ULTRALIFE BATTERIES INC
Form 10-K
March 19, 2008

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

(Mark One)

þ **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2007

OR

o **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from

Commission file number 0-20852
ULTRALIFE BATTERIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	16-1387013
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2000 Technology Parkway, Newark, New York	14513
(Address of principal executive offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.10 per share	The Nasdaq Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K þ

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company	Smaller Reporting Company o

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

On June 30, 2007, the aggregate market value of the Common Stock of Ultralife Batteries, Inc. held by non-affiliates of the Registrant was approximately $109,000,000 (in whole dollars) based upon the closing price for such Common Stock as reported on the NASDAQ National Market System on June 29, 2007.

As of March 1, 2008, the Registrant had 17,318,682 shares of Common Stock outstanding, net of 728,690 treasury shares.

DOCUMENTS INCORPORATED BY REFERENCE

Part III Ultralife Batteries, Inc. Proxy Statement Certain portions of the Registrant s Definitive Proxy Statement relating to the June 5, 2008 Annual Meeting of Shareholders are specifically incorporated by reference in Part III, Items 10-14 herein, except for the equity plan information required by Item 12 as set forth therein.

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PART I

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This report contains certain forward-looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to management. The statements contained in this report relating to matters that are not historical facts are forward-looking statements that involve risks and uncertainties, including, but not limited to, future demand for our products and services, addressing the process of U.S. military procurement, the successful commercialization of our products, general economic conditions, 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 materials 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. See Risk Factors in Item 1A of this report.

As used in this report, unless otherwise indicated, the terms we , our and us refer to Ultralife Batteries, Inc. and include our wholly-owned subsidiaries, Ultralife Batteries (UK) Ltd., McDowell Research Co., Inc., ABLE New Energy Co., Limited and its wholly-owned subsidiary ABLE New Energy Co., Ltd, RedBlack Communications, Inc. (formerly Innovative Solutions Consulting, Inc.), Stationary Power Services, Inc. and Reserve Power Systems, Inc.

Dollar amounts throughout this Form 10-K Annual Report are presented in thousands of dollars, except for per share amounts.

ITEM 1. BUSINESS

General

We offer products and services ranging from portable and standby power solutions to communications and electronics systems. Through our engineering and collaborative approach to problem solving, we serve government, defense and commercial customers across the globe. We design, manufacture, install and maintain power and communications systems including: portable and 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 enjoy strong name recognition in our markets under our Ultralife® Batteries, McDowell Research®, RedBlack™ Communications, Stationary Power Services™, Reserve Power Systems and ABLE™ brands. We have sales, operations and product development facilities in North America, Europe and Asia.

We report our results in four operating segments: Non-Rechargeable Products, Rechargeable Products, Communications Systems (formerly named Communications Accessories) and Design and Installation Services (formerly named Technology Contracts). The Non-Rechargeable Products segment includes: lithium 9-volt, cylindrical and various other non-rechargeable batteries, including seawater-activated 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 10 in the Notes to Consolidated Financial Statements.)

We continually evaluate various ways to grow, including opportunities to expand through mergers, acquisitions and business partnerships. On May 19, 2006, we acquired 100% of the equity securities of ABLE New Energy Co., Ltd. (ABLE), an established manufacturer of lithium batteries located in Shenzhen, China. The total consideration for the acquisition was a combination of cash and equity. The initial cash portion of the purchase price was $1,896 (net of

$104 in cash acquired), with an additional $500 cash payment contingent on the achievement of certain performance milestones,

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payable in separate $250 increments, when cumulative ABLE revenues from the date of acquisition attain $5,000 and $10,000, respectively. In August 2007, the $5,000 cumulative revenues milestone was attained, and as such, we have recorded the first $250 contingent cash payment. The equity portion of the purchase price consisted of 96,247 shares of our common stock valued at $1,000, and 100,000 stock warrants valued at $526, for a total equity consideration of $1,526. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On July 3, 2006, we finalized the acquisition of substantially all the assets of McDowell Research, Ltd. (McDowell), a manufacturer of military communications accessories located in Waco, Texas. Under the terms of the acquisition agreement, the purchase price of approximately $25,000 consisted of $5,000 in cash and a $20,000 non-transferable, subordinated convertible promissory note to be held by the sellers. In addition, the purchase price was subject to a post-closing adjustment based on a final valuation of trade accounts receivable, inventory and trade accounts payable that were acquired or assumed on the date of the closing, using a base value of $3,000. The final net value of these assets, under our contractual obligation under the acquisition agreement, was $6,389, resulting in a revised purchase price of approximately $28,448. On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell, which resolved various operational issues that arose during the first several months following the acquisition that significantly reduced our profit margins. The settlement agreement reduced the overall purchase price by approximately $7,900, by reducing the principal amount on the convertible note from $20,000 to $14,000, and eliminating a $1,889 liability related to the Purchase Price Adjustment formula. 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. In January 2008, the convertible notes were converted in full into 700,000 shares of our common stock. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On September 28, 2007, we finalized the acquisition of all of the issued and outstanding shares of common stock of Innovative Solutions Consulting, Inc. (ISC), a provider of a full range of engineering and technical services for communication electronic systems to government agencies and prime contractors located in Hollywood, Maryland. In January 2008, we renamed ISC to RedBlack Communications, Inc. (RedBlack). The initial cash purchase price was $943 (net of $57 in cash acquired), with up to $2,000 in additional cash consideration contingent on the achievement of certain sales milestones. The additional cash consideration is payable in up to three annual payments and subject to possible adjustments as set forth in the stock purchase agreement. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On November 16, 2007, we completed the acquisition of all of the issued and outstanding shares of common stock of Stationary Power Services, Inc. (SPS), an infrastructure power management services firm specializing in engineering, installation and preventative maintenance of standby power systems, uninterruptible power supply systems, DC power systems and switchgear/control systems for the telecommunications, aerospace, banking and information services industries located in Clearwater, Florida. Under the terms of the stock purchase agreement, the initial purchase price of $10,000 consisted of $5,889 (net of $111 in cash acquired) in cash and a $4,000 subordinated convertible promissory note to be held by the seller. In addition, on the achievement of certain post-acquisition sales milestones, we will issue up to an aggregate amount of 100,000 shares of our common stock. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On November 16, 2007, we completed the acquisition of all of the issued and outstanding shares of common stock of Reserve Power Systems, Inc. (RPS), an affiliate of SPS, and a supplier of lead acid batteries primarily for use by SPS in the design and installation of standby power systems. Under the terms of the stock purchase agreement, the initial purchase price consisted of 100,000 shares of our common stock, valued at $1,383. In addition, on the achievement of certain post-acquisition sales milestones, we will pay the sellers, in cash, 5% of sales up to the sales in the operating plan, and 10% of sales that exceed the sales in the operating plan, for the remainder of the calendar year 2007 and for calendar years 2008, 2009 and 2010. The additional contingent cash consideration is payable in annual installments, and excludes sales made to SPS, which historically have comprised substantially all of RPS s sales. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

Our website address is www.ultralifebatteries.com. We make available free of charge via a hyperlink on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). We will provide copies of these reports upon written request to the attention of Peter F. Comerford, Secretary, Ultralife Batteries, Inc., 2000 Technology Parkway, Newark, New York, 14513. Our filings with the SEC are also available through the SEC website at www.sec.gov or at the SEC Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or by calling 1-800-SEC-0330.

Non-Rechargeable Products

We manufacture and/or market a family of lithium-manganese dioxide (Li-MnO_2) non-rechargeable batteries including 9-volt, HiRateÒ cylindrical, and Thin CellÒ, in addition to magnesium silver-chloride seawater-activated batteries, and other chemistries and form factors. We also manufacture and market a family of lithium-thionyl chloride (Li-$SOCl_2$) non-rechargeable batteries produced by our ABLE operating unit. Applications for our 9-volt batteries include: smoke alarms, wireless security systems and intensive care monitors, among many other devices. Our HiRate and Thin Cell lithium non-rechargeable batteries are sold primarily to the military and to OEMs in industrial markets for use in a variety of applications including radios, automotive telematics, emergency radio beacons, search and rescue transponders, pipeline inspection gauges, portable medical devices and other specialty instruments and applications. Military applications for our non-rechargeable HiRate batteries include: man-pack and survival radios, night vision goggles, targeting devices, chemical agent monitors and thermal imaging equipment. Our lithium-thionyl chloride batteries, sold under our ABLE brand as well as various private label brands, can be used in a wide variety of applications including utility meters, security devices, electronic meters, automotive electronics and geothermal devices. We also manufacture seawater-activated batteries for specialty marine applications. We believe that the chemistry of lithium batteries provides significant advantages over other currently available non-rechargeable battery technologies. These advantages include: lighter weight, longer operating time, longer shelf life, and a wider operating temperature range. Our non-rechargeable batteries also have relatively flat voltage profiles, which provide stable power. Conventional non-rechargeable batteries, such as alkaline batteries, have sloping voltage profiles that result in decreasing power output during discharge. While the price for our lithium batteries is generally higher than alkaline batteries, the increased energy per unit of weight and volume of our lithium batteries allow longer operating times and less frequent battery replacements for our targeted applications.

Revenues for this segment for the year ended December 31, 2007 were $80,262 and segment contribution was $17,747.

Rechargeable Products

We believe that our range of lithium ion and lithium polymer rechargeable batteries and chargers offer substantial benefits, including the ability to design and produce lightweight batteries in a variety of custom sizes, shapes, and thickness. We market lithium ion and lithium polymer rechargeable batteries comprised of cells manufactured by qualified cell manufacturers. Our rechargeable products can be used in a wide variety of applications including communications, medical and other portable electronic devices. The chemistry of lithium ion and lithium polymer batteries provides significant advantages over other currently available rechargeable batteries. These advantages include lighter weight, longer operating time, longer time between charges and a wider operating temperature range. Conventional rechargeable batteries, nickel metal hydride and nickel cadmium, are heavier, have lower energy and require more frequent charging. Additionally, we offer lead-acid batteries and uninterruptable power supplies for the standby power market. Products include standby batteries and uninterruptable power supplies for use in telecommunications, banking, aerospace and information services industries.

Revenues for this segment for the year ended December 31, 2007 were $16,756 and segment contribution was $3,578.

Communications Systems

In 2006, as a result of the acquisition of McDowell, we formed a new segment, Communications Accessories, which was renamed Communications Systems in 2007. We design and manufacture a line of power solutions and accessories to support military communications systems including power supplies, power cables, connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication systems. Products include field deployable systems, which operate from wide-ranging AC and DC sources using a basic building block approach, allowing for a quick response to specialized applications. All systems are packaged to meet specific customer needs in rugged enclosures to allow their use in severe environments. We market these products to all branches of the U.S. military, approved foreign defense organizations, and U.S. and international prime defense contractors.

Revenues for this segment in the year ended December 31, 2007 were $37,140 and segment contribution was $6,693.

Design and Installation Services

In the fourth quarter of 2007, as a result of the acquisitions of RedBlack and SPS, we renamed our Technology Contracts segment to Design and Installation Services. These services include the design, installation, integration and maintenance of both communications electronics and standby power systems. We also seek to fund part of our efforts to identify and develop new applications for our products and to advance our technologies through contracts with both government agencies and third parties. We have been successful in obtaining awards for such programs for both rechargeable and non-rechargeable battery technologies.

Revenues for this segment in the year ended December 31, 2007 were $3,438 and segment contribution was $756. We continue to obtain contracts that are in parallel with our efforts to ultimately commercialize products that we develop. Revenues in this segment may vary widely each year, depending upon the quantity and size of contracts obtained.

Corporate

We allocate revenues and cost of sales across the above business segments. The balance of income and expense, including but not limited to research and development expenses, and selling, general and administrative expenses, are reported as Corporate expenses.

There were no revenues for this category in the year ended December 31, 2007 and corporate contribution was a loss of $28,973.

See Management s Discussion and Analysis of Financial Condition and Results of Operations and the 2007 Consolidated Financial Statements and Notes thereto for additional information. For information relating to total assets by segment and revenues for the last three years by segment, see Note 10 in the Notes to Consolidated Financial Statements.

