 | \$                    | 19,248                 | \$                               | 126,675   | \$    | 11,499 | \$ | 205,478  |           |
| Segment contribution     |                           | 7,213  |                       | 3,760                  |                                  | 34,233    |       | 1,983  |    | (29,591) | 17,598    |
| Interest expense, net    |                           |        |                       |                        |                                  |           |       |        |    | (799)    | (799)     |
| Gain on debt conversion  |                           |        |                       |                        |                                  |           |       |        |    | 313      | 313       |
| Miscellaneous            |                           |        |                       |                        |                                  |           |       |        |    | (27)     | (27)      |
| Income taxes-current     |                           |        |                       |                        |                                  |           |       |        |    | (469)    | (469)     |
| Income taxes-deferred    |                           |        |                       |                        |                                  |           |       |        |    | (3,148)  | (3,148)   |
| Non controlling interest |                           |        |                       |                        |                                  |           |       |        |    | 18       | 18        |
|                          |                           |        |                       |                        |                                  |           |       |        |    |          | \$ 13,486 |

Net loss attributable to  
Ultralife

|              |    |        |    |        |    |        |    |        |    |       |    |         |
|--------------|----|--------|----|--------|----|--------|----|--------|----|-------|----|---------|
| Total assets | \$ | 43,527 | \$ | 22,212 | \$ | 44,559 | \$ | 16,081 | \$ | 9,965 | \$ | 136,344 |
|--------------|----|--------|----|--------|----|--------|----|--------|----|-------|----|---------|

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**13. FIRE AT MANUFACTURING FACILITY**

In November 2006, we experienced a fire that damaged certain inventory and property at our facility in China, which began in a battery storage area. Certain inventory and portions of buildings were damaged. We believe we maintain adequate insurance coverage for this operation. The total amount of the loss pertaining to assets and the related expenses was approximately \$849. The majority of the insurance claim is related to the recovery of damaged inventory. In July 2007, we received approximately \$637 as a partial payment on our insurance claim, which resulted in no gain or loss being recognized. In March 2008, we received a final settlement payment of \$191, which offset the outstanding receivable of approximately \$152 and resulted in a non-operating gain of approximately \$39.

**14. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The fair value of cash, 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 our convertible note approximates carrying value based on the short duration (thirteen months) of this note. 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.

**15. RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS**

In June 2009, the FASB issued amended guidance for the accounting for transfers of financial assets. The amended guidance removes the concept of a qualifying special-purpose entity. The amended guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. Earlier application is prohibited. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In June 2009, the FASB issued amended guidance for the accounting for variable interest entities. The amendments include: (1) the elimination of the exemption for qualifying special purpose entities, (2) a new approach for determining who should consolidate a variable-interest entity, and (3) changes to when it is necessary to reassess who should consolidate a variable-interest entity. The amended guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. Earlier adoption is prohibited. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In June 2009, the FASB issued the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. The FASB Accounting Standards Codification ( Codification ) is intended to be the source of authoritative U.S. generally accepted accounting principles ( GAAP ) and reporting standards as issued by the FASB. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. The Codification is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. The Codification does not change or alter existing GAAP and did not have an impact on our consolidated financial position or results of operations.

In May 2009, the FASB issued guidance for the accounting for subsequent events. The guidance incorporates guidance into the accounting literature that was previously addressed only in auditing standards. The guidance refers to subsequent events that provide additional evidence about conditions that existed at the balance-sheet date as recognized subsequent events . Subsequent events which provide evidence about conditions that arose after the balance-sheet date but prior to the issuance of the financial statements are referred to as non-recognized subsequent events . It also requires the disclosure of the date through which subsequent events have been evaluated and whether this date is the date the financial statements were issued or the date the financial statements were available to be issued. The adoption of this pronouncement did not have a significant impact on our financial statements. See Note 1 for disclosures associated with the adoption of this accounting pronouncement.

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In April 2009, the FASB issued new guidance related to the disclosures about fair value of financial instruments. The new guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The new guidance requires those disclosures in summarized financial information at interim reporting periods. The new guidance is effective for interim reporting periods ending after June 15, 2009. The new guidance does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, the new guidance requires comparative disclosures only for periods ending after initial adoption. The adoption of this pronouncement did not have a significant impact on our financial statements. See Note 14 for disclosures associated with the adoption of this accounting pronouncement.

In June 2008, the FASB ratified the consensus reached by the Emerging Issues Task Force ( EITF ) on determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The consensus clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under the FASB's guidance for accounting for derivative instruments and hedging activities. The consensus is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The adoption of this pronouncement did not have a significant impact on our financial statements.

In May 2008, the FASB issued guidance on the accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The guidance clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by the FASB's guidance on accounting for convertible debt and debt issued with stock purchase warrants. Additionally, the guidance specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

In April 2008, the FASB issued guidance on the determination of the useful life of intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB's accounting for goodwill and other intangible assets. The guidance intends to improve the consistency between the useful life of a recognized intangible asset under FASB's accounting for goodwill and other intangible assets and the period of expected cash flows used to measure the fair value of the asset under the revised FASB guidance on business combinations, and other U.S. generally accepted accounting principles. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

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In March 2008, the FASB issued new guidance on the disclosures about derivative instruments and hedging activities. The statement amends and expands the disclosure requirements to provide users of financial statements with an enhanced understanding of (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. The statement also requires (i) qualitative disclosures about objectives for using derivatives by primary underlying risk exposure, (ii) information about the volume of derivative activity, (iii) tabular disclosures about balance sheet location and gross fair value amounts of derivative instruments, income statement, and other comprehensive income location and amounts of gains and losses on derivative instruments by type of contract, and (iv) disclosures about credit-risk-related contingent features in derivative agreements. The new guidance is effective for financial statements issued for fiscal years or interim periods beginning after November 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

In December 2007, the FASB issued revised guidance on business combinations. The guidance retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. The revised guidance is effective for fiscal years beginning on or after December 15, 2008 and will apply prospectively 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 the revised guidance will depend on the future business combinations that we may pursue.

In December 2007, the FASB issued amended guidance on noncontrolling interests in consolidated financial statements, which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. The amended guidance is effective for fiscal years beginning on or after December 15, 2008 and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The adoption of this pronouncement did not have a significant impact on our financial statements, except for the revised disclosures that are required. The future impact of adopting the amended guidance will depend on the structure of future business combinations or partnerships that we may pursue.

In September 2006, the FASB issued new guidance on fair value measurements. The new guidance provides enhanced guidance for using fair value to measure assets and liabilities. It does not require any new fair value measurements, but does require expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. The new guidance is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption encouraged. In February 2008, the FASB issued guidance delaying, for one year, the effective date of the new guidance for all nonfinancial assets and liabilities, except those that are recognized or disclosed in the financial statements on at least an annual basis. As such, we partially adopted the provisions of the new guidance effective January 1, 2008. The partial adoption of this statement did not have a material impact on our financial statements. We adopted the deferred provisions of the new guidance effective January 1, 2009 which impacts the way in which we calculate fair value for assets and liabilities initially measured at fair value in a business combination, our annual impairment review of goodwill and non-amortizable intangible assets, and when conditions exist that require us to calculate the fair value of long-lived assets. The adoption of this pronouncement did not have a significant impact on our financial statements, except for the additional disclosures that are required.