History

We were formed as a Delaware corporation in December 1990. In March 1991, we acquired certain technology and assets from Eastman Kodak Company (Kodak) relating to its 9-volt lithium-manganese dioxide non-rechargeable battery. In December 1992, we completed our initial public offering and became listed on NASDAQ. In June 1994, we formed a subsidiary, Ultralife Batteries (UK) Ltd. (Ultralife UK), which acquired certain assets of the Dowty Group PLC (Dowty) and provided us with a presence in Europe. In May 2006, we acquired ABLE, an established manufacturer of lithium batteries located in Shenzhen, China, which broadened our product offering and provided additional exposure to new markets. In July 2006, we finalized the acquisition of substantially all the assets of McDowell, a manufacturer of military communications accessories formerly located in Waco, Texas, which enhanced our channels into the military communications area and strengthened our presence in global military markets. In September 2007, we acquired ISC, located in Hollywood, Maryland, which we renamed RedBlack in January 2008, an engineering and technical services firm specializing in the design, integration, and fielding of mobile, modular, and fixed-site communication and electronic systems. The acquisition provided a natural extension to our communications systems business and opened another channel of distribution for our broad portfolio of communications systems, accessories and portable power products. In November 2007, we acquired SPS and RPS, affiliated companies both located in Clearwater, Florida. SPS is an infrastructure power management services firm specializing in the engineering, installation and preventive maintenance of standby power systems, uninterrupted power supply systems, DC power systems and switchgear/control systems for the telecommunications, aerospace, banking and information services industries. RPS supplies lead acid batteries for use in the design and installation of standby power systems. The SPS acquisition furthered our transformation to a value-added power solutions, accessories and engineering services company serving a broad spectrum of government, defense and commercial markets.

Products, Services and Technology

Non-Rechargeable Products

A non-rechargeable battery is used until discharged and then discarded. The principal competing non-rechargeable battery technologies are carbon-zinc, alkaline and lithium. We manufacture a range of non-rechargeable battery products based on lithium-manganese dioxide, lithium-thionyl chloride and magnesium-silver chloride technologies.

Our non-rechargeable battery products are based predominantly on lithium-manganese dioxide and lithium-thionyl chloride technologies. Our only non-lithium-based non-rechargeable product is our magnesium-silver chloride battery, also known as a seawater-activated battery. We believe that the chemistry of lithium batteries provides significant advantages over currently available non-rechargeable battery technologies, which include: lighter weight, longer operating time, longer shelf life, and a wider operating temperature range. Our non-rechargeable batteries also have relatively flat voltage profiles, which provide stable power. Conventional non-rechargeable batteries, such as alkaline batteries, have sloping voltage profiles that result in decreasing power outage during discharge. While the prices for our lithium batteries

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are generally higher than commercially available alkaline batteries produced by others, we believe that the increased energy per unit of weight and volume of our batteries will allow longer operating time and less frequent battery replacements for our targeted applications. As a result, we believe that our non-rechargeable batteries are price competitive with other battery technologies on a price per watt-hour basis.

Our non-rechargeable products include the following product configurations:

9-Volt Lithium Battery. Our 9-volt lithium battery delivers a unique combination of high energy and stable voltage, which results in a longer operating life for the battery and, accordingly, fewer battery replacements. While our 9-volt battery price is generally higher than conventional 9-volt carbon-zinc and alkaline batteries, we believe the enhanced operating performance and decreased costs associated with battery replacement make our 9-volt battery more cost effective than conventional batteries on a cost per watt-hour basis when used in a variety of applications.

We market our 9-volt lithium batteries to OEM, distributor and retail markets including industrial electronics, safety and security, medical and music/audio. Significant applications include: smoke alarms, wireless alarm systems, bone growth stimulators, telemetry devices, blood analyzers, ambulatory infusion pumps, parking meters, wireless audio devices and guitar pickups. A significant portion of the sales of our 9-volt battery is to major U.S. and international smoke alarm OEMs for use in their long-life smoke alarms. We also manufacture our 9-volt lithium battery under private label for a variety of U.S. and international companies. Additionally, we sell our 9-volt battery to the broader consumer market through national and regional retail chains and Internet retailers.

We believe that we manufacture the only standard size 9-volt battery warranted to last 10 years when used in ionization-type smoke alarms. Although designs exist using other battery configurations, such as three 2/3 A or 1/2 AA-type battery cells, we believe that our 9-volt solution is superior to these alternatives. Our current 9-volt battery manufacturing capacity is adequate to meet forecasted customer demand.

Cylindrical Batteries. Featuring high energy, wide temperature range, long shelf life and operating life, our cylindrical cells and batteries, based on both lithium-manganese dioxide and lithium-thionyl chloride technologies, represent some of the most advanced lithium power sources currently available. We market a wide range of cylindrical non-rechargeable lithium cells and batteries in various sizes under both the HiRate and ABLE brands, which include: D, C, 5/4 C, 1/2 AA, 2/3 A and other sizes, which are sold individually as well as packaged into multi-cell battery packs, including our leading BA-5390 military battery, which is an alternative to the Li-SO_2 BA-5590 battery, which is the most widely used battery in the U.S. armed forces for portable applications and is manufactured and sold by our competitors. Our BA-5390 battery provides 50% to 100% more energy (mission time) than the BA-5590, and it is used in approximately 60 military applications.

We market our line of lithium cells and batteries to the OEM market for commercial, military, medical, automotive, asset tracking and search and rescue applications, among others. Significant commercial applications include pipeline inspection equipment, autoreclosers and oceanographic devices. Asset tracking applications include RFID (Radio Frequency Identification) systems. Among the military uses are manpack radios, night vision goggles, chemical agent monitors, and thermal imaging equipment. Medical applications include: AED s (Automated External Defibrillators), infusion pumps and telemetry systems. Automotive applications include: telematics, tire-pressure monitoring and engine electronics systems. Search and rescue applications include: ELT s (Emergency Locator Transmitters) for aircraft and EPIRB s (Emergency Position Indicating Radio Beacons) for ships.

Thin Cell Batteries. We manufacture a range of thin lithium-manganese dioxide batteries under the Thin Cell brand. Thin Cell batteries are flat, lightweight batteries providing a unique combination of high energy, long shelf life, wide operating temperature range and light weight. With their thin prismatic form and a high ratio of active materials to packaging, Thin Cell batteries can efficiently fill most battery cavities. We are currently marketing these batteries to OEMs for applications such as wearable medical devices, theft detection systems, and RFID devices.

Seawater-Activated Batteries. We produce a variety of seawater-activated batteries based on magnesium-silver chloride technology. Seawater-activated batteries are custom designed and manufactured to end user specifications. The batteries, which can be stored almost indefinitely, are activated when placed in salt water, which acts as the electrolyte allowing current to flow. We market seawater-activated batteries to naval and specialty OEMs for applications including sonobuoys, underwater defense systems, air-sea rescue equipment, airborne surveillance drones and meteorological radiosondes.

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Rechargeable Products

In contrast to non-rechargeable batteries, after a rechargeable battery is discharged, it can be recharged and reused many times. Generally, discharge and recharge cycles can be repeated hundreds of times in rechargeable batteries, but the achievable number of cycles (cycle life) varies among technologies and is an important competitive factor. All rechargeable batteries experience a small, but measurable, loss in energy with each cycle. The industry commonly reports cycle life in the number of cycles a battery can achieve until 80% of the battery s initial energy capacity remains. In the rechargeable battery market, the principal competing technologies are nickel-cadmium, nickel-metal hydride, lithium-ion and lithium-polymer-based batteries. Rechargeable batteries can be used in many applications, such as military radios, laptop computers, mobile telephones, portable medical devices, wearable devices and many other commercial, military and consumer products.

Three important parameters for describing the performance characteristics of a rechargeable battery suited for today s portable electronic devices are design flexibility, energy density and cycle life. Design flexibility refers to the ability of rechargeable batteries to be designed to fit a variety of shapes and sizes of battery compartments. Thin profile batteries with prismatic geometry provide the design flexibility to fit the battery compartments of today s electronic devices. Energy density refers to the total electrical energy per unit volume stored in a battery. High energy density batteries generally are longer lasting power sources providing longer operating time and necessitating fewer battery recharges. Lithium batteries, by the nature of their electrochemical properties, are capable of providing higher energy density than comparably sized batteries that utilize other chemistries and, therefore, tend to consume less volume and weight for a given energy content. Long cycle life is a preferred feature of a rechargeable battery because it allows the user to charge and recharge many times before noticing a difference in performance.

Energy density refers to the total amount of electrical energy stored in a battery divided by the battery s weight and volume as measured in watt-hours per kilogram and watt-hours per liter, respectively. High energy density and long achievable cycle life are important characteristics for comparing rechargeable battery technologies. Greater energy density will permit the use of batteries of a given weight or volume for a longer time period. Accordingly, greater energy density will enable the use of smaller and lighter batteries with energy comparable to those currently marketed. Long achievable cycle life, particularly in combination with high energy density, is suitable for applications requiring frequent battery recharges, such as cellular telephones and portable computers.

Lithium Ion and Lithium Polymer Cells and Batteries. We offer a variety of lithium ion and lithium polymer cells and batteries. Additionally, we offer battery packs made from single and multiple lithium ion and lithium polymer cells. These products can be used in a wide variety of applications including communications, medical and other portable electronic devices.

Lead-Acid Batteries. We offer a variety of lead-acid batteries primarily for use in the design and installation of standby power systems. These products include standby batteries and uninterruptable power supplies for use in telecommunications, banking, aerospace and information services industries.

Battery Charging Systems and Accessories. To provide our customers with complete power system solutions, we offer a wide range of rugged military and commercial battery charging systems and accessories including smart chargers, multi-bay charging systems and a variety of cables.

Communications Systems

Our McDowell unit designs and manufactures power solutions and accessories to support military communications systems including power supplies, RF amplifiers, battery chargers, amplified speakers, equipment mounts, case equipment and integrated communication systems. We specialize in field deployable power systems, which operate from wide-ranging AC and DC sources using a basic building block approach, allowing for a quick response to specialized applications. We package all systems to meet specific customer needs in rugged enclosures to allow their use in severe environments.

We offer a wide range of military communications accessories designed to enhance and extend the operation of communications equipment such as vehicle-mounted, manpack and handheld transceivers. Our communications accessories include the following product configurations:

Integrated Systems. Our integrated systems include: SATCOM on the Move (SOTM); ruggedized deployable case systems; multiband transceiver kits and HF transceiver kits; briefcase power systems; dual transceiver cases; enroute communications cases; four radio cases; and tactical repeater systems. These systems give communications operators everything that is needed to provide reliable links to support C4I (Command, Control, Communications, Computers and Information systems).

Power Systems. Our power systems include: universal AC/DC power supplies with battery backup for tactical manpack and handheld transceivers; Rover III power supplies; interoperable power adapters and chargers; portable power systems; tactical combat and AC to DC power supplies for encryption units, among many others. We can provide power supplies for virtually all tactical communications devices.

RF Amplifiers. Our RF amplifiers include: 20 and 100-watt multiband (30 512 MHz) and 50 watt VHF RF (30 90 MHz) amplifiers. These amplifiers are used to extend the range of manpack and handheld tactical transceivers and can be used on mobile or fixed site applications.

Design and Installation Services

Our design and installation services focus on standby power system design, installation and maintenance, integrating communications equipment and power systems for maximum mobility and optimum customer utility. These include equipment installations in commercial, military and law enforcement application, including vehicles for satellite communications, engineering services, upgrading current fleet vehicles and integrated logistics and project management support.

Communications and Electronics. Our communications and electronics services include the design, integration, fielding and life cycle management of portable, mobile and fixed-site communications systems. Capabilities include engineering, rapid prototyping, systems integration and logistics support.

Standby Power. Our standby power services provide mission critical solutions to a broad range of applications in the telecommunications, aerospace, banking and information services industries involving the installation and preventive maintenance of standby power systems, uninterrupted power supply systems, DC power systems and switchgear/control systems.

Technology Contracts. Our technology contract activities involve the development of new products or the advancement of existing products through contracts with both government agencies and third parties.

Sales and Marketing

We employ a staff of sales and marketing personnel in North America, Europe and Asia. We sell our current products and services directly to commercial customers, including OEMs, as well as government and defense agencies in the U.S. and abroad and have contractual arrangements with sales agents who market our products on a commission basis in particular areas. While OEM agreements and contracts contain volume-based pricing based on expected volumes, industry practices dictate that pricing is rarely adjusted retroactively when contract volumes are not achieved. Every effort is made to adjust future prices accordingly, but the ability to adjust prices is generally based on market conditions.

We also distribute our products through domestic and international distributors and retailers. Our sales are generated primarily from customer purchase orders. We have several long-term contracts with the U.S. government and companies within the automotive industry. These contracts do not commit the customers to specific purchase volumes, nor to specific timing of purchase order releases, and they include fixed price agreements over various periods of time. We do not believe our sales are seasonal.

In 2007, sales to U.S. and non-U.S. customers were approximately $79,300 and $58,300, respectively. (See Note 10 in the Notes to Consolidated Financial Statements.)

Non-Rechargeable Products

We have targeted sales of our non-rechargeable products to manufacturers of security and safety equipment, automotive telematics, medical devices, search and rescue equipment, specialty instruments, point of sale equipment and metering applications, as well as users of military equipment. Our strategy is to develop sales and marketing alliances with OEMs and governmental agencies that utilize our batteries in their products, commit to cooperative research and development or marketing programs, and recommend our products for design-in or replacement use in their products. We are addressing these markets through direct contact by our sales and technical personnel, use of sales agents and stocking distributors, manufacturing under private label and promotional activities.

We seek to capture a significant market share for our products within our targeted OEM markets, which we believe, if successful, will result in increased product awareness and sales at the end-user or consumer level. We are also selling our 9-volt battery to the consumer market through retail distribution. Most military procurements are done directly by the specific government organizations requiring products, based on a competitive bidding process. For those military

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procurements that are not bid, the procurements are typically subject to an audit of the product s underlying cost structure and associated profitability. Additionally, we are typically required to successfully meet contractual specifications and to pass various qualification testing for the products under contract by the military. An inability by us to pass these tests in a timely fashion could have a material adverse effect on our business, financial condition and results of operations. When a government contract is awarded, there is a government procedure that allows for unsuccessful companies to formally protest the award if they believe they were unjustly treated in the government s bid evaluation process. A prolonged delay in the resolution of a protest, or a reversal of an award resulting from such a protest could have a material adverse effect on our business, financial condition and results of operations.

During 2007, we had three major customers for our military products, the U.S. Department of Defense, the U.K. Ministry of Defence and Raytheon Company. Direct sales to the U.S. Department of Defense comprised approximately 14% of our revenue in 2007, 20% in 2006, and 25% in 2005. Direct sales to the U.K. Ministry of Defence comprised approximately 12% of our revenue in 2007, 7% in 2006, and 6% in 2005. Direct sales to Raytheon Company comprised approximately 13% of our revenue in 2007, 3% in 2006, and 1% in 2005. We believe that the loss of these customers could have a material adverse effect on us. We believe that we have a good relationship with these customers.

We have been successfully marketing our products to military organizations in the U.S. and other countries. These efforts have resulted in us winning significant contracts. For example, in December 2004, we were awarded 100% of the Next Gen II Phase IV battery production contracts by the U.S. Defense Department to provide five types of non-rechargeable lithium-manganese dioxide batteries to the U.S. Army. Combined, these batteries comprise what is called the Rectangular Lithium Manganese Dioxide Battery Group. The government awarded 60 percent to our U.S. operation and 40 percent to our U.K operation. The contract provides for order releases over a five-year period with a maximum potential value of up to $286,000. In January 2005, a competitor of ours filed a protest with the U.S. government of our award of the Next Gen II Phase IV contract with the U.S. military, and in April 2005 the protest was denied by the government, allowing us to proceed with the qualification process for the batteries under this contract. In January 2006, our BA-5390A battery with State of Charge Indicator, one of the five battery types under this contract, passed the qualification process, allowing for future orders of this approved battery. Ultimate orders under this contract are dependent upon the demand for these batteries by end users and inventory stocking strategies, among other things. Through December 31, 2007, we have received orders for deliveries under this contract totaling $15,900. In February 2005, we were awarded a five-year production contract by the U.S. Defense Department, with a maximum total potential of $15,000, to provide our BA-5347/U non-rechargeable lithium-manganese dioxide batteries to the U.S. military. The contract value represented 60 percent of a small business set-aside award. In March 2005, a competitor contested this award and in August 2005, the competitor s protest was denied. Production deliveries began in the first quarter of 2006.

At December 31, 2007 and 2006, our backlog of non-rechargeable products was approximately $15,300 and $15,700, respectively. The majority of the 2007 backlog was related to orders that are expected to ship throughout 2008.

Rechargeable Products

We have targeted sales of our rechargeable batteries and charging systems through OEM customers, as well as distributors and resellers focused on our target markets. We seek design wins with OEMs, and believe that our design capabilities, product characteristics and solution integration will drive OEMs to incorporate our batteries into their product offerings, resulting in revenue growth opportunities for us.

We continue to expand our marketing activities as part of our strategic plan to increase sales of our rechargeable products for commercial, military and communications applications, as well as hand-held devices, wearable devices and other electronic portable equipment. A key part of this expansion includes increasing our design and assembly capabilities as well as building our network of distributors and value added distributors throughout the world.

At December 31, 2007 and 2006, our backlog related to rechargeable products was approximately $7,500 and $5,900, respectively. The majority of the 2007 backlog was related to orders that are expected to ship throughout 2008.

Communications Systems

We have targeted sales of our communications systems, which include power solutions and accessories to support military communications systems such as battery chargers, power supplies, power cables, connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication systems, to military OEMs and military organizations including the U.S. Department of Defense. We sell our products directly and through authorized distributors to OEMs and to military organizations in the U.S. and internationally.

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We have been successfully marketing our products to military organizations and OEMs in the U.S. and internationally. These efforts have recently resulted in a number of significant contracts for us. For example, in September 2007, we were awarded a $24,000 contract from Raytheon Company to produce and supply SATCOM-On-The-Move (SOTM) satellite communications systems for installation on Mine Resistant Ambush Protected (MRAP) armored vehicles. In December 2007, we received orders valued at $62,000 and $40,000, respectively, from a U.S. defense contractor to supply advanced communications systems.

At December 31, 2007 and 2006, our backlog related to communications systems orders was approximately $115,500 and $12,800, respectively. The majority of the 2007 backlog was related to orders that are expected to ship throughout 2008.

Design and Installation Services

We continue to expand our sales and marketing activities to increase sales of our design and installation services for communications electronics systems and standby power applications. We provide our services directly to military organizations, government agencies and commercial customers.

At December 31, 2007 and 2006, our backlog related to design and installation services was approximately $3,600 and $-0-, respectively. The majority of the 2007 backlog was related to services that are expected to be performed throughout 2008.

Patents, Trade Secrets and Trademarks

We rely on licenses of technology as well as our patented and unpatented proprietary information, know-how and trade secrets to maintain and develop our commercial position. Although we seek to protect our proprietary information, there can be no assurance that others will not either develop the same or similar information independently or obtain access to our proprietary information, despite our efforts to protect such proprietary information. In addition, there can be no assurance that we would prevail if we asserted our intellectual property rights against third parties, or that third parties will not successfully assert infringement claims against us in the future. We believe, however, that our success is more dependent on the knowledge, ability, experience and technological expertise of our employees, as opposed to the legal protection that our patents and other proprietary rights may or will afford.

We hold twelve patents in the U.S. and foreign countries. Our patents protect technology that makes automated production more cost-effective and protect important competitive features of our products. However, we do not consider our business to be dependent on patent protection.

In 2003, we entered into an agreement with Saft Groupe S.A. to license certain tooling for certain BA-5390 battery cases. The licensing fee associated with this agreement is essentially one dollar per battery case sold. The total royalty expense reflected in 2007 was $13. This agreement expires in the year 2017.

All of our employees in the U.S. and all our key employees involved with our technology in England and China are required to enter into agreements providing for confidentiality and the assignment of rights to inventions made by them while employed by us. These agreements also contain certain noncompetition and nonsolicitation provisions effective during the employment term and for varying periods thereafter depending on position and location. There can be no assurance that we will be able to enforce these agreements.

The following are registered trademarks or trademarks of ours: Ultralifeâ, Ultralife Thin Cellâ, Ultralife HiRateâ, Ultralife Polymerâ, The New Power GenerationÒ, LithiumPowerÒ, SmartCircuitÒ, PowerBugÒ, We Are PowerÒ, ABLEÔ, RedBlack , Reserve Power Systems , Stationary Power Systems , McDowell Research®, Max Juice For More Gigs®, and Litron .

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Manufacturing and Raw Materials

We manufacture our products from raw materials and component parts that we purchase. We have ISO 9001:2000 certification for our manufacturing facilities in Newark, New York, Abingdon, England, and Shenzhen, China. In addition, our manufacturing facilities in Newark, New York and Shenzhen, China are ISO 14001 certified.

We expect that in the future, raw material purchases will fluctuate based on the timing of customer orders, the related need to build inventory in anticipation of orders and actual shipment dates.

Non-Rechargeable Products

Our Newark, New York facility has the capacity to produce in excess of nine million 9-volt batteries per year, approximately fourteen million cylindrical cells per year and approximately 500,000 thin cells per year. Our manufacturing facility in Abingdon, England is capable of producing more than two million cylindrical cells per year. This facility also manufactures seawater-activated batteries and assembles customized multi-cell battery packs. Capacity, however, is also related to individual operations and product mix changes can produce bottlenecks in an individual operation, constraining overall capacity. Our ABLE operating unit in Shenzhen, China is capable of producing more than three million cylindrical cells per year. We have acquired new machinery and equipment in areas where production bottlenecks have resulted in the past and believe that we have sufficient capacity in these areas. We continually evaluate our requirements for additional capital equipment, and we believe that the planned increases in our current manufacturing capacity will be adequate to meet foreseeable customer demand. However, with unanticipated growth in demand for our products, demand could exceed capacity, which would require us to install additional capital equipment to meet these incremental needs, which in turn may require us to lease or contract additional space to accommodate needs.

We utilize lithium foil as well as other metals and chemicals to manufacture our batteries. Although we know of only three major suppliers that extrude lithium into foil and provide such foil in the form required by us, we do not anticipate any shortage of lithium foil or any difficulty in obtaining the quantities we require. Certain materials used in our products are available only from a single source or a limited number of sources. Additionally, we may elect to develop relationships with a single or limited number of sources for materials that are otherwise generally available. Although we believe that alternative sources are available to supply materials that could replace materials we use and that, if necessary, we would be able to redesign our products to make use of an alternative product, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers. Although we have experienced interruptions of product deliveries by sole source suppliers, none of such interruptions has had a material adverse effect on us. All other raw materials utilized by us are readily available from many sources.

We use various utilities to provide heat, light and power to our facilities. As energy costs rise, we continue to seek ways to reduce these costs and will initiate energy-saving projects at times to assist in this effort. It is possible, however, that rising energy costs may have an adverse effect on our financial results.

The total carrying value of our non-rechargeable products inventory, including raw materials, work in process and finished goods, amounted to approximately $14,800 as of December 31, 2007.

Rechargeable Products

We believe that the raw materials and components utilized for our rechargeable batteries are readily available from many sources. Although we believe that alternative sources are available to supply materials that could replace materials we use, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers.

Our Newark, New York facility has the capacity to produce significant volumes of rechargeable batteries, as this segment generally assembles battery packs and chargers and is limited only by physical space and is not constrained by manufacturing equipment capacity. In addition, our facility in Abingdon, England has the capacity to produce significant volumes of rechargeable batteries and chargers.

The total carrying value of our rechargeable products inventory, including raw materials, work in process and finished goods, amounted to approximately $11,500 as of December 31, 2007.

Communications Systems

In general, we believe that the raw materials and components utilized by us for our communications accessories and systems, including RF amplifiers, power supplies and integration kits, are available from many sources. Although we believe that alternative sources are available to supply materials that could replace materials we use, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers.

Our Newark, New York facility has the capacity to produce significant volumes of communication accessories, as this segment generally assembles products and is limited only by physical space and is not constrained by manufacturing equipment capacity.

Our Woodinville, Washington facility has the capacity to produce significant volumes of RF amplifiers, as this operation generally assembles products and is limited only by physical space and is not constrained by manufacturing equipment capacity.

The total carrying value of our communications systems inventory, including raw materials, work in process and finished goods, amounted to approximately $7,500 as of December 31, 2007.

Design and Installation Services

We believe that the raw materials and components utilized for our standby power installations are readily available from many sources. Although we believe that alternative sources are available to supply materials that could replace materials we use, any interruption in our supply from any supplier that serves currently as our sole source could delay product shipments and adversely affect our financial performance and relationships with our customers.

The total carrying value of our design and installation services inventory, including raw materials, work in process and finished goods, amounted to approximately $1,300 as of December 31, 2007.

Research and Development

We concentrate significant resources on research and development activities to improve upon our technological capabilities and to design new products for customers applications. We conduct our research and development in Newark, New York, Shenzhen, China and Woodinville, Washington. During 2007, 2006 and 2005 we expended approximately $7,000, $5,100 and $3,800, respectively, on research and development. We expect that research and development expenditures in the future will be modestly higher than those in 2007, as new product development initiatives will drive our growth. As in the past, we will continue to make funding decisions for our research and development efforts based upon strategic demand for customer applications.

Non-Rechargeable Products

We continue to develop non-rechargeable cells that broaden our product offering to our customers.