**Table of Contents****Item 2. 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, potential delays in the release of purchase orders for our products pursuant to outstanding contracts, consequences of inventory buildups in anticipation of purchase orders that may not be fulfilled, addressing the process of U.S. military procurement, the successful commercialization of our products, the successful integration of our acquired businesses, potential restrictions on our ability to access our line of credit, general domestic and global economic conditions, including the recent distress in the financial markets that has had an adverse impact on the availability of credit and liquidity resources generally, government and environmental regulation, 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 as anticipated, believed, estimated or expected or words of similar import. For further discussion of certain of the matters described above, see Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008 and Part II, Item 1A, "Risk Factors" in this Form 10-Q.

The following discussion and analysis should be read in conjunction with the accompanying Condensed Consolidated Financial Statements and Notes thereto appearing elsewhere in this Form 10-Q and our Consolidated Financial Statements and Notes thereto contained in our Form 10-K for the year ended December 31, 2008.

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.

**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, standby power systems, communications and electronics systems and accessories, and custom engineered systems, solutions and services. 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 four operating segments: Non-Rechargeable Products, Rechargeable Products, Communications Systems and Design and Installation Services. The Non-Rechargeable Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries. The Rechargeable Products segment includes: rechargeable batteries, charging systems, uninterruptable power supplies and accessories, such as cables. The Communications Systems segment includes: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication system kits. The Design and Installation Services segment includes: standby power and communications and electronics systems design, installation and maintenance activities and revenues and related costs associated with various development contracts. We look at our segment performance at the gross margin level, and we do not allocate research and development or selling, general and administrative costs against the segments. All other items that do not specifically relate to these four segments and are not considered in the performance of the segments are considered to be Corporate charges. (See Note 12 in the Notes to Condensed Consolidated Financial Statements for additional information.)



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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.

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 \$86 in cash into the India JV, as consideration for our 51% ownership stake in the India JV.

In June 2008, we changed our corporate name from Ultralife Batteries, Inc. to Ultralife Corporation. The purpose of the name change was to align our corporate name more closely with the business now being conducted by us, as we are no longer exclusively a battery manufacturing company.

On November 10, 2008, we acquired certain assets of U.S. Energy Systems, Inc. and its service affiliate, U.S. Power Services, Inc. ( USE collectively), a nationally recognized standby power installation and power management services business. USE is located in Riverside, California. Under the terms of the agreement, the initial purchase price consisted of \$2,865 in cash. In addition, on the achievement of certain annual post-acquisition financial milestones, we will issue up to an aggregate of 200,000 unregistered shares of our common stock, during the period ending December 31, 2012. (See Note 2 in the Notes to Condensed Consolidated Financial Statements for additional information.)

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. 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 Condensed Consolidated Financial Statements for additional information.)

On June 1, 2009, the Board of Directors appointed John C. Casper as our Vice-President of Finance and Chief Financial Officer, succeeding Robert W. Fishback.

**Overview**

We reported revenue of \$42,400 for the third quarter of 2009 and an operating loss of \$400 with an adjusted EBITDA of \$1,400. Third quarter revenue was up slightly from the second quarter of 2009.

Subsequent to the end of the third quarter, an Indefinite Delivery/Indefinite Quantity ( IDIQ ) contract for our SATCOM-on-the-Move ( SOTM ) systems was finally concluded between our Prime Contractor customer and the U.S. Department of Defense. With an IDIQ contract now in place, our customer placed a \$20,000 order for our SOTM systems, which we announced in late October 2009. We also learned that the delay in finalizing the MRAP All Terrain Vehicle ( MATV ) contract caused the government to source a different system for the MATV program, at least for the current demand under the program, despite the fact that ours was the specified system, and even though our cables were being pre-installed in the vehicles. This outcome was a disappointment for us. Although we exhausted numerous channels in challenging this decision, our status as a subcontractor limits our remedies.

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The government's decision to source a different system in the MATV program does not alter our standing as one of the two government-approved suppliers of SOTM systems. Advanced communications systems remain an important part of our government and military product portfolio and a tremendous opportunity. We expect to see continued requirements for these types of systems for new vehicle programs and for existing fleet inventory. In geographies such as Afghanistan and Pakistan, line of sight communications can be extremely limited. We anticipate that virtually every vehicle, and especially those going into remote areas, will need SATCOM capability. Based on our understanding and belief, our tactical repeater is being used to extend the range of handheld radios by U.K. Special Operations units operating in Afghanistan to great effect. We are also responding to a greater number of inquiries for our communications products from foreign government/defense organizations for both our SATCOM systems and tactical repeater systems. The deployment of these range extension systems has not gone unnoticed by our government's international allies, and it is a capability that we are starting to aggressively market internationally.

During the third quarter of 2009, we decreased inventories by more than \$8,000. We expect another major reduction in the fourth quarter of 2009 as we start to make long awaited shipments of SOTM systems on our recently announced order.

Sales of batteries remained strong during the third quarter of 2009 with rechargeable sales down slightly due to shipment timing issues. During the fourth quarter of 2009, we expect to start shipping on the \$12,000 order for chargers and one particular battery to the U.K. military under our new contract with General Dynamics United Kingdom Limited. Three other battery types are included on the contract, all for use with the U.K. Ministry of Defence's primary communications radio system. Over the next year we will be qualifying those batteries so that we can accept orders for them as well.

Communications systems sales increased during the third quarter of 2009, mostly due to the direct sale of some SOTM systems to the U.S. Military. Our recently acquired AMTI amplifier unit had a very strong quarter, and we are starting to use the AMTI amplifiers in our systems including the latest version of our tactical repeater. Our compact amplifier gives us a highly advantaged product in the fast growing handheld radio market as well as an advantage in designing compact and portable advanced communications systems.

We also saw a sequential increase in sales in our standby power unit during the third quarter of 2009. While very competitive equipment pricing is adversely impacting margins on our products and services, a better mix of service revenue improved overall margins in the third quarter of 2009. As adjustments in inventory levels and competitive shakeouts improve pricing, we expect a continued gradual improvement in margins.

In commercial markets, we have focused our product development efforts on our smart lithium ion rechargeable batteries for backup power and energy storage. We have developed and have begun customer testing of lithium ion batteries for rack mounted communications or computing systems and for distributed communications hubs. These batteries are up to 10Kw in size and can discharge up to as high as 120 amps. We are also in development of larger energy storage and backup battery systems in the 100Kw to 2Mw range for use in supporting renewable energy and smart grid projects. This is an area where our smart circuit technology, our manufacturing capability and our installation and service resources can change the way backup and energy storage systems are deployed and managed, and can start to address the energy storage needs of renewable energy systems.

**Table of Contents****Results of Operations*****Three-month periods ended September 27, 2009 and September 27, 2008***

**Revenues.** Consolidated revenues for the three-month period ended September 27, 2009 amounted to \$42,363, a decrease of \$25,630, or 37.7%, from the \$67,993 reported in the same quarter in the prior year.

Non-Rechargeable product sales increased \$2,617, or 16.6%, from \$15,741 last year to \$18,358 this year. The increase in Non-Rechargeable revenues was mainly attributable to higher shipments of our BA-5390 batteries to government/defense customers, offset in part by a decline in sales to automotive telematics customers.

Rechargeable product sales increased \$464, or 5.8%, from \$8,020 last year to \$8,484 this year. The increase in Rechargeable revenues was mainly attributable to strong demand for batteries and charging systems from U.S. defense customers.

Communications Systems revenues decreased \$31,110, or 76.5%, from \$40,675 last year to \$9,565 this year, due to deliveries of SATCOM-on-the-Move and other advanced communications systems in 2008 resulting primarily from the sizeable orders we received during the latter part of 2007, that did not reoccur in 2009.

Design and Installation Services revenues increased \$2,399, or 67.4%, from \$3,557 last year to \$5,956 this year, mainly due to the added revenue base provided from the acquisition of USE in the fourth quarter of 2008.