Rechargeable Products

The rechargeable product portfolio continues to grow as our customers needs continue to grow for portable power. We support these needs through designing rechargeable batteries and charging solutions.

Communications Systems

In 2006, we acquired McDowell, which provides a variety of communications accessories to the military market. We have redesigned a number of McDowell s products to meet the ever-changing customer demands. There has been a significant emphasis to add a line of amplifiers to support the customers requirements.

Design and Installation Services

The U.S. government sponsors research and development programs designed to improve the performance and safety of existing battery systems and to develop new battery systems. In 2003, we were awarded the initial phase of a government-sponsored contract for battery charging systems. We successfully completed the contract during 2003. In

December 2003, we were awarded a Small Business Innovative Research (SBIR) contract for the development of a polymer battery. The development phase of this contract was completed in mid-2004.

In addition, we work to receive contracts with military contractors and commercial customers. For example, in February 2004, we announced that we received a development contract from General Dynamics valued at approximately $2,700. The contract was for lithium non-rechargeable and lithium ion rechargeable batteries, as well as vehicle and soldier-based chargers for the Land Warrior-Stryker Interoperable (LW-SI) program. In 2005, we received an added scope award of this project, increasing the total project to approximately $4,000. Additionally, purchase orders have been received for the products developed under this contract as the batteries have become commercialized. In 2005, we were awarded various development contracts, including the development of a rechargeable battery for a portable radio. In 2006, we completed the General Dynamics contract work and were awarded several small development contracts for rechargeable product development and new generation high-powered cells.

In January 2008, we entered into a technology partnership with Mississippi State University (MSU) to develop fuel cell-battery portable power systems enabling lightweight, long endurance military missions. The development of this power system is to be performed under a $1,600 program that was awarded by a U.S. Defense Department agency to MSU as the prime contractor. MSU has awarded us a $475 contract to participate in this program as a subcontractor. Under the contract, we will oversee the development, testing, approval and manufacturing of prototypes of a new compact military battery to be used with handheld tactical radios, building on its ongoing development work under the Land Warrior System Stryker Interoperable Program. In addition, we are establishing a development and assembly operation in a 14,000 square-foot facility located in West Point, Mississippi to manufacture products coming out of the technology partnership and other of our products. We plan to commence operations in the first half of 2008.

Safety; Regulatory Matters; Environmental Considerations

Certain of the materials utilized in our batteries may pose safety problems if improperly used. We have designed our batteries to minimize safety hazards both in manufacturing and use.

The transportation of non-rechargeable and rechargeable lithium batteries is regulated by the International Civil Aviation Organization (ICAO) and corresponding International Air Transport Association (IATA) Dangerous Goods Regulations and the International Maritime Dangerous Goods Code (IMDG), and in the U.S. by the Department of Transportation s Pipeline and Hazardous Materials Safety Administration (PHMSA). These regulations are based on the United Nations Recommendations on the Transport of Dangerous Goods Model Regulations and the United Nations Manual of Tests and Criteria. We currently ship our products pursuant to ICAO, IATA and PHMSA hazardous goods regulations. New regulations that pertain to all lithium battery manufacturers went into effect in January 2008, and additional regulations will go into effect in 2009 and 2010. The regulations require companies to meet certain testing, packaging, labeling and shipping specifications for safety reasons. We have not incurred, and do not expect to incur, any significant costs in order to comply with these regulations. We comply with all current U.S. and international regulations for the shipment of our products, and we intend and expect to comply with any new regulations that are imposed. We have established our own testing facilities to ensure that we comply with these regulations. If we are unable to comply with the new regulations, however, or if regulations are introduced that limit our ability to transport our products to customers in a cost-effective manner, this could have a material adverse effect on our business, financial condition and results of operations. Our RPS lead acid products have been tested and have been deemed to meet all requirements as specified in 49CFR 173.159 (d) for exception as hazardous material classification. Our RPS lead acid batteries have been tested and have been deemed to meet all requirements as specified in the special provision 238 for determination of Non-Spillable and are not subject to the provision of 49CFR 173.159 (d).

The European Union s Restriction of Hazardous Substances (RoHS) Directive places restrictions on the use of certain hazardous substances in electrical and electronic equipment. All applicable products sold in the European Union market after July 1, 2006 must pass RoHS compliance. While this directive does not apply to batteries and does not currently affect our military products, should any changes occur in the directive that would affect our products, we intend and expect to comply with any new regulations that are imposed. Our commercial chargers are in compliance with this directive. Additional European Union Directives, entitled the Waste Electrical and Electronic Equipment

(WEEE) Directive and the Directive on Batteries and Accumulators and Waste Batteries and Accumulators, impose regulations affecting our non-military products. These directives require that producers or importers of particular classes of electrical goods are financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. These directives assign levels of responsibility to companies doing business in European Union markets based on their relative market share. These directives call on each European Union member state to enact enabling legislation to implement the directive. As additional European Union member states pass enabling legislation

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our compliance system should be sufficient to meet such requirements. Our current estimated costs associated with our compliance with these directives based on our current market share are not significant. However, we continue to evaluate the impact of these directives as European Union member states implement guidance, and actual costs could differ from our current estimates.

China s Management Methods for Controlling Pollution Caused by Electronic Information Products Regulation (China RoHS) provides a two-step, broad regulatory framework including similar hazardous substance restrictions as are imposed by the European Union s RoHS Directive, and apply to methods for the control and reduction of pollution and other public hazards to the environment caused during the production, sale, and import of electronic information products (EIP) in China affecting a broad range of electronic products and parts, with an implementation date of March 1, 2007. Currently, only the first step of the regulatory framework of China RoHS, which details marking and labeling requirements under Standard SJT11364-2006 (Marking Standard), is in effect. However, the methods under China RoHS only apply to EIP placed in the marketplace in China. Additionally, the Marking Standard does not apply to components sold to OEM s for use in other EIP. Our sales in China are limited to sales to OEM s and to distributors who supply to OEM s. Should our sales strategy change to include direct sales to end-users, our compliance system is sufficient to meet our requirements under China RoHS. Our current estimated costs associated with our compliance with this regulation based on our current market share are not significant. However, we continue to evaluate the impact of this regulation, and actual costs could differ from our current estimates.

National, state and local laws impose various environmental controls on the manufacture, transportation, storage, use and disposal of batteries and of certain chemicals used in the manufacture of batteries. Although we believe that our operations are in substantial compliance with current environmental regulations, there can be no assurance that changes in such laws and regulations will not impose costly compliance requirements on us or otherwise subject us to future liabilities. There can be no assurance that additional or modified regulations relating to the manufacture, transportation, storage, use and disposal of materials used to manufacture our batteries or restricting disposal of batteries will not be imposed or how these regulations will affect us or our customers, that could have a material adverse effect on our business, financial condition and results of operations. In 2007, we spent approximately $327 on environmental controls, including costs to properly dispose of potentially hazardous waste.

Since non-rechargeable and rechargeable lithium battery chemistries react adversely with water and water vapor, certain of our manufacturing processes must be performed in a controlled environment with low relative humidity. Our Newark, New York and UK facilities contain dry rooms as well as specialized air-drying equipment.

Non-Rechargeable Products

Our non-rechargeable battery products incorporate lithium metal, which reacts with water and may cause fires if not handled properly. In the past, we have experienced fires that have temporarily interrupted certain manufacturing operations. We believe that we have adequate fire insurance, including business interruption insurance, to protect against fire losses in our facilities.

Our 9-volt battery, among other sizes, is designed to conform to the dimensional and electrical standards of the American National Standards Institute, and the 9-volt battery and a range of 3-volt cells are recognized under the Underwriters Laboratories, Inc. Component Recognition Program.

Rechargeable Products

We are not currently aware of any regulatory requirements regarding the disposal of lithium polymer or lithium ion rechargeable cells and batteries.

Our lead acid batteries are recovered from our customers and delivered to a permitted lead smelter for reclamation following applicable federal, state and local regulations.

Communications Systems

We are not currently aware of any other regulatory requirements regarding the disposal of communications accessories.

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Design and Installation Services

Our RPS lead acid products have been tested and have been deemed to meet all requirements as specified in 49CFR 173.159 (d) for exception as hazardous material classification. Our RPS batteries have been tested and have been deemed to meet all requirements as specified in the special provision 238 for determination of Non-Spillable and are not subject to the provision of 49CFR 173.159 (d).

Corporate

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

Competition

Competition in the battery and communications systems markets is, and is expected to remain, intense. The competition ranges from development stage companies to major domestic and international companies, many of which have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. We compete against companies producing batteries as well as those offering standby power installation services, and companies producing communications systems, design and installation services. We compete on the basis of design flexibility, performance and reliability. There can be no assurance that our technology and products will not be rendered obsolete by developments in competing technologies that are currently under development or that may be developed in the future or that our competitors will not market competing products that obtain market acceptance more rapidly than ours.

Historically, although other entities may attempt to take advantage of the growth of the battery market, the lithium battery industry has certain technological and economic barriers to entry. The development of technology, equipment and manufacturing techniques and the operation of a facility for the automated production of lithium batteries require large capital expenditures, which may deter new entrants from commencing production. Through our experience in battery manufacturing, we have also developed expertise, which we believe would be difficult to reproduce without substantial time and expense in the non-rechargeable battery market.

Competition in the standby power market is concentrated among a number of suppliers and installers ranging from small distributors who purchase, resell and install products manufactured by others to major battery and power supply manufacturers, which have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than those of ours. We compete on the basis of product and installation design, functionality, flexibility, performance and reliability. There can be no assurance that our technology and products will not be rendered obsolete by developments in competing technologies that are currently under development or that may be developed in the future or that our competitors will not market competing products that obtain market acceptance more rapidly than ours.

Employees

As of February 2, 2008, we employed a total of 1,092 permanent and temporary employees: 76 in research and development, 909 in production and 107 in sales and administration. Of the total, 745 are employed in the U.S., 53 in Europe and 294 in Asia. None of our employees is represented by a labor union. We consider our employee relations to be satisfactory.

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ITEM 1A. RISK FACTORS

A decline in demand for products or services using our batteries or communications systems could reduce demand for our products or services.

A substantial portion of our business depends on the continued demand for products or services using our batteries and communications systems sold by our customers, including OEM s. Our success depends significantly upon the success of those customers products or services in the marketplace. We are subject to many risks beyond our control that influence the success or failure of a particular product or service offered by a customer, including:

- competition faced by the customer in its particular industry,
- market acceptance of the customer s product or service,
- the engineering, sales, marketing and management capabilities of the customer,
- technical challenges unrelated to our technology or products faced by the customer in developing its products or services, and
- the financial and other resources of the customer.

For instance, in the years ended December 31, 2005, 2006, 2007, 32%, 27% and 17% of our revenues, respectively, were comprised of sales of our 9-volt batteries, and of this, approximately 21%, 47% and 41%, respectively, pertained to sales to smoke alarm OEMs. If the retail demand for long-life smoke alarms decreases significantly, this could have a material adverse effect on our business, financial condition and results of operations.

Our customers may not meet the volume requirements in our supply agreements.

We sell most of our products and services through supply agreements and contracts. While supply agreements and contracts contain volume-based pricing based on expected volumes, industry practices dictate that pricing is rarely adjusted retroactively when contract volumes are not achieved. Every effort is made to adjust future prices accordingly, but the ability to adjust prices is generally based on market conditions.

Our growth and expansion strategy could strain or overwhelm our resources.

Rapid growth of our business could significantly strain management, operations and technical resources. If we are successful in obtaining rapid market growth of our products and services, we will be required to deliver large volumes of quality products and increased levels of services to customers on a timely basis at a reasonable cost to those customers. For example, the large contracts received from the U.S. military for our batteries using cylindrical cells could strain the current capacity capabilities of our manufacturing facilities and require additional equipment and time to build a sufficient support infrastructure. This demand could also create working capital issues for us, as we may need increased liquidity to fund purchases of raw materials and supplies. We cannot assure, however, that business will grow rapidly or that our efforts to expand manufacturing and quality control activities will be successful or that we will be able to satisfy commercial scale production requirements on a timely and cost-effective basis.

We have a strategy to grow our business through the acquisition of complementary businesses or through business partnerships, for example joint ventures, in addition to organic growth. Our inability to acquire such businesses, or increased competition for such businesses which could increase our acquisition costs, could adversely affect our growth strategy and results of operations. In addition, our inability to improve the operating margins of businesses we acquire or operate such acquired businesses profitably or to effectively integrate the operations of those acquired businesses could also adversely affect our business, financial condition and results of operations.

In 2006 we acquired McDowell and ABLE, and in 2007 we acquired ISC, SPS and RPS, which added new facilities and operations to our overall business. We experienced some initial operational challenges at McDowell that required a greater amount of management s time to resolve than we expected. The integration of recent, and future, acquisitions could place an increased burden on our management team which could adversely impact our ability to effectively manage these businesses.

We also will be required to continue to improve our operations, management and financial systems and controls in order to remain competitive. The failure to manage growth and expansion effectively could have an adverse effect on our business, financial condition, and results of operations.

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Our acquisitions and business partnerships may not result in the revenue growth and profitability that we expect. In addition, we may not be able to successfully integrate our acquisitions.

We are integrating our acquisitions into our business and assimilating their operations, services, products and personnel with our management policies, procedures and strategies. We cannot be sure that we will achieve the benefits of revenue growth and profitability that we expect from these acquisitions or that we will not incur unforeseen additional costs or expenses in connection with the integration of these acquisitions. To effectively manage our expected growth, we must continue to successfully manage our integration of these companies and continue to improve our operational and information technology systems, internal procedures, accounts receivable and management, financial and operational controls to accommodate these acquisitions. If we fail in any of these areas, our business could be adversely affected.

The U.S. and foreign governments can audit our contracts with their respective military and government agencies and, under certain circumstances, can adjust the economic terms of those contracts.

A significant portion of our business comes from sales of products and services to the U.S. and foreign governments through various contracts. These contracts are subject to procurement laws and regulations that lay out policies and procedures for acquiring goods and services. The regulations also contain guidelines for managing contracts after they are awarded, including conditions under which contracts may be terminated, in whole or in part, at the government s convenience or for default. Failure to comply with the procurement laws or regulations can result in civil, criminal or administrative proceedings involving fines, penalties, suspension of payments, or suspension or disbarment from government contracting or subcontracting for a period of time.

We have had certain exigent , non-bid contracts with the U.S. government that have been subject to an audit and final price adjustment and have resulted in decreased margins compared with the original terms of the contracts. As of December 31, 2007, there were no outstanding exigent contracts with the U.S. government. As part of its due diligence, the U.S. government has conducted post-audits of the completed exigent contracts to ensure that information used in supporting the pricing of exigent contracts did not differ materially from actual results. In September 2005, the Defense Contracting Audit Agency (DCAA) presented its findings related to the audits of three of the exigent contracts, suggesting a potential pricing adjustment of approximately $1,400 related to reductions in the cost of materials that occurred prior to the final negotiation of these contracts. 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 are cooperating with the DoD IG inquiry and have furnished 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 operation.

We are subject to the contract rules and procedures of the U.S. and foreign governments. These rules and procedures create significant risks and uncertainties for us that are not usually present in contracts with private parties.

We will continue to develop battery products, communications systems and services to meet the needs of the U.S. and foreign governments. We compete in solicitations for awards of contracts. The receipt of an award, however, does not usually result in the immediate release of an order and does not guarantee in any way any given volume of orders. Any delay of solicitations or anticipated purchase orders by, or future failure of, the U.S. or foreign governments to purchase products manufactured by us could have a material adverse effect on our business, financial condition and results of operations. Additionally, in these scenarios we are typically required to successfully meet contractual specifications and to pass various qualification-testing for the products under contract. Our inability to pass these tests in a timely fashion, as well as meet delivery schedules for orders released under contract, could have a material adverse effect on our business, financial condition and results of operations.

When a government contract is awarded, there is a government procedure that permits unsuccessful companies to formally protest such award if they believe they were unjustly treated in the evaluation process. As a result of these protests, the government is precluded from proceeding under these contracts until the protests are resolved. A prolonged delay in the resolution of a protest, or a reversal of an award resulting from such a protest could have a material adverse effect on our business, financial condition and results of operations.

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

A significant portion of our revenues is derived from contracts with the U.S. and foreign militaries or OEMs that supply the U.S. and foreign militaries. In the years ended December 31, 2005, 2006 and 2007, approximately 45%, 47%, and 67% respectively, of our revenues were comprised of sales made directly or indirectly to the U.S. and foreign militaries. We have three major customers: the U.S. Department of Defense, that comprised 25%, 20%, and 14% of our revenue in the years ended December 31, 2005, 2006 and 2007, respectively; the U.K. Ministry of Defence, that comprised 6%, 7%, and 12% of our revenue in the years ended December 31, 2005, 2006 and 2007, respectively; and Raytheon Company, that comprised 1%, 3%, and 13% of our revenue in the years ended December 31, 2005, 2006 and 2007, respectively. There were no other customers that comprised greater than 10% of our total revenues in those years. While sales to these customers were substantial during 2007, we do not consider these customers to be significant credit risks. Government decisions regarding military deployment and budget allocations to fund military operations may have an impact on the demand for our products and services. If the demand for products and services from the U.S. or foreign militaries were to decrease significantly, this could have a material adverse effect on our business, financial condition and results of operations.

We generally do not distribute our products to a concentrated geographical area nor is there a significant concentration of credit risks arising from individuals or groups of customers engaged in similar activities, or who have similar economic characteristics. Two customers comprised 42% of our trade accounts receivables as of December 31, 2007. There were no other customers that comprised greater than 10% of our total trade accounts receivables as of December 31, 2007. One customer comprised 22% of our total trade accounts receivables as of December 31, 2006. There were no other customers that comprised greater than 10% of our total trade accounts receivables as of December 31, 2006. We do not normally obtain collateral on trade accounts receivable.

Our efforts to develop new commercial applications for our products could fail.

Although we are involved with developing certain products for new commercial applications, we cannot assure that volume acceptance of our products will occur due to the highly competitive nature of the business. There are many new product and technology entrants into the marketplace, and we must continually reassess the market segments in which our products can be successful and seek to engage customers in these segments that will adopt our products for use in their products. In addition, these companies must be successful with their products in their markets for us to gain increased business. Increased competition, failure to gain customer acceptance of products, the introduction of competitive technologies or failure of our customers in their markets could have a further adverse effect on our business.

We may incur significant costs because of the warranties we supply with our products.

With respect to our battery products, we typically offer warranties against any defects due to product malfunction or workmanship for a period up to one year from the date of purchase. With respect to our communications systems products, we typically offer up to a four-year warranty. We also offer a 10-year warranty on our 9-volt batteries that are used in ionization-type smoke alarms. We provide for a reserve for these potential warranty expenses, which is based on an analysis of historical warranty issues. There is no assurance that future warranty claims will be consistent with past history, and in the event we experience a significant increase in warranty claims, there is no assurance that our reserves will be sufficient. This could have a material adverse effect on our business, financial condition and results of operations.

We are subject to certain safety risks, including the risk of fire, inherent in the manufacture and use of lithium batteries.

Due to the high energy inherent in lithium batteries, our lithium batteries can pose certain safety risks, including the risk of fire. We incorporate procedures in research, development, product design, manufacturing processes and the transportation of lithium batteries that are intended to minimize safety risks, but we cannot assure that accidents will not occur or that our products will not be subject to recall for safety concerns. Although we currently carry insurance policies which cover loss of the plant and machinery, leasehold improvements, inventory and business interruption, any accident, whether at the manufacturing facilities or from the use of the products, may result in significant production delays or claims for damages resulting from injuries. While we maintain what we believe to be sufficient casualty liability coverage to protect against such occurrences, these types of losses could have a material adverse effect on our business, financial condition and results of operation.

We may incur significant costs because of known and unknown environmental matters.

National, state and local laws impose various environmental controls on the manufacture, transportation, storage, use and disposal of batteries and of certain chemicals used in the manufacture of batteries. Although we believe that our operations are in substantial compliance with current environmental regulations and that, except as noted below, there are no environmental conditions that will require material expenditures for clean-up at our present or former facilities or at facilities to which we have sent waste for disposal, there can be no assurance that changes in such laws and regulations will not impose costly compliance requirements on us or otherwise subject us to future liabilities. There can be no assurance that additional or modified regulations relating to the manufacture, transportation, storage, use and disposal of materials used to manufacture our batteries or restricting disposal of batteries will not be imposed or how these regulations will affect us or our customers, that could have a material adverse effect on our business, financial condition and results of 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 provides 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 have submitted various work plans to the New York State Department of Environmental Conservation (NYSDEC) regarding further environmental testing and sampling in order to determine the scope of any additional remediation. We subsequently 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 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 investigative 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 the New York State Department of Health (NYSDOH) took place in September 2007. As a result of this meeting, NYSDEC and NYSDOH have 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 and we are awaiting the results of the work from our environmental consulting firm. The results of the additional investigation requested by the NYSDEC may increase the estimated remediation costs modestly. At December 31, 2007, we have reserved $85 for this matter. The ultimate resolution of this matter may result in us incurring costs in excess of what we have reserved.

The future regulatory direction of the European Union s Restriction of Hazardous Substances (RoHS) and Waste Electrical and Electronic Equipment (WEEE) Directives, as they pertain to our products, is uncertain. Their potential impact to our business would become material if battery packs were to be included in new guidelines and we were unable to procure materials in a timely manner. Other associated risks related to these directives include excess inventory risk due to a write off of non- compliant inventory. We continue to monitor the regulatory activity of the European Union to ascertain such risks.

China s Management Methods for Controlling Pollution Caused by Electronic Information Products Regulation (China RoHS) provides a two-step, broad regulatory framework, including similar hazardous substance restrictions as are imposed by the European Union s RoHS Directive, and apply to methods for the control and reduction of pollution and other public hazards to the environment caused during the production, sale, and import of electronic information products (EIP) in China affecting a broad range of electronic products and parts, with an implementation date of March 1, 2007. Currently, only the first step of the regulatory framework of China RoHS, which details marking and labeling requirements under Standard SJT11364-2006 (Marking Standard), is in effect. However, the methods under China RoHS only apply to EIP placed in the marketplace in China. Additionally, the Marking Standard does not apply to components sold to OEMs for use in other EIP. Our sales in China are limited to sales to OEMs and to distributors who supply to OEMs. Should our sales strategy change to include direct sales to end-users, our compliance system is sufficient to meet our requirements under China RoHS. Our current estimated costs associated with our compliance with this regulation based on our current market share and strategy are not significant. However, we continue to evaluate the impact of China RoHS, and actual costs could differ from our current estimates.

Any inability to comply with changes to the regulations for the shipment of our products could limit our ability to transport our products to customers in a cost-effective manner.

The transportation of non-rechargeable and rechargeable lithium batteries is regulated by the International Civil Aviation Organization (ICAO) and corresponding International Air Transport Association (IATA) Dangerous Goods Regulations and the International Maritime Dangerous Goods Code (IMDG) and in the U.S. by the Department of

Transportation s Pipeline and Hazardous Materials Safety Administration (PHMSA). These regulations are based on the United Nations Recommendations on the Transport of Dangerous Goods Model Regulations and the United Nations Manual of Tests and Criteria. We currently ship our products pursuant to ICAO, IATA and PHMSA hazardous goods regulations. New regulations that pertain to all lithium battery manufacturers went into effect in January 2008, and additional regulations will go into effect in 2009 and 2010. The regulations require companies to meet certain testing, packaging, labeling and shipping specifications for safety reasons. We comply with all current U.S. and international regulations for the shipment of our products, and we intend and expect to comply with any new regulations that are imposed. We have established our own testing facilities to ensure that we comply with these regulations. If we are unable to comply with the new regulations, however, or if regulations are introduced that limit our ability to transport our products to customers in a cost-effective manner, this could have a material adverse effect on our business, financial condition and results of operations.

Our supply of raw materials and components could be disrupted.

Certain materials and components used in our products are available only from a single or a limited number of suppliers. As such, some materials and components could become in short supply resulting in limited availability and/or increased costs. Additionally, we may elect to develop relationships with a single or limited number of suppliers for materials and components that are otherwise generally available. Due to our involvement with supplying military products to the government, we could receive a government preference to continue to obtain critical supplies to meet military production needs. However, if the government did not provide us with a government preference in such circumstances, the difficulty in obtaining supplies could have a material adverse effect on our business, financial condition and results of operations. Although we believe that alternative suppliers are available to supply materials and components that could replace materials and components currently used and that, if necessary, we would be able to redesign our products to make use of such alternatives, any interruption in the supply from any supplier that serves as a sole source could delay product shipments and have a material adverse effect on our business, financial condition and results of operations. We have experienced interruptions of product deliveries by sole source suppliers in the past, and we cannot guarantee that we will not experience a material interruption of product deliveries from sole source suppliers in the future. Additionally, we could face increasing pricing pressure from our suppliers dependent upon volume, due to rising costs by these suppliers that could be passed on to us in higher prices for our raw materials, which could have a material effect on our business, financial condition and results of operations.