**Cost of Products Sold.** Cost of products sold totaled \$31,999 for the quarter ended September 27, 2009, a decrease of \$20,308, or 38.8%, from the \$52,307 reported for the same three-month period a year ago. Consolidated cost of products sold as a percentage of total revenue decreased from 76.9% for the three-month period ended September 27, 2008 to 75.5% for the three-month period ended September 27, 2009. Correspondingly, consolidated gross margin was 24.5% for the three-month period ended September 27, 2009, compared with 23.1% for the three-month period ended September 27, 2008, generally attributable to the margin improvements in all of the operating segments. The margin results in the Communications Systems segment were positively impacted due to the recognition of a gain on litigation settlement totaling \$1,256, in relation to the settlement of an ongoing litigation with a vendor, which partially offset the significant reduction in sales of our higher margin Communications Systems products.

In our Non-Rechargeable Products segment, the cost of products sold increased \$1,166, from \$13,835 in the three-month period ended September 27, 2008 to \$15,001 in 2009. Non-Rechargeable gross margin for 2009 was \$3,357, or 18.3% of revenues, an increase of \$1,451 from 2008's gross margin of \$1,906, or 12.1% of revenues. Non-Rechargeable gross margin and gross margin as a percentage of revenues both increased for the three-month period ended September 27, 2009, primarily as a result of higher sales volumes and product mix, in comparison to the three-month period ended September 27, 2008. In addition, ongoing transition costs related to our second quarter of 2008 restructuring initiative at our UK operation, factored into our margin results for 2008.

In our Rechargeable Products segment, the cost of products sold increased \$201, from \$6,282 in the three-month period ended September 27, 2008 to \$6,483 in 2009. Rechargeable gross margin for 2009 was \$2,001, or 23.6% of revenues, an increase of \$263 from 2008's gross margin of \$1,738, or 21.7% of revenues. Rechargeable gross margin improved primarily as a result of higher sales volumes and favorable product mix, as well as lower costs for material and component parts.

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In our Communications Systems segment, the cost of products sold decreased \$23,484, from \$29,304 in the three-month period ended September 27, 2008 to \$5,820 in 2009. Communications Systems gross margin for 2009 was \$3,745, or 39.2% of revenues, a decrease of \$7,626 from 2008's gross margin of \$11,371, or 28.0% of revenues. The increase in the gross margin percentage for Communications Systems resulted from the recognition of a gain on litigation settlement totaling \$1,256, in relation to the settlement of an ongoing litigation with a vendor, which was partially offset by the overall sales mix and lower sales volume in this segment. We had also implemented a four-day work week for production personnel in our Newark operations, which included a significant portion of our communications systems manufacturing operations, in the third quarter of 2009, to align inventory and production levels with current sales levels. For the fourth quarter of 2009, we have resumed a full five-day work week for production personnel in our Newark operations in response to increased production demand.

In our Design and Installation Services segment, the cost of sales increased \$1,809, from \$2,886 in the three-month period ended September 27, 2008 to \$4,695 in 2009. Design and Installation Services gross margin for 2009 was \$1,261, or 21.2% of revenues, an increase of \$590 from 2008's gross margin of \$671, or 18.9% of revenues. Gross margin in this particular segment improved due to the overall increase in higher margin service revenue. The improvement was partially offset by the continued short-term price competition with component suppliers and ongoing integration efforts related to the USE acquisition.

**Operating Expenses.** Total operating expenses for the three-month period ended September 27, 2009 totaled \$10,768, an increase of \$380 from the prior year's amount of \$10,388. Overall, operating expenses as a percentage of sales increased to 25.4% in the third quarter of 2009 from 15.3% reported in the prior year, due to the overall expense increase over a lower revenue base. In response to this unfavorable change to the percentage of sales, we have consolidated some of our operations in an effort to lower the fixed costs basis of our operations, performed an overall cost reduction analysis and tightened our cost controls, and deferred some of our discretionary spending. Amortization expense associated with intangible assets related to our acquisitions was \$449 for 2009 (\$310 in selling, general and administrative expenses and \$139 in research and development costs), compared with \$517 for 2008 (\$362 in selling, general, and administrative expenses and \$155 in research and development costs). Research and development costs were \$2,748 in 2009, an increase of \$587, or 27.2%, over the \$2,161 reported in 2008 as we increased our investment in product development and design activity. Selling, general, and administrative expenses decreased \$207, or 2.5%, to \$8,020. This decrease was comprised of the consolidation of some of our operations, tightened overall cost controls and the deferral of some discretionary spending.

**Other Income (Expense).** Other income (expense) totaled (\$104) for the third quarter of 2009, compared to (\$418) for the third quarter of 2008. Interest expense, net of interest income, increased \$211, to \$454 for the third quarter of 2009 from \$243 for the comparable period in 2008, mainly as a result of higher average borrowings under our revolving credit facility. Miscellaneous income/expense amounted to income of \$350 for the third quarter of 2009 compared with expense of \$175 for the same period in 2008. The income in 2009 and expense in 2008 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 \$105 for the third quarter of 2009 compared with \$213 in the third quarter of 2008. The effective tax rate for the total consolidated company for the three-month periods ended September 27, 2009 and 2008 was:

|  | Three-Month Periods Ended |          |
|--|---------------------------|----------|
|  | September 27,             |          |
|  | 2009                      | 2008     |
| Income (Loss) before Incomes Taxes (a) | \$ (508)                  | \$ 4,880 |
| Total Income Tax Provision (b)         | \$ 105                    | \$ 213   |
| Effective Tax Rate (b/a)               | 20.7%                     | 4.4%     |



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During the fiscal quarter ended December 31, 2006, we recorded a full valuation allowance on our net deferred tax asset, due to the determination, at that time, that it was more likely than not that we would not be able to utilize our U.S. and U.K. net operating loss carryforwards ( NOL s ) that had accumulated over time. At September 27, 2009, we continue to recognize a valuation allowance on our U.S. deferred tax asset, to the extent that we believe, that it is more likely than not that we will not be able to utilize that portion of our U.S. NOL s that had accumulated over time. A U.S. valuation allowance is not required for the portion of the deferred tax asset that will be realized by the reversal of temporary differences related to deferred tax liabilities to the extent those temporary differences are expected to reverse in our carryforward period. At September 27, 2009, we continue to recognize a full valuation allowance on our U.K. net deferred tax asset, as we believe, at this time, that it is more likely than not that we will not be able to utilize our U.K. NOL s that had accumulated over time. (See Note 8 in the Notes to Condensed Consolidated Financial Statements for additional information.) We continually monitor the assumptions and performance results to assess the realizability of the tax benefits of the U.S. and U.K. NOL s and other deferred tax assets, in accordance with the applicable 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. We believe such limitation will not impact our ability to realize the deferred tax asset.

In addition, certain of our NOL carryforwards are subject to U.S. alternative minimum tax such that carryforwards can offset only 90% of alternative minimum taxable income. This limitation did not have an impact on income taxes determined for the third quarter of 2009. However, this limitation did have an impact of \$151 on income taxes determined for the third quarter of 2008. 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 further discussion, see Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Net Income (Loss) Attributable to Ultralife.** Net loss attributable to Ultralife and loss attributable to Ultralife common shareholders per diluted share were \$605 and \$0.04, respectively, for the three months ended September 27, 2009, compared to a net income attributable to Ultralife and earnings attributable to Ultralife common shareholders per diluted share of \$4,657 and \$0.26, respectively, for the same quarter last year, primarily as a result of the reasons described above. Average common shares outstanding used to compute diluted earnings per share decreased from 17,722,000 in the third quarter of 2008 to 16,921,000 in 2009, mainly due to the share repurchase program we initiated in the fourth quarter of 2008, offset by stock option and warrant exercises and restricted stock grants.