Any inability to protect our proprietary and intellectual property could allow our competitors and others to produce competing products based on our proprietary and intellectual property.

Our success depends more on the knowledge, ability, experience and technological expertise of our employees than on the legal protection of patents and other proprietary rights. We claim proprietary rights in various unpatented technologies, know-how, trade secrets and trademarks relating to products and manufacturing processes. We cannot guarantee the degree of protection these various claims may or will afford, or that competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technology. We protect our proprietary rights in our products and operations through contractual obligations, including nondisclosure agreements with certain employees, customers, consultants and strategic partners. There can be no assurance as to the degree of protection these contractual measures may or will afford. We have had patents issued and have patent applications pending in the U.S. and elsewhere. We cannot assure (1) that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect our technology, (2) that any patents issued to us will not be challenged, invalidated or circumvented, or (3) as to the degree or adequacy of protection any patents or patent applications may or will afford. If we are found to be infringing third party patents, there can be no assurance that we will be able to obtain licenses with respect to such patents on acceptable terms, if at all. The failure to obtain necessary licenses could delay product shipment or the introduction of new products, and costly attempts to design around such patents could foreclose the development, manufacture or sale of products.

The loss of key personnel could significantly harm our business, and the ability and technical competence of persons we hire will be critical to the success of our business.

Because of the specialized, technical nature of our business, we are highly dependent on certain members of our management, marketing, engineering and technical staff. The loss of these employees could have a material adverse effect on our business, financial condition and results of operations. In addition to developing manufacturing capacity to produce high volumes of batteries, we must attract, recruit and retain a sizeable workforce of technically competent employees. Our ability to pursue effectively our business strategy will depend upon, among other factors, the successful recruitment and retention of additional highly skilled and experienced managerial, marketing, engineering and technical personnel, and the integration of such personnel obtained through business acquisitions. We cannot assure that we will be able to retain or recruit this type of personnel. An inability to hire sufficient numbers of people or to find people with the desired skills could result in greater demands being placed on limited management resources which could have a material adverse effect on our business, financial condition and results of operations.

We are subject to competition from other manufacturers and suppliers of portable and standby batteries, communications systems and services.

We compete with other manufacturers and suppliers of non-rechargeable and rechargeable portable and standby batteries, communications systems and services. We cannot assure that we will successfully compete with these manufacturers and suppliers, many of which have substantially greater financial, technical, manufacturing, distribution, marketing, sales and other resources.

Our products could become obsolete.

The market for our products is characterized by changing technology and evolving industry standards, often resulting in product obsolescence or short product lifecycles. Although we believe that our products are comprised of state-of-the-art technology, there can be no assurance that competitors will not develop technologies or products that would render our technologies and products obsolete or less marketable.

Many of the companies with which we compete have substantially greater resources than us, and some have the capacity and volume of business to be able to produce their products more efficiently than we can at the present time. In addition, these companies are developing or have developed products using a variety of technologies that are expected to compete with our technologies. If these companies successfully market their products in a manner that renders our technologies obsolete, there will be a material adverse effect on our business, financial condition and results of operations.

We are subject to foreign currency fluctuations.

We maintain manufacturing operations in the North America, Europe and Asia, and we export products to various countries. We purchase materials and sell our products in foreign currencies, and therefore currency fluctuations may impact our pricing of products sold and materials purchased. In addition, our foreign subsidiaries maintain their books in local currency, and the translation of those subsidiary financial statements into U.S. dollars for our consolidated financial statements could have an adverse effect on our consolidated financial results, due to changes in local currency relative to the U.S. dollar. Accordingly, currency fluctuations could have a material adverse effect on our business, financial condition and results of operations.

Our ability to use our Net Operating Loss Carryforwards in the future may be limited, which could have an adverse impact on our tax liabilities.

At December 31, 2007, we had approximately $83,700 of net operating loss carryforwards, or NOLs, available to offset future taxable income. We continually assess the carrying value of this asset based on the relevant accounting standards. As of December 31, 2007, we reflected a full valuation allowance against our net deferred tax asset and have reflected a net deferred tax asset of $0 in the United States and in the United Kingdom due to our current assessment that it is more likely than not to not be realized. As we continue to assess the realizability of our deferred tax assets, the amount of the valuation allowance could be reduced. In addition, certain of our NOL carryforwards are subject to U.S. alternative minimum tax such that carryforwards can offset only 90% of alternative minimum taxable income. Achieving our business plan targets, particularly those relating to revenue and profitability, is integral to our assessment regarding the recoverability of our net deferred tax asset.

We have determined that a change in ownership, as defined under Internal Revenue Code Section 382, has occurred. As such, the domestic net operating loss carryforward will be subject to an annual limitation estimated to be in the range of approximately $12,000. This limitation did not have an impact on income taxes determined for 2007. Such a limitation could result in the possibility of a cash outlay for income taxes in a future year when earnings exceed the amount of net operating loss carryforwards that can be used by us.

Our quarterly and annual results and the price of our common stock could fluctuate significantly.

Our future operating results may vary significantly from quarter to quarter and from year to year depending on factors such as the timing and shipment of significant orders, new product introductions, delays in customer releases of purchase orders, delays in receiving raw materials from vendors, the mix of distribution channels through which we sell our products and services and general economic conditions. Frequently, a substantial portion of our revenue in each quarter is generated from orders booked and fulfilled during that quarter. As a result, revenue levels are difficult to predict for each quarter. If revenue results are below expectations, operating results will be adversely affected as we have a sizeable base of fixed overhead costs that do not fluctuate much with the changes in revenue. Due to such variances in operating results, we have sometimes failed to meet, and in the future may not meet, market expectations or even our own guidance regarding our future operating results.

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In addition to the uncertainties of quarterly and annual operating results, future announcements concerning us or our competitors, including technological innovations or commercial products, litigation or public concerns as to the safety or commercial value of one or more of our products may cause the market price of our common stock to fluctuate substantially for reasons which may be unrelated to our operating results. These fluctuations, as well as general economic, political and market conditions, may have a material adverse effect on the market price of our common stock.

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

While we believe that our revenue growth projections and our ongoing cost controls will allow us to generate cash and achieve profitability in the foreseeable 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. In addition, recent significant orders have required us to ramp up our supply chain quickly, and this will result in a need for additional working capital. We may need to seek additional credit or access capital markets for additional funds. There is no assurance that we would be successful in this regard.

We have certain debt covenants that must be maintained in accordance with the provisions of our credit facility. There is no assurance that we will be able to continue to meet these debt covenants in the future. If we default on any of our debt covenants and we are unable to renegotiate credit terms in order to comply with such covenants, this could have a material adverse effect on our business, financial condition and results of operations.

While we believe relations with our lenders are good and have received waivers as necessary in the past, there can be no assurance that such waivers will always be obtained when needed. In such case, we believe we have, in the aggregate, sufficient cash, cash generation capabilities from operations, working capital and financing alternatives at our disposal, including but not limited to alternative borrowing arrangements and other available lenders, to fund operations in the normal course for the foreseeable future. If we are unable to achieve our plans or unforeseen events occur, we may need to implement alternative plans to provide us with sufficient levels of liquidity and working capital. While we believe we could 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.

The re-payment of the debt outstanding under our credit facility and the vesting of options under certain of our equity compensation plans may both be accelerated if any single shareholder owns more than 30% of our stock. Currently, our largest shareholder owns in excess of 25% of our stock.

Our largest single shareholder is Grace Brothers, Ltd., which, as of its most recent Schedule 13D/A filing, beneficially owned 26.3% of our issued and outstanding shares of common stock. On June 6, 2007, Mr. Bradford T. Whitmore, general partner of Grace Brothers, Ltd., became a member of our Board of Directors. If Grace Brothers, Ltd. were to increase its ownership to more than 30%, it would be deemed a change in control for purposes of our credit facility administered by JP Morgan Chase and for purposes of options granted under our 2004 Amended and Restated Long Term Incentive Plan, or LTIP. If a change in control were to occur, our commercial lenders would be able to demand payment of all amounts outstanding under our existing credit facility and the vesting of all outstanding options granted under our LTIP would be accelerated resulting in a significant expense being charged against our income for the period during which the change in control occurred, all of which would have a material, adverse effect on our business, financial condition and results of operations.

Our operations in China are subject to unique risks and uncertainties.

Our operating facility in China presents risks including, but not limited to, political changes, civil unrest, labor disputes, currency restrictions and changes in currency exchange rates, taxes, duties, import and export laws and boycotts and other civil disturbances that are outside of our control. Any such disruptions could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to adequately maintain and monitor our internal controls over financial reporting.

We maintain and monitor various internal control processes over our financial reporting. Whenever we acquire a new business or operations, we need to integrate those operations with our existing control processes, which can prove to be a challenge if the acquired business had not been required to have such controls in effect. We are in the process of

integrating our recently acquired companies into our business and assimilating their operations, services, products and personnel with our management policies, procedures and strategies. While we work to ensure a stringent control environment, it is possible that we may fail to adequately maintain and monitor our various internal control processes over our financial reporting. Any such failure could result in internal control deficiencies that might be considered to be material weaknesses. Such material weaknesses in internal controls would be indicative of potential factors that affect the reliability of our financial statements and other reported financial information and impact the financial results we report.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2007, we own two buildings in Newark, New York comprising approximately 250,000 square feet. In February 1998, we entered into a lease/purchase agreement with the local county authority with respect to our 110,000 square foot manufacturing building in Newark, New York, the adjacent building of approximately 140,000 square feet and approximately 65 acres of contiguous land. Pursuant to the lease, we delivered a down payment in the amount of $440 and paid the local governmental authority annual installments in the amount of $50 through December 2001 decreasing to approximately $30 annually for the periods commencing December 2001 and ending December 2007. Upon expiration of the lease in December 2007, we took ownership of the facility. In addition, we lease approximately 35,000 square feet in a facility based in Abingdon, England. We lease approximately 19,900 square feet in a facility located in Waco, Texas. We lease approximately 130,000 square feet in four buildings in Shenzhen, China. We lease approximately 14,000 square feet in a facility located in West Point, Mississippi. We lease approximately 7,200 square feet in a facility located in Woodinville, Washington. We lease 12,614 square feet in a facility located in Clearwater, Florida. We lease approximately 2,650 square feet in a facility located in Alpharetta, Georgia. We lease approximately 15,000 square feet in Hollywood, Maryland. All locations, with the exception of the Alpharetta, Georgia location, consist of administrative offices, manufacturing and production facilities and an engineering department. The Alpharetta location consists of a warehouse and administrative offices. The Shenzhen location includes dormitory facilities. Our research and development efforts for our battery products are conducted at our Newark, New York and Shenzhen, China facilities, while our research and development efforts for our communications accessories are conducted at our Newark facility and our research and development efforts for our amplifier products are conducted at our Woodinville facility. Our corporate headquarters are located in the Newark facility. We believe that our facilities are adequate and suitable for our current needs. However, we may require additional manufacturing space if demand for our products continues to grow.

We lease a facility in Abingdon, England. The term of the lease was extended and continues until March 24, 2013. It currently has an annual rent of GBP163 (approximately $325 as of December 31, 2007) and is subject to review every five years based on current real estate market conditions. The next five-year review is scheduled for March 2009.

We currently lease one building in Waco, Texas, from a former related party. The lease term is month to month and has a base monthly rent of $10.

We lease four buildings in an industrial park in Shenzhen, China. The lease term expires on January 31, 2009. The lease has a base monthly rent of RMB132 (approximately $18 as of December 31, 2007). Under the terms of the lease, we have a right of first refusal to purchase the premises described in the lease from the landlord.

We lease a facility in West Point, Mississippi. The lease term commences on the completion of the renovation work, which is currently expected to occur in the second quarter of 2008 and shall continue for a period of three years. The lease has a base annual rent of approximately $57. Under the terms of the lease, we have the right to extend the lease for three additional one-year terms at our discretion.

We lease a facility in Woodinville, Washington. The lease term commenced on December 1, 2007 and expires on November 30, 2010. The lease has a base monthly rent of approximately $6 for months 1-12, approximately $7 for months 13-24 and approximately $7 for months 25-36. In addition to the base monthly rent, we are obligated to pay monthly operating expenses, which are currently estimated to be approximately $2.

We currently lease a facility in Clearwater, Florida, from a related party. The lease term expires on November 15, 2010. The lease has a base monthly rent of approximately $12. In addition to the base monthly rate, we are obligated to pay the real estate and personal property taxes associated with the facility. Under the terms of the lease, we have the right to extend the lease for one additional three-year term. The base monthly rent applicable for such an extended term is approximately $12.

We currently lease a facility in Alpharetta, Georgia. The lease term commenced on October 1, 2007 and expires on October 31, 2010. The lease has a base monthly rent of approximately $1. The base rent is increased by 4% on each anniversary of the commencement date of October 1, 2007. In addition to the base monthly rent, we are obligated to pay monthly operating expenses at the greater of less than $1 per month or our 3.2% pro-rata share of the total operating expenses.

We currently lease a facility in Hollywood, Maryland. The lease term expires on June 30, 2008. The lease has a base monthly rent of $12, plus monthly common area charges and real estate taxes.

On occasion, we rent additional warehouse space to store inventory and non-operational equipment.

ITEM 3. LEGAL PROCEEDINGS

We are subject to legal proceedings and claims that arise in the normal course of business. We believe that the final disposition of such matters will not have a material adverse effect on 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 provides 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 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 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 have 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 and we are awaiting the results from our environmental consulting firm. The results of the additional investigation requested by the NYSDEC may increase the estimated remediation costs modestly. Through December 31, 2007, total costs incurred have amounted to approximately $195, none of which has been capitalized. At December 31, 2007 and December 31, 2006, we had $85 and $35, respectively, reserved for this matter.

A retail end-user of a product manufactured by one of our customers (the Customer), made a claim against the Customer wherein it asserted that the Customer s product, which is powered by one of our batteries, does not operate according to the Customer s product specification. No claim has been filed against us. However, in the interest of fostering good customer relations, in September 2002, we agreed to lend technical support to the Customer in defense of its claim. Additionally, we assured the Customer that we would honor our warranty by replacing any batteries that may be determined to be defective. Subsequently, we learned that the end-user and the Customer settled the matter. In February 2005, we entered into a settlement agreement with the Customer. Under the terms of the agreement, we have agreed to provide replacement batteries for product determined to be defective, to warrant each replacement battery under our standard warranty terms and conditions, and to provide the Customer product at a discounted price for shipments made

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prior to December 31, 2008 in recognition of the Customer s administrative costs in responding to the claim of the retail end-user. In consideration of the above, the Customer released us from any and all liability with respect to this matter. Consequently, we do not anticipate any further expenses with regard to this matter other than our obligation under the settlement agreement. As of December 31, 2007, we no longer have an accrual in the warranty reserve related to anticipated replacements under this agreement, due to the lack of actual claims for replacements during the past few years. Further, we do not expect the ongoing terms of the settlement agreement to have a material impact on our operations or financial condition.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our Common Stock is included for quotation on the Global Market System of the National Association of Securities Dealers Automated Quotation System (NASDAQ) under the symbol ULBI.

The following table sets forth the quarterly high and low closing sales prices of our Common Stock during 2006 and 2007:

	Closing Sales Prices	
	High	Low
2006:		
Quarter ended April 1, 2006	$13.67	$10.41
Quarter ended July 1, 2006	12.49	8.31
Quarter ended September 30, 2006	10.41	8.79
Quarter ended December 31, 2006	13.72	10.15
2007:		
Quarter ended March 31, 2007	$11.74	$ 8.04
Quarter ended June 30, 2007	10.57	9.00
Quarter ended September 29, 2007	12.86	10.57
Quarter ended December 31, 2007	20.75	12.19

Holders

As of January 14, 2008, there were 414 registered holders of record of our Common Stock. Based upon information from our stock transfer agent, management estimates that there are approximately 7,000 beneficial holders of our Common Stock.

Recent Sales of Unregistered Securities

None.

Dividends

We have never declared or paid any cash dividend on our capital stock. We intend to retain earnings, if any, to finance future operations and expansion and, therefore, do not anticipate paying any cash dividends in the foreseeable future. Any future payment of dividends will depend upon our financial condition, capital requirements and earnings, as well as upon other factors that the Board of Directors may deem relevant. Pursuant to our current credit facility, we are precluded from paying any dividends.

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ITEM 6. SELECTED FINANCIAL DATA

The financial results presented in this table include results from the last five calendar years ended December 31, 2007, 2006, 2005, 2004 and 2003.

SELECTED FINANCIAL DATA
(In Thousands, Except Per Share Amounts)

	Year Ended December 31, 2007	2006	2005	2004	2003
Statement of Operations Data:					
Revenues	$137,596	$ 93,546	$70,501	$ 98,182	$79,450
Cost of products sold	108,822	76,103	58,243	77,880	62,354
Gross margin	28,774	17,443	12,258	20,302	17,096
Research and development expenses	7,000	5,097	3,751	2,633	2,505
Selling, general and administrative expenses	21,973	15,303	11,409	10,771	8,610
Impairment of long lived assets				1,803	
Total operating and other expenses	28,973	20,400	15,160	15,207	11,115
Operating income (loss)	(199)	(2,957)	(2,902)	5,095	5,981
Interest (expense)/income, net	(2,184)	(1,298)	(636)	(482)	(520)
Gain on insurance settlement		191		214	
Gain on McDowell settlement	7,550				
Write-off of UTI investment and note receivable				(3,951)	
Gain from forgiveness of debt/grant					781
Other income (expense), net	493	311	(318)	352	311
Income/(loss) before income taxes	5,660	(3,753)	(3,856)	1,228	6,553
Income tax provision-current			3	32	106
Income tax provision/(benefit)-deferred	77	23,735	486	(21,136)	
Total income taxes	77	23,735	489	(21,104)	106
Net income (loss)	$ 5,583	$(27,488)	$ (4,345)	$ 22,332	$ 6,447
Net income (loss) per share-basic	$ 0.36	$ (1.84)	$ (0.30)	$ 1.59	$ 0.49
Net income (loss) per share-diluted	$ 0.36	$ (1.84)	$ (0.30)	$ 1.48	$ 0.46

Weighted average shares outstanding-basic	15,316	14,906	14,551	14,087	13,132
Weighted average shares outstanding-diluted	15,557	14,906	14,551	15,074	13,917

			December 31,		
	2007	2006	2005	2004	2003
Balance Sheet Data:					
Cash and available-for-sale securities	$ 2,245	$ 720	$ 3,214	$11,529	$ 882
Working capital	$ 26,461	$18,070	$20,979	$30,645	$14,702
Total assets	$122,048	$97,758	$80,757	$81,134	$52,352
Total long-term debt and capital lease obligations	$ 16,224	$20,043	$ 25	$ 7,215	$ 68
Stockholders equity	$ 63,007	$39,589	$62,107	$63,625	$34,430

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This report contains certain forward-looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to management. The statements contained in this report relating to matters that are not historical facts are forward-looking statements that involve risks and uncertainties, including, but not limited to, future demand for our products and services, addressing the process of U.S. military procurement, the successful commercialization of our products, general economic conditions, 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 materials 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 described herein as anticipated, believed, estimated or expected. See Risk Factors in Item 1A of this report.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto appearing elsewhere in this report.

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 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 approaches to problem solving, we serve government, defense and commercial customers across the globe. We design, manufacture, install and maintain power and communications systems including: portable and 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, including seawater-activated batteries. The Rechargeable Products segment includes: rechargeable batteries, charging systems, uninterruptable power supplies and accessories, such as cables. In 2006, as a result of the acquisition of McDowell, we formed a new segment, Communications Accessories, which was renamed Communications Systems in 2007. The Communications Systems segment includes: power supplies, cable and connector assemblies, RF amplifiers, amplified speakers, equipment mounts, case equipment and integrated communication system kits. In the fourth quarter of 2007, as a result of the acquisitions of RedBlack and SPS, we renamed our Technology Contracts segment to Design and Installation Services. 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 10 in the Notes to Consolidated Financial Statements.)

We continually evaluate ways to grow, including opportunities to expand through mergers, acquisitions and business partnerships. On May 19, 2006, we acquired 100% of the equity securities of ABLE New Energy Co., Ltd. (ABLE), an established manufacturer of lithium batteries located in Shenzhen, China. The total consideration given was a combination of cash and equity. The initial cash portion of the purchase price was $1,896 (net of $104 in cash acquired), with an additional $500 cash payment contingent on the achievement of certain performance milestones, payable in separate $250 increments, when cumulative ABLE revenues from the date of acquisition attain $5,000 and $10,000, respectively. In August 2007, the $5,000 cumulative revenues milestone was attained, and as such, we have recorded the first $250 contingent cash payment. The equity portion of the purchase price consisted of 96,247 shares of our common stock, valued at $1,000, and 100,000 stock warrants valued at $526, for a total equity consideration of $1,526. (See Note 2 in Notes to Consolidated Financial Statements for additional information.)

On July 3, 2006, we finalized the acquisition of substantially all of the assets of McDowell Research, Ltd. (McDowell), a manufacturer of military communications accessories located in Waco, Texas. Under the terms of the acquisition agreement, the purchase price of approximately $25,000 consisted of $5,000 in cash and a $20,000 non-transferable, subordinated convertible promissory note to be held by the sellers. In addition, the purchase price was subject to a post-closing adjustment based on a final valuation of trade accounts receivable, inventory and trade accounts payable that were acquired or assumed on the date of the closing, using a base value of $3,000. The final net value of these assets, under our contractual obligation under the acquisition agreement, was $6,389, resulting in a revised purchase price of approximately $28,448. On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell, which resolved various operational issues that arose during the first several months following the acquisition that significantly reduced our profit margins. The settlement agreement reduced the overall purchase price by approximately $7,900, by reducing the principal amount on the convertible note from $20,000 to $14,000, and eliminating a $1,889 liability related to the Purchase Price Adjustment formula. 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. In January 2008, the convertible notes were converted in full into 700,000 shares of our common stock. (See Note 2 in Notes to Consolidated Financial Statements for additional information.)

On September 28, 2007, we finalized the acquisition of all the issued and outstanding shares of common stock of Innovative Solutions Consulting, Inc. (ISC), a provider of a full range of engineering and technical services for communication electronic systems to government agencies and prime contractors located in Hollywood, Maryland. In January 2008, we renamed ISC to RedBlack Communications, Inc. (RedBlack). The initial cash purchase price was $943 (net of $57 in cash acquired), with up to $2,000 in additional cash consideration contingent on the achievement of certain sales milestones. The additional cash consideration is payable in up to three annual payments and subject to possible adjustments as set forth in the stock purchase agreement. (See Note 2 to Consolidated Financial Statements for additional information.)

On November 16, 2007, we completed the acquisition of all of the issued and outstanding shares of common stock of Stationary Power Services, Inc. (SPS), an infrastructure power management services firm specializing in engineering, installation and preventative maintenance of standby power systems, uninterruptible power supply systems, DC power systems and switchgear/control systems for the telecommunications, aerospace, banking and information services industries located in Clearwater, Florida. Under the terms of the stock purchase agreement, the initial purchase price of $10,000 consisted of $5,889 (net of $111 in cash acquired) in cash and a $4,000 subordinated convertible promissory note to be held by the seller. In addition, on the achievement of certain post-acquisition sales milestones, we will issue up to an aggregate amount of 100,000 shares of our common stock. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

On November 16, 2007, we completed the acquisition of all of the issued and outstanding shares of common stock of Reserve Power Systems, Inc. (RPS), an affiliate of SPS, and a supplier of lead acid batteries primarily for use by SPS in the design and installation of standby power systems. Under the terms of the stock purchase agreement, the initial purchase price consisted of 100,000 shares of our common stock, valued at $1,383. In addition, on the achievement of certain post-acquisition sales milestones, we will pay the sellers, in cash, 5% of sales up to the sales in the operating plan, and 10% of sales that exceed the sales in the operating plan, for the remainder of the calendar year 2007 and for calendar years 2008, 2009 and 2010. The additional contingent cash consideration is payable in annual installments, and excludes sales made to SPS, which historically have comprised substantially all of RPS s sales. (See Note 2 in the Notes to Consolidated Financial Statements for additional information.)

Subsequent to our fourth quarter 2007 earnings release dated February 28, 2008, we reclassified certain short-term liabilities related to the term loan component of our credit facility to long-term liabilities as of December 31, 2007. As a result, our Consolidated Balance Sheet as of December 31, 2007 has been adjusted accordingly, resulting in a decrease of $1,167 in current liabilities and a corresponding increase in long-term liabilities. The Consolidated Statement of Operations was not impacted by this adjustment.

Currently, we do not experience significant seasonal sales trends in any of our operating segments, although sales to the U.S. Defense Department and other international defense organizations can be sporadic based on the needs of those particular customers.