***Nine-month periods ended September 27, 2009 and September 27, 2008***

**Revenues.** Consolidated revenues for the nine-month period ended September 27, 2009 amounted to \$121,759, a decrease of \$83,719, or 40.7%, from the \$205,478 reported in the prior year.

Non-Rechargeable product sales increased \$4,799, or 10.0%, from \$48,056 last year to \$52,855 this year. The increase in Non-Rechargeable revenues was mainly attributable to higher shipments of our BA-5390 batteries to government/defense customers, offset in part by a decline in sales to automotive telematics customers.

Rechargeable product sales increased \$13,397, or 69.6%, from \$19,248 last year to \$32,645 this year. The increase in Rechargeable revenues was mainly attributable to strong demand for batteries and charging systems from U.S. defense customers.

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Communications Systems revenues decreased \$106,273, or 83.9%, from \$126,675 last year to \$20,402 this year, due to deliveries of SATCOM-on-the-Move and other advanced communications systems in 2008 resulting primarily from the sizeable orders we received during the latter part of 2007, that did not reoccur in 2009.

Design and Installation Services revenues increased \$4,358, or 37.9%, from \$11,499 last year to \$15,857 this year, mainly due to the added revenue base provided from the acquisition of USE in the fourth quarter of 2008.

**Cost of Products Sold.** Cost of products sold totaled \$96,834 for the nine-month period ended September 27, 2009, a decrease of \$61,455, or 38.8%, from the \$158,289 reported for the same nine-month period a year ago. Consolidated cost of products sold as a percentage of total revenue increased from 77.0% for the nine-month period ended September 27, 2008 to 79.5% for the nine-month period ended September 27, 2009. Correspondingly, consolidated gross margin was 20.5% for the nine-month period ended September 27, 2009, compared with 23.0% for the nine-month period ended September 27, 2008, generally attributable to the margin decreases in the Design and Installation Services segments, offset by improvements in the Non-Rechargeable Products, Rechargeable Products and Communications Systems segments. The margin results in the Communications Systems segment were positively impacted due to the recognition of a gain on litigation settlement totaling \$1,256, in relation to the settlement of an ongoing litigation with a vendor, which partially offset the significant reduction in sales of our higher margin Communications Systems products.

In our Non-Rechargeable Products segment, the cost of products sold increased \$2,476, from \$40,843 in the nine-month period ended September 27, 2008 to \$43,319 in 2009. Non-Rechargeable gross margin for 2009 was \$9,536, or 18.0% of revenues, an increase of \$2,323 from 2008's gross margin of \$7,213, or 15.0% of revenues. Non-Rechargeable gross margin and gross margin as a percentage of revenues both increased for the nine-month period ended September 27, 2009, primarily as a result of higher sales volumes and product mix, in comparison to the nine-month period ended September 27, 2008. Also, the approximate \$750 restructuring charge that was recorded relating to refocusing our U.K. operations toward enhancing our ability to serve our customers, including the U.K. Ministry of Defence, resulting in employee termination costs and certain asset valuation adjustments in 2008, did not reoccur in 2009.

In our Rechargeable Products segment, the cost of products sold increased \$9,731, from \$15,488 in the nine-month period ended September 27, 2008 to \$25,219 in 2009. Rechargeable gross margin for 2009 was \$7,426, or 22.7% of revenues, an increase of \$3,666 from 2008's gross margin of \$3,760, or 19.5% of revenues. Rechargeable gross margin improved primarily as a result of higher sales volumes and favorable product mix, as well as lower costs for material and component parts.

In our Communications Systems segment, the cost of products sold decreased \$78,000, from \$92,442 in the nine-month period ended September 27, 2008 to \$14,442 in 2009. Communications Systems gross margin for 2009 was \$5,960, or 29.2% of revenues, a decrease of \$28,273 from 2008's gross margin of \$34,233, or 27.0% of revenues. The increase in the gross margin percentage for Communications Systems resulted from the recognition of a gain on litigation settlement totaling \$1,256, in relation to the settlement of an ongoing litigation with a vendor, which was partially offset by the overall sales mix and lower sales volume in this segment. We had also implemented a four-day work week for production personnel in our Newark operations, which included a significant portion of our communications systems manufacturing operations, in the third quarter of 2009, to align inventory and production levels with current sales levels. For the fourth quarter of 2009, we have resumed a full five-day work week for production personnel in our Newark operations in response to increased production demand.

In our Design and Installation Services segment, the cost of sales increased \$4,338, from \$9,516 in the nine-month period ended September 27, 2008 to \$13,854 in 2009. Design and Installation Services gross margin for 2009 was \$2,003, or 12.6% of revenues, an increase of \$20 from 2008's gross margin of \$1,983, or 17.2% of revenues. Gross margin in this particular segment was weaker than expected due to expected short-term price competition with component suppliers, relatively low margin jobs that carried over from year-end, and ongoing integration efforts related to the USE acquisition.



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**Operating Expenses.** Total operating expenses for the nine-month period ended September 27, 2009 were \$33,911, an increase of \$4,320 from the prior year's amount of \$29,591. Overall, operating expenses as a percentage of sales increased to 27.9% in the first nine months of 2009 from 14.4% reported in the prior year, due to the overall expense increase over a lower revenue base. In response to this unfavorable change to the percentage of sales, we have consolidated some of our operations that is designed to lower the fixed costs basis of our operations, performed an overall cost reduction analysis and tightened our cost controls, along with deferring some of our discretionary spending. Amortization expense associated with intangible assets related to our acquisitions was \$1,256 for 2009 (\$859 in selling, general and administrative expenses and \$397 in research and development costs), compared with \$1,563 for 2008 (\$1,091 in selling, general, and administrative expenses and \$472 in research and development costs). Research and development costs were \$7,242 in 2009, an increase of \$1,335, or 22.6%, over the \$5,907 reported in 2008, as we increased our investment in product development and design activity. Selling, general, and administrative expenses increased \$2,985, or 12.6%, to \$26,669. This increase was comprised of costs related to recently acquired companies, in addition to higher sales and marketing expenses related to development of new territories for the standby power business and generally higher administrative costs.

**Other Income (Expense).** Other income (expense) totaled (\$830) for the first nine months of 2009, compared to (\$513) for the first nine months of 2008. Interest expense, net of interest income, increased \$183, to \$982 for the first nine months of 2009 from \$799 for the comparable period in 2008, mainly as a result of higher average borrowings under our revolving credit facility. In 2008, we recognized a gain of \$313 on the early conversion of the \$10,500 convertible notes held by the sellers of McDowell, which related to an increase in the interest rate on the notes from 4.0% to 5.0% in October 2007. Miscellaneous income/expense amounted to income of \$152 for the first nine months of 2009 compared with expense of \$27 for the same period in 2008. The income in 2009 and expense in 2008 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 \$291 for the first nine months of 2009 compared with \$3,617 in the first nine months of 2008. The second quarter of 2008 tax provision included an approximate \$3,100 non-cash charge to record a deferred tax liability for liabilities generated from goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carryforward periods. Substantially all of this adjustment related to book/tax differences that occurred during 2007 and was identified during the second quarter of 2008. In connection with this adjustment, we reviewed the illustrative list of qualitative considerations provided in SEC Staff Accounting Bulletin No. 99 and other qualitative factors in our determination that this adjustment was not material to the 2007 consolidated financial statements or this quarterly report on Form 10-Q.

The effective tax rate for the total consolidated company for the nine-month periods ended September 27, 2009 and 2008 was:

|  | Nine-Month Periods Ended<br>September 27, |           |
|--|---|-----------|
|  | 2009                                      | 2008      |
| Income (Loss) before Incomes Taxes (a) | \$ (9,816)                                | \$ 17,085 |
| Total Income Tax Provision (b)         | \$ 291                                    | \$ 3,617  |
| Effective Tax Rate (b/a)               | 3.0%                                      | 21.2%     |

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During the fiscal quarter ended December 31, 2006, we recorded a full valuation allowance on our net deferred tax asset, due to the determination, at that time, that it was more likely than not that we would not be able to utilize our U.S. and U.K. net operating loss carryforwards ( NOL s ) that had accumulated over time. At September 27, 2009, we continue to recognize a valuation allowance on our U.S. deferred tax asset, to the extent that we believe, that it is more likely than not that we will not be able to utilize that portion of our U.S. NOL s that had accumulated over time. A U.S. valuation allowance is not required for the portion of the deferred tax asset that will be realized by the reversal of temporary differences related to deferred tax liabilities to the extent those temporary differences are expected to reverse in our carryforward period. At September 27, 2009, we continue to recognize a full valuation allowance on our U.K. net deferred tax asset, as we believe, at this time, that it is more likely than not that we will not be able to utilize our U.K. NOL s that had accumulated over time. (See Note 8 in the Notes to Condensed Consolidated Financial Statements for additional information.) We continually monitor the assumptions and performance results to assess the realizability of the tax benefits of the U.S. and U.K. NOL s and other deferred tax assets, in accordance with the applicable 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. We believe such limitation will not impact our ability to realize the deferred tax asset.

In addition, certain of our NOL carryforwards are subject to U.S. alternative minimum tax such that carryforwards can offset only 90% of alternative minimum taxable income. This limitation did not have an impact on income taxes determined for the first nine months of 2009. However, this limitation did have an impact of \$469 on income taxes determined for the first nine months of 2008. 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 further discussion, see Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Net Income (Loss) Attributable to Ultralife.** Net loss attributable to Ultralife and loss attributable to Ultralife common shareholders per diluted share were \$10,081 and \$0.59, respectively, for the nine months ended September 27, 2009, compared to a net income attributable to Ultralife and earnings attributable to Ultralife common shareholders per diluted share of \$13,486 and \$0.77, respectively, for the same period last year, primarily as a result of the reasons described above. Average common shares outstanding used to compute diluted earnings per share decreased from 17,742,000 in the first nine months of 2008 to 16,996,000 in 2009, mainly due to the share repurchase program we initiated in the fourth quarter of 2008, offset by stock option and warrant exercises and restricted stock grants.

**Adjusted EBITDA**

In evaluating our business, we consider and use Adjusted EBITDA, a non-GAAP financial measure, as a supplemental measure of our operating performance. We define Adjusted EBITDA as net income (loss) 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. We use Adjusted EBITDA 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 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-cash, non-operating expenses or income. We also present Adjusted EBITDA 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 to net income (loss) attributable to Ultralife, the most comparable financial measure under U.S. generally accepted accounting principles ( U.S. GAAP ).



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We use Adjusted EBITDA 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 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 provide information relating to our Adjusted EBITDA 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 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 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 has limitations as an analytical tool, and when assessing our operating performance, Adjusted EBITDA 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 (1) does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments; (2) does not reflect changes in, or cash requirements for, our working capital needs; (3) does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt; (4) does not reflect income taxes or the cash requirements for any tax payments; and (5) does not reflect 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 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; and

other companies may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

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

|   | <b>Three-Month Periods Ended</b> |                  | <b>Nine-Month Periods Ended</b> |                  |
|---|----------------------------------|------------------|---------------------------------|------------------|
|   | <b>September</b>                 | <b>September</b> | <b>September</b>                | <b>September</b> |
|   | <b>27,</b>                       | <b>27,</b>       | <b>27,</b>                      | <b>27,</b>       |
|   | <b>2009</b>                      | <b>2008</b>      | <b>2009</b>                     | <b>2008</b>      |
| Net income (loss) attributable to Ultralife | \$ (605)                         | \$ 4,657         | \$ (10,081)                     | \$ 13,486        |
| Add: interest expense, net                  | 454                              | 243              | 982                             | 779              |
| Add: income tax provision                   | 105                              | 213              | 291                             | 3,617            |
| Add: depreciation expense                   | 1,047                            | 965              | 2,986                           | 2,896            |
| Add: amortization expense                   | 449                              | 517              | 1,256                           | 1,563            |
| Add: stock-based compensation expense       | (82)                             | 495              | 995                             | 1,691            |
| Less: gain on debt conversion               |                                  |                  |                                 | (313)            |
| <br>  |                                  |                  |                                 |                  |
| Adjusted EBITDA                             | \$ 1,368                         | \$ 7,090         | \$ (3,571)                      | \$ 23,739        |

**Liquidity and Capital Resources**

As of September 27, 2009, cash and cash equivalents totaled \$1,697, a decrease of \$181 from the beginning of the year. During the nine-month period ended September 27, 2009, we used \$15,058 of cash from operating activities as compared to the generation of \$16,460 for the nine-month period ended September 27, 2008. The use of cash from operating activities in 2009 resulted mainly from increased working capital requirements, including higher balances of accounts receivables and inventory and lower balances in accounts payable, as we prepared to deliver on anticipated contract awards and to meet the anticipated delivery schedules for those awards, which awards ultimately went to another government contractor (see Overview discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations).

We used \$8,209 in cash for investing activities during the first nine months of 2009 compared with \$2,650 in cash used for investing activities in the same period in 2008. In 2009, we spent \$1,443 to purchase plant, property and equipment, and \$6,766 was used in connection with the acquisition of AMTI, as well as contingent purchase price payouts related to RedBlack and RPS. In 2008, we spent \$2,282 to purchase plant, property and equipment.

During the nine-month period ended September 27, 2009, we generated \$22,817 in funds from financing activities compared to the usage of \$10,597 in funds in the same period of 2008. The financing activities in 2009 included a \$26,550 inflow from drawdowns on the revolver portion of our primary credit facility, an inflow of \$751 for proceeds from the issuance of debt, and an inflow of cash from stock option and warrant exercises of \$310, offset by an outflow of \$1,468 for principal payments on term debt under our primary credit facility and capital lease obligations, and an outflow of \$3,326 for the purchase of treasury shares related to our share repurchase program.

Inventory turnover for the first nine months of 2009 was an annualized rate of approximately 2.6 turns per year, a decrease from the 4.6 turns for the full year of 2008. The decrease in this metric is mainly due to a buildup in inventory in anticipation of certain orders from the U.S. Government that were delayed and ultimately awarded to another contractor, as well as the decrease in the sales volumes during 2009. Our Days Sales Outstanding (DSOs) as of September 27, 2009, was 70 days, an increase from the 53 days at year-end December 31, 2008, mainly due to the overall domestic and global recessionary economic conditions.

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As of September 27, 2009, we had made commitments to purchase approximately \$346 of production machinery and equipment, which we expect to fund through operating cash flows or the use of debt.