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Results of Operations

Twelve Months Ended December 31, 2007 Compared With the Twelve Months Ended December 31, 2006

	12 Months Ended		Increase /
	12/31/2007	12/31/2006	(Decrease)
Revenues	$ 137,596	$ 93,546	$ 44,050
Cost of products sold	108,822	76,103	32,719
Gross margin	28,774	17,443	11,331
Operating and other expenses	28,973	20,400	8,573
Operating income	(199)	(2,957)	2,758
Other (expense) income, net	5,859	(796)	6,655
Income before taxes	5,660	(3,753)	9,413
Income tax provision/(benefit)	77	23,735	(23,658)
Net (loss)/income	$ 5,583	$ (27,488)	$ 33,071
Net (loss)/income per share basic	$ 0.36	$ (1.84)	$ 2.20
Net (loss)/income per share diluted	$ 0.36	$ (1.84)	$ 2.20
Weighted average shares outstanding-basic	15,316,000	14,906,000	410,000
Weighted average shares outstanding-diluted	15,557,000	14,906,000	651,000

Revenues. Total revenues for the twelve months ended December 31, 2007 amounted to $137,596, an increase of $44,050, or 47% from the $93,546 reported for the twelve months ended December 31, 2006.

Non-Rechargeable product sales increased $12,483, or 18%, from $67,779 last year to $80,262 this year. The increase in revenues was mainly attributable to an increase in sales of batteries to international defense organizations, an increase in demand from automotive telematics customers, and a full year contribution from ABLE which was acquired in mid-2006, offset in part by lower 9-volt battery revenues.

Rechargeable product revenues decreased $989, or 6%, from $17,745 last year to $16,756 this year. The decrease in revenues was attributable to a strong prior year in which we shipped a large order of batteries and chargers for an IED jammer application.

Sales of communications systems increased $29,707, or 400%, from $7,433 last year to $37,140 this year. This increase in revenues was mainly attributable to a growing demand for advanced communications systems and kits sold to government/defense customers, including systems such as SATCOM-On-The-Move and other systems that provide a person with the ability to significantly extend the range of a communications radio. In addition, since McDowell was acquired in July 2006, only a partial year s results were included in 2006.

Design and Installation Services revenues increased $2,849, or 484%, from $589 last year to $3,438 this year. This increase in revenues was mainly attributable to the added contributions from the acquisitions of RedBlack in September 2007 and SPS in November 2007.

Cost of Products Sold. Cost of products sold increased $32,719, or 43%, from $76,103 for the year ended December 31, 2006 to $108,822 for the year ended December 31, 2007, primarily as a result of the increase in revenues. Consolidated cost of products sold as a percentage of total revenue decreased from 81% for the twelve months ended December 31, 2006 to 79% for the year ended December 31, 2007. Correspondingly, consolidated gross margins were 21% for the year ended December 31, 2007, compared with 19% for the year ended December 31, 2006, generally attributable to higher sales and production volumes and a more favorable sales mix of higher margin products.

In the Non-Rechargeable products segment, the cost of products sold increased $6,594, from $55,921 in the year ended December 31, 2006 to $62,515 in 2007, mainly related to higher sales and production volumes. Non-Rechargeable gross margins for 2007 were $17,747, or 22%, an increase of $5,889 from 2006 s gross margin of $11,858, or 17%. This increase in gross margin was mainly attributable to shipments of higher margin products to international customers.

In the Rechargeable products segment, the cost of products sold decreased $745, from $13,923 in 2006 to $13,178 in 2007. Rechargeable gross margins for 2007 were $3,578, or 21%, a decrease of $244 from 2006 s gross margin of $3,822, or 22%. This decrease in gross margin was the result of the decline in sales volumes and a modest change in sales mix.

In the Communications Systems segment, the cost of products sold increased $24,785, from $5,662 in 2006 to $30,447 in 2007, reflective of the increase in revenues. Communications Systems gross margins for 2007 were $6,693, or 18%, a decrease from 2006 s gross margin of $1,771, or 24%. The decrease in gross margin percentages was mainly related to operational issues incurred at our Waco, Texas operation shortly after the acquisition of McDowell in July 2006 that resulted in the procurement of premium cost inventory, increasing our Cost of goods sold during 2007 as this inventory was sold to customers. As a result of manufacturing inefficiencies at that facility, we relocated the Waco operations to our Newark, New York facility during the third and fourth quarters of 2007, to instill better processes and manufacturing disciplines. The actual costs associated with this relocation were relatively modest, amounting to approximately $156. In addition, we encountered certain inefficiencies in our manufacturing process during the fourth quarter as we ramped up our production operation to begin to fulfill certain large orders we received during the latter portion of 2007 for advanced communications systems, as we increased our workforce and trained new people on processes, procedures and systems.

Design and Installation Services cost of sales increased $2,085, from $597 for the year ended December 31, 2006, to $2,682 in 2007. Design and Installation Services gross margins for 2007 were $756, or 22%, an increase from 2006 s gross margin of ($8), or (1)%. This increase was mainly due to varying margins realized under different technology contracts, in addition to the contribution from RedBlack and SPS.

Operating and Other Expenses. Total operating expenses increased $8,573, from $20,400 for the year ended December 31, 2006 to $28,973 for the year ended December 31, 2007. Overall, operating expenses as a percentage of sales decreased to 21% in 2007 from 22% reported the prior year. Research and development costs were $7,000 in 2007, an increase of $1,903, or 37%, over the $5,097 reported in 2006. This increase was mainly due to greater investments in the development of various new products, including products resulting from our acquisitions and support for a broader base of products. In addition to the research and development line shown in Operating Expenses, we also consider our efforts associated with technology contracts for which we are paid (revenues and related costs are included in the Design and Installation Services segment), to be related to key product development efforts. Selling, general, and administrative expenses increased $6,670, or 44%, to $21,973, mainly related to costs associated with acquired companies and costs associated with providing a significantly higher level of support to enhance the growth prospects of these acquisitions, including increased personnel-related costs, and higher professional fees incurred and corporate costs required to support a broader, more diverse business. Included in research and development and selling, general and administrative expenses is $2,317 for 2007 in amortization expense associated with intangible assets related to our acquisitions ($1,290 in selling, general and administrative expenses and $1,027 in research and development costs), an increase of $1,118 from the prior year amount of $1,199, driven by the timing of the acquisitions.

Other Income (Expense). Interest expense (net) increased $886, from $1,298 for the year ended December 31, 2006 to $2,184 for the year ended December 31, 2007. This change was mainly related to higher interest on convertible debt and higher borrowings under our revolving credit facility. We recorded a gain on the McDowell settlement of $7,550 as a result of a negotiated reduction in the purchase price that was finalized in November 2007 (see Note 2 for additional information). Miscellaneous income/expense amounted to income of $493 for 2007 compared with income of $311 for 2006. This income was primarily due to foreign currency exchange gains, and the increase related mainly to the strengthening of the U.K. pound sterling compared with the U. S. dollar.

Income Taxes. We reflected a tax provision of $77 for the twelve-month period ended December 31, 2007 compared with $23,735 in the same period of 2006. At the end of 2006, we recorded a full valuation allowance on our net deferred tax asset, due to the determination that it was more likely than not that we would not be able to utilize these benefits in the future. At December 31, 2007, we continue to recognize a full valuation allowance on our net deferred tax asset, as we believe that it is more likely than not that we will not be able to utilize these benefits in the future. (See Notes 1 and 8 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. net operating losses and other deferred tax assets.

Net Income. Net income was $5,583, or $0.36 per basic and diluted common share, for the year ended December 31, 2007 compared with a net loss of $27,488, or $1.84 per basic and diluted common share, for the year ended December 31, 2006, primarily as a result of an improvement in the operating loss due to improved profit margins on revenues and overall increase in sales volumes, the recognition of a non-operating gain on the McDowell settlement, and the recognition of a full valuation allowance against our deferred tax asset in 2006 that did not reoccur in 2007. Average common shares outstanding used to compute diluted earnings per share increased from 14,906,000 in 2006 to 15,557,000 in 2007, mainly due to stock option exercises, the dilutive impact from unexercised options and warrants, and the partial-year impact of the limited public offering completed in November 2007 where an additional 1,000,000 shares were issued.

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Twelve Months Ended December 31, 2006 Compared With the Twelve Months Ended December 31, 2005

	12 Months Ended 12/31/2006	12 Months Ended 12/31/2005	Increase / (Decrease)
Revenues	$ 93,546	$ 70,501	$ 23,045
Cost of products sold	76,103	58,243	17,860
Gross margin	17,443	12,258	5,185
Operating and other expenses	20,400	15,160	5,240
Operating income	(2,957)	(2,902)	(55)
Other (expense) income, net	(796)	(954)	158
Income before taxes	(3,753)	(3,856)	103
Income tax provision/(benefit)	23,735	489	23,246
Net (loss)/income	$ (27,488)	$ (4,345)	$ (23,143)
Net (loss)/income per share basic	$ (1.84)	$ (0.30)	$ (1.54)
Net (loss)/income per share diluted	$ (1.84)	$ (0.30)	$ (1.54)
Weighted average shares outstanding-basic	14,906,000	14,551,000	355,000
Weighted average shares outstanding-diluted	14,906,000	14,551,000	355,000

Revenues. Total revenues for the twelve months ended December 31, 2006 amounted to $93,546, an increase of $23,045, or 33% from the $70,501 reported for the twelve months ended December 31, 2005.

Non-Rechargeable product sales increased $9,270, or 16%, year-over-year, driven mainly by an increase in sales of automotive telematics backup batteries and higher sales of 9-volt batteries, as well as $2,694 attributable to the addition of ABLE in May of 2006.

Rechargeable product revenues rose $7,678, or 76%, from $10,067 to $17,745, mainly due to higher shipments of multi-cell lithium ion rechargeable battery packs and charger systems, sold primarily to government customers.

Sales of communications systems amounted to $7,433 in 2006 reflecting sales of various products related to McDowell, which was acquired in July 2006. We had no comparable sales in 2005.

Design and installation services revenues, consisting of technology contracts, decreased $1,336 to $589 for the year ended December 31, 2006, mainly due to the completion of work on our development contract with General Dynamics.

Cost of Products Sold. Cost of products sold increased $17,860 from $58,243 for the year ended December 31, 2005 to $76,103 for the year ended December 31, 2006, primarily as a result of the increase in revenues. Consolidated cost of products sold as a percentage of total revenue decreased from 83% for the twelve months ended December 31, 2005 to 81% for the year ended December 31, 2006. Correspondingly, consolidated gross margins were 19% for the year ended December 31, 2006, compared with 17% for the year ended December 31, 2005, mainly attributable to margin improvements in Rechargeable product sales in addition to margins generated in communications systems.

In the Non-Rechargeable products segment, the cost of products sold increased $8,295, from $47,626 in the year ended December 31, 2005 to $55,921 in 2006, mainly related to higher production volumes and shipments. As a percent of total non-rechargeable battery sales, the cost of non-rechargeable products sold for the year ended

December 31, 2006 was 83%, an increase over the 81% reported for the year ended December 31, 2005. The corresponding non-rechargeable gross margins were 17% in 2006 and 19% in 2005. Gross margins in 2006 were adversely impacted as costs in the second half of the year were higher than expected due to certain operating inefficiencies in our 9-volt operations that have subsequently been resolved, in addition to a shift in sales mix.

In the Rechargeable products segment, the cost of products sold increased $5,172, from $8,751 in 2005 to $13,923 in 2006. Rechargeable gross margins for 2006 were $3,822, or 22%, an increase of $2,506 over 2005 s gross margin of $1,316, or 13%. This improvement in gross margin was attributable to higher sales volumes and a more favorable sales mix.

Cost of products sold in Communications Systems amounted to $5,662 in 2006, reflecting a gross margin of 24%.

Design and installation services cost of sales, consisting of technology contracts, decreased $1,269, from $1,866 for the year ended December 31, 2005, to $597 in 2006. This decline in costs was related to a decrease in revenue in the segment.

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Design and installation services cost of sales as a percentage of revenue was 101% for the year ended December 31, 2006, compared with 97% for the year ended December 31, 2005. Correspondingly, gross margins were a 1% loss in 2006 compared with a 3% profit in 2005. This margin decline was mainly due to adjustments in the estimated costs to complete our contracts with General Dynamics and Harris RF Communications as these projects transition from development to production.

Operating and Other Expenses. Total operating expenses increased $5,240, from $15,160 for the year ended December 31, 2005 to $20,400 for the year ended December 31, 2006. Excluding the impact of expensing stock options of $1,286 ($1,193 in selling, general, and administrative expenses and $93 in research and development charges) related to the adoption of FAS 123R in 2006, operating expenses increased $3,954. Amortization expense associated with the recognition of intangible assets related to the acquisitions of ABLE and McDowell created $1,199 ($