*Debt Commitments*

Our primary credit facility consists of both a term loan component and a revolver component, and the facility is collateralized by essentially all of our assets, including those of our subsidiaries. The lenders of the credit facility are JP Morgan Chase Bank, N.A. and Manufacturers and Traders Trust Company (together, the Lenders ), with JP Morgan Chase Bank acting as the administrative agent ( Agent ). The current revolver loan commitment is \$35,000. Availability under the revolving credit component is subject to meeting certain financial covenants, including a debt to earnings ratio and a fixed charge coverage ratio. In addition, we are required to meet certain non-financial covenants. The rate of interest, in general, is based upon either the Prime Rate plus 200 basis points or LIBOR plus 500 basis points. On June 30, 2004, we drew down on a \$10,000 term loan under the credit facility. The term loan was being repaid in equal monthly installments of \$167 over five years. On July 1, 2004, we entered into an interest rate swap arrangement in the notional amount of \$10,000 to be effective on August 2, 2004, related to the \$10,000 term loan, in order to take advantage of historically low interest rates. We received a fixed rate of interest in exchange for a variable rate. The swap rate received was 3.98% for five years. The total rate of interest paid by us was equal to the swap rate of 3.98% plus the applicable Eurodollar spread associated with the term loan. During the full year of 2008, the adjusted rate ranged from 5.73% to 6.48%. During the first nine months of 2009, the adjusted rate was 6.48%. Derivative instruments are accounted for in accordance with FASB's guidance on accounting for derivative instruments and hedging activities, which requires that all derivative instruments be recognized in the financial statements at fair value.

In July 2009, we paid the final monthly installment for the term loan under the credit facility and have no further obligations relating to the term loan portion of the credit facility. Correspondingly, the interest rate swap arrangement we entered into in connection with the term loan under the credit facility has expired and we have no further obligations under the interest rate swap arrangement.

There have been several amendments to the credit facility during the past few years, including amendments to authorize acquisitions and modify financial covenants. Effective April 23, 2008, we entered into Amendment Number Ten to Credit Agreement ( Amendment Ten ) with the Lenders. Amendment Ten increased the amount of the revolving credit facility from \$15,000 to \$22,500, an increase of \$7,500. Additionally, Amendment Ten amended the applicable revolver and term rates under the Credit Agreement from a variable pricing grid based on quarterly financial ratios to a set interest rate structure based on either the current prime rate, or a LIBOR rate plus 250 basis points.

Effective January 27, 2009, we entered into an Amended and Restated Credit Agreement (the Restated Credit Agreement ) with the Lenders. The Restated Credit Agreement reflects the previous ten amendments to the original Credit Agreement dated June 30, 2004 between us and the Lenders and modifies certain of those provisions. The Restated Credit Agreement among other things (i) increased the revolver loan commitment from \$22,500 to \$35,000, (ii) extended the maturity date of the revolving credit component from January 31, 2009 to June 30, 2010, (iii) modified the interest rate, and (iv) modified certain covenants. The rate of interest is based, in general, upon either a LIBOR rate plus a Eurodollar spread or an Alternate Base Rate plus an ABR spread, as that term is defined in the Restated Credit Agreement, within a predetermined grid, which is dependent upon whether Earnings Before Interest and Taxes for the most recently completed fiscal quarter is greater than or less than zero. Generally, borrowings under the Restated Credit Agreement bear interest based primarily on the Prime Rate plus 50 to 200 basis points or LIBOR plus 300 to 500 basis points. Additionally, among other covenant modifications, the Restated Credit Agreement modified the financial covenants by (i) revising the debt to earnings ratio and fixed charge coverage ratio and (ii) deleting the current assets to total liabilities ratio.

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Effective June 28, 2009, we entered into Waiver and Amendment Number One to Amended and Restated Credit Agreement ( Waiver and Amendment ) with the Lenders and Agent. The Waiver and Amendment provided that the Lenders and Agent would waive their right to exercise their respective rights and remedies under the credit facility arising from our failure to comply with the financial covenants in the credit facility with respect to the fiscal quarter ended June 28, 2009. In addition to a number of revisions to non-financial covenants, the Waiver and Amendment revised the applicable revolver rate under the Restated Credit Agreement to an interest rate structure based on the Prime Rate plus 200 basis points or LIBOR plus 500 basis points.

As stated in the Restated Credit Agreement, as amended by the Waiver and Amendment, we are required to maintain a debt to earnings ratio at or below 2.75 to 1 and a fixed charge ratio at or above 1.25 to 1. As of September 27, 2009, our debt to earnings ratio was (34.37) to 1 and our fixed charge ratio was (0.07) to 1. Accordingly, we were not in compliance with the financial covenants of our credit facility. This constitutes an event of default under the terms of our existing credit facility which would entitle our Lenders to provide us with notice that they were exercising their rights under the credit facility. Although we have not received such a notice from our Lenders, there are no constraints on their ability to do so. If we were to receive a notice of default from our Lenders, we would not be able to cure our default, and our Lenders would be able to exercise their rights and remedies as secured creditors of our indebtedness. Our Lenders would be able to terminate any commitment to lend additional funds to us and demand payment in full of the outstanding indebtedness under our credit facility, which indebtedness totaled \$15,500 as of the date of this Quarterly Report on Form 10-Q. We currently do not have sufficient liquidity to satisfy such payment demand, were it to occur. Unless we were able to obtain additional capital resources, or appropriate waivers and forbearances from our Lenders, we would not be able to continue to fund our operations in the ordinary course or continue our business as currently conducted.

We are seeking to change our existing revolving credit line to an asset-based credit facility that will more closely match our operating needs and provide funding for our future operations and have evaluated proposals from our existing Lenders as well as other potential lenders. We have accepted a proposal for an asset-based credit facility which, if and when completed, would result in full payment of all of our obligations under our existing credit facility. In connection with that proposal, we are in active discussions with our current Lenders to secure a forbearance agreement. If we do not succeed in securing that agreement, our current Lenders could demand payment in full of the current outstanding indebtedness upon providing notice of default. We can provide no assurance that we will be able to obtain the forbearance agreement that we are currently discussing. Nor can we assure that we will succeed in obtaining any commitments to secure the asset-based credit facility that we are currently seeking. If we do not succeed in negotiating a forbearance agreement with our Lenders, they would be able to commence foreclosure on some or all of our assets that serve as collateral for the debt owed our Lenders, or exercise other rights and remedies given them under our current credit facility. Substantially all of our assets, tangible and intangible, serve as collateral for the debt that is owed our Lenders. In that event, we would likely be compelled to seek protection under Chapter 11 of the United States Bankruptcy Code. If this were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

As of September 27, 2009, we had \$0- outstanding under the term loan component of our credit facility with our primary lending bank and \$26,550 was outstanding under the revolver component. At September 27, 2009, the interest rate on the revolver component was 5.25%. As of September 27, 2009, the revolver arrangement provided for up to \$35,000 of borrowing capacity, including outstanding letters of credit. At September 27, 2009, we had \$325 of outstanding letters of credit related to this facility, leaving \$8,125 of additional borrowing capacity.

Our relations with our Lenders have become strained due to our recent operating results and our failure to meet the financial covenants of our existing credit facility. We have received waivers as necessary in the past, and we are in active discussions with our current Lenders to secure a forbearance agreement. There can be no assurance, however, that such discussions will result in the execution and delivery of an appropriate forbearance agreement. Similarly, there can be no assurance that waivers or forbearances will always be obtained when needed in the future. If we are unable to obtain the forbearance agreement from our Lenders, we may need to implement alternative plans to provide us with sufficient levels of liquidity and working capital. 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.



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Our ability to refinance our current credit facility, if necessary, or to secure additional capital resources to fund our operational and growth strategies will depend, in large part, on our ability to access the credit markets. The recent disruption in credit markets and our recent operating losses make it uncertain whether we will be able to access the credit markets when necessary or desirable. If we are not able to access credit markets and obtain financing on commercially reasonable terms when needed, our business could be materially harmed and our results of operations could be adversely affected.

*Equity Transactions*

During the first nine months of 2009 and 2008, we issued 70,000 and 271,000 shares of common stock, respectively, as a result of exercises of stock options and warrants. We received approximately \$310 in 2009 and \$2,276 in 2008 in cash proceeds as a result of these transactions.

On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell Research, Ltd. relating to various operational issues that arose during the first several months following the July 2006 acquisition that significantly reduced our profit margins. The settlement agreement amount was approximately \$7,900. The settlement agreement reduced the principal amount on the convertible notes initially issued in that transaction from \$20,000 to \$14,000, and eliminated a \$1,889 liability related to a purchase price adjustment. In addition, the interest rate on the convertible notes was increased from 4% to 5% and we made prepayments totaling \$3,500 on the convertible notes. Upon payment of the \$3,500 in November 2007, we reported a one-time, non-operating gain of approximately \$7,550 to account for the settlement, net of certain adjustments related to the change in the interest rate on the convertible notes. Based on the facts and circumstances surrounding the settlement agreement, there was not a clear and direct link to the acquisition's purchase price; therefore, we recorded the settlement as an adjustment to income in accordance with FASB's pre-revised guidance on business combinations. In January 2008, the remaining \$10,500 principal balance on the convertible notes was converted in full into 700,000 shares of our common stock, and the remaining \$313 that pertained to the change in the interest rate on the notes was recorded in other income as a gain on debt conversion.

*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. We can provide no assurance, given the current state of credit markets, that we would be successful in this regard, especially in light of our recent operating performance.

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.

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As described in Part II, Item 1, Legal Proceedings of this report, we are involved in certain environmental matters with respect to our facility in Newark, New York. Although we have reserved for expenses related to this potential exposure, there can be no assurance that such reserve will be adequate. The ultimate resolution of this matter may have a significant adverse impact on the results of operations in the period in which it is resolved.

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 four-year warranty. We also offer a 10-year warranty on our 9-volt batteries that are used in ionization-type smoke detector applications. 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.

### Outlook

Based on expected shipments of government/defense orders in the fourth quarter, we have revised our outlook for 2009 and now expect revenue for the year of approximately \$175,000. We expect to be profitable in the fourth quarter but expect an operating loss of between \$8,000 and \$9,000 for the year.

A caveat to our forecast for 2009 should be considered. As we have worked to streamline the business and realize cost efficiencies, we have been evaluating our multi-brand strategy. We have acquired several businesses with strong brands that had value and meaning to their customer base, but our objective has always been to leverage the reputation, the power and the global reach of the Ultralife brand. As the identity of these businesses has become increasingly identified with Ultralife, we are constantly reviewing the costs and the benefits of retiring several of these brands. Ultimately, we may decide to take such an action on any of these brands, which could result in a non-cash impairment charge of the associated intangible asset, reducing operating earnings by the associated amount or amounts on the balance sheet.

### Recent Accounting Pronouncements and Developments

In June 2009, the FASB issued amended guidance for the accounting for transfers of financial assets. The amended guidance removes the concept of a qualifying special-purpose entity. The amended guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. Earlier application is prohibited. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In June 2009, the FASB issued amended guidance for the accounting for variable interest entities. The amendments include: (1) the elimination of the exemption for qualifying special purpose entities, (2) a new approach for determining who should consolidate a variable-interest entity, and (3) changes to when it is necessary to reassess who should consolidate a variable-interest entity. The amended guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. Earlier adoption is prohibited. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In June 2009, the FASB issued the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. The FASB Accounting Standards Codification ( Codification ) is intended to be the source of authoritative U.S. generally accepted accounting principles ( GAAP ) and reporting standards as issued by the FASB. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. The Codification is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. The Codification does not change or alter existing GAAP and did not have an impact on our consolidated financial position or results of operations.

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In May 2009, the FASB issued guidance for the accounting for subsequent events. The guidance incorporates guidance into the accounting literature that was previously addressed only in auditing standards. The guidance refers to subsequent events that provide additional evidence about conditions that existed at the balance-sheet date as recognized subsequent events. Subsequent events which provide evidence about conditions that arose after the balance-sheet date but prior to the issuance of the financial statements are referred to as non-recognized subsequent events. It also requires the disclosure of the date through which subsequent events have been evaluated and whether this date is the date the financial statements were issued or the date the financial statements were available to be issued. The adoption of this pronouncement did not have a significant impact on our financial statements. See Note 1 for disclosures associated with the adoption of this accounting pronouncement.

In April 2009, the FASB issued new guidance related to the disclosures about fair value of financial instruments. The new guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The new guidance requires those disclosures in summarized financial information at interim reporting periods. The new guidance is effective for interim reporting periods ending after June 15, 2009. The new guidance does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, the new guidance requires comparative disclosures only for periods ending after initial adoption. The adoption of this pronouncement did not have a significant impact on our financial statements. See Note 14 for disclosures associated with the adoption of this accounting pronouncement.

In June 2008, the FASB ratified the consensus reached by the Emerging Issues Task Force ( EITF ) on determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The consensus clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under the FASB's guidance for accounting for derivative instruments and hedging activities. The consensus is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The adoption of this pronouncement did not have a significant impact on our financial statements.

In May 2008, the FASB issued guidance on the accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The guidance clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by the FASB's guidance on accounting for convertible debt and debt issued with stock purchase warrants. Additionally, the guidance specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

In April 2008, the FASB issued guidance on the determination of the useful life of intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB's accounting for goodwill and other intangible assets. The guidance intends to improve the consistency between the useful life of a recognized intangible asset under FASB's accounting for goodwill and other intangible assets and the period of expected cash flows used to measure the fair value of the asset under the revised FASB guidance on business combinations, and other U.S. generally accepted accounting principles. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

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In March 2008, the FASB issued new guidance on the disclosures about derivative instruments and hedging activities. The statement amends and expands the disclosure requirements to provide users of financial statements with an enhanced understanding of (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. The statement also requires (i) qualitative disclosures about objectives for using derivatives by primary underlying risk exposure, (ii) information about the volume of derivative activity, (iii) tabular disclosures about balance sheet location and gross fair value amounts of derivative instruments, income statement, and other comprehensive income location and amounts of gains and losses on derivative instruments by type of contract, and (iv) disclosures about credit-risk-related contingent features in derivative agreements. The new guidance is effective for financial statements issued for fiscal years or interim periods beginning after November 15, 2008. The adoption of this pronouncement did not have a significant impact on our financial statements.

In December 2007, the FASB issued revised guidance on business combinations. The guidance retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. The revised guidance is effective for fiscal years beginning on or after December 15, 2008 and will apply prospectively 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 the revised guidance will depend on the future business combinations that we may pursue.

In December 2007, the FASB issued amended guidance on noncontrolling interests in consolidated financial statements, which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. The amended guidance is effective for fiscal years beginning on or after December 15, 2008 and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The adoption of this pronouncement did not have a significant impact on our financial statements, except for the revised disclosures that are required. The future impact of adopting the amended guidance will depend on the structure of future business combinations or partnerships that we may pursue.

In September 2006, the FASB issued new guidance on fair value measurements. The new guidance provides enhanced guidance for using fair value to measure assets and liabilities. It does not require any new fair value measurements, but does require expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. The new guidance is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption encouraged. In February 2008, the FASB issued guidance delaying, for one year, the effective date of the new guidance for all nonfinancial assets and liabilities, except those that are recognized or disclosed in the financial statements on at least an annual basis. As such, we partially adopted the provisions of the new guidance effective January 1, 2008. The partial adoption of this statement did not have a material impact on our financial statements. We adopted the deferred provisions of the new guidance effective January 1, 2009 which impacts the way in which we calculate fair value for assets and liabilities initially measured at fair value in a business combination, our annual impairment review of goodwill and non-amortizable intangible assets, and when conditions exist that require us to calculate the fair value of long-lived assets. The adoption of this pronouncement did not have a significant impact on our financial statements, except for the additional disclosures that are required.



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**Critical Accounting Policies**

Management exercises judgment in making important decisions pertaining to choosing and applying accounting policies and methodologies in many areas. Not only are these decisions necessary to comply with U.S. generally accepted accounting principles, but they also reflect management's view of the most appropriate manner in which to record and report our overall financial performance. All accounting policies are important, and all policies described in Note 1 ( Summary of Operations and Significant Accounting Policies ) in our Annual Report on Form 10-K should be reviewed for a greater understanding of how our financial performance is recorded and reported.

During the first nine months of 2009, there were no significant changes in the manner in which our significant accounting policies were applied or in which related assumptions and estimates were developed.

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**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

(Dollars in thousands)

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 debt obligations. In July 2004, we hedged this risk by entering into an interest rate swap arrangement in connection with the term loan component of our credit facility. Under the swap arrangement, effective August 2, 2004, we received a fixed rate of interest in exchange for a variable rate. The swap rate received was 3.98% for five years and was adjusted accordingly for a Eurodollar spread incorporated in the agreement. (See Note 6 in Notes to Condensed Consolidated Financial Statements for additional information.)

In July 2009, we paid the final monthly installment for the term loan under the credit facility and have no further obligations relating to the term loan portion of the credit facility. Correspondingly, the interest rate swap arrangement we entered into in connection with the term loan under the credit facility has expired and we have no further obligations under the interest rate swap arrangement.

We are subject to foreign currency risk, due to fluctuations in currencies relative to the U.S. dollar. 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 effects relative to the U.S. dollar.

We maintain manufacturing operations in North America, Europe and Asia, and export products internationally. 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, which is translated into U.S. dollars for our Condensed Consolidated Financial Statements.

**Item 4. CONTROLS AND PROCEDURES**

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

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

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**PART II OTHER INFORMATION**

**Item 1. 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 the financial position or results of our operations. 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. Our environmental consulting firm prepared and submitted a Final Investigation Report in January 2009 to the New York State Department of Environmental Conservation ( 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 is working to incorporate the requested changes and will submit a revised work plan for review and approval. The final Remedial Action Plan selected may increase the estimated remediation costs modestly. Through September 27, 2009, total costs incurred have amounted to approximately \$247, none of which has been capitalized. At September 27, 2009 and December 31, 2008, we had \$39 and \$52, respectively, reserved for this matter.

**Item 1A. Risk Factors**

We have updated, amended and restated certain of the risk factors that were included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Each of the risk factors set forth below, as well as those set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 could materially adversely affect our business, operating results and financial condition, as well as the value of an investment in our common stock.

Additional risks and uncertainties not presently known to us, or those we currently deem immaterial, may also materially harm our business, operating results and financial condition.

**Updated Risk Factor**

*We may be unable to obtain financing to fund ongoing operations and future growth.*

While we believe our ongoing cost controls will allow us to generate cash and achieve profitability in the future, there is no assurance as to when or if we will be able to achieve our projections. Our future cash flows from operations, combined with our accessibility to cash and credit, may not be sufficient to allow us to finance ongoing operations or to make required investments for future growth. We may need to seek additional credit or access capital markets for additional funds. There is no assurance, given the current state of credit markets and our recent operating performance, that we would be successful in this regard.

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We have certain debt covenants in accordance with the provisions of our credit facility. At September 27, 2009 we were not in compliance with such debt covenants. This constitutes an event of default under the terms of our existing credit facility which would entitle our Lenders to provide us with notice that they were exercising their rights under the credit facility. Although we have not received such a notice from our Lenders, there are no constraints on their ability to do so. If we were to receive a notice of default from our Lenders, we would not be able to cure our default, and our Lenders would be able to exercise their rights and remedies as secured creditors of our indebtedness. Our Lenders would be able to terminate any commitment to lend additional funds to us and demand payment in full of the outstanding indebtedness under our credit facility. We currently do not have sufficient liquidity to satisfy such payment demand, were it to occur. Unless we were able to obtain additional capital resources, or appropriate waivers and forbearances from our Lenders, we would not be able to continue to fund our operations in the ordinary course or continue our business as currently conducted.

We are seeking to change our existing revolving credit line to an asset-based credit facility that will more closely match our operating needs and provide funding for our future operations and have evaluated proposals from our existing Lenders as well as other potential lenders. We have accepted a proposal for an asset-based credit facility which, if and when completed, would result in full payment of all of our obligations under our existing credit facility. In connection with that proposal, we are in active discussions with our current Lenders to secure a forbearance agreement. If we do not succeed in securing that agreement, our current Lenders could demand payment in full of the current outstanding indebtedness upon providing notice of default. We can provide no assurance that we will be able to obtain the forbearance agreement that we are currently discussing. Nor can we assure that we will succeed in obtaining any commitments to secure the asset-based credit facility that we are currently seeking. If we do not succeed in negotiating a forbearance agreement with our Lenders, they would be able to commence foreclosure on some or all of our assets that serve as collateral for the debt owed our Lenders, or exercise other rights and remedies given them under our current credit facility. Substantially all of our assets, tangible and intangible, serve as collateral for the debt that is owed our Lenders. In that event, we would likely be compelled to seek protection under Chapter 11 of the United States Bankruptcy Code. If this were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

Our relations with our Lenders have become strained due to our recent operating results and our failure to meet the financial covenants of our existing credit facility. We have received waivers as necessary in the past, and we are in active discussions with our current Lenders to secure a forbearance agreement. There can be no assurance, however, that such discussions will result in the execution and delivery of an appropriate forbearance agreement. Similarly, there can be no assurance that waivers or forbearances will always be obtained when needed in the future. If we are unable to obtain the forbearance agreement from our Lenders, we may need to implement alternative plans to provide us with sufficient levels of liquidity and working capital. 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.

**New Risk Factor**

*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 are currently in the process of completing our annual impairment analysis for goodwill and indefinite-lived intangible assets, in accordance with the applicable accounting guidance.

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Item 6. Exhibits

| Exhibit<br>Index | Description of Document  | Incorporated By Reference from:                       |
|------------------|--|---|
| 10.1             | Employment Agreement between the Registrant and John D. Kavazanjian  | Exhibit 99.1 of the Form 8-K filed on July 9, 2009    |
| 10.2             | Employment Agreement between the Registrant and William A. Schmitz   | Exhibit 99.2 of the Form 8-K filed on July 9, 2009    |
| 10.3             | Waiver and Amendment Number One to Amended and Restated Credit Agreement as of June 28, 2009, with the Lenders Party Thereto and JPMorgan Chase Bank, N.A. as Administrative Agent | Exhibit 10.4 of the Form 10-Q for the August 10, 2009 |
| 31.1             | CEO 302 Certifications   | Filed herewith  |
| 31.2             | CFO 302 Certifications   | Filed herewith  |
| 32.1             | 906 Certifications   | Filed herewith  |

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SIGNATURES

Pursuant to the requirements 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**

(Registrant)

Date: November 6, 2009

By: /s/ John D. Kavazanjian  
John D. Kavazanjian  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 6, 2009

By: /s/ John C. Casper  
John C. Casper  
Vice President of Finance and  
Chief Financial Officer  
(Principal Financial and  
Principal Accounting Officer)

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Index to Exhibits

- 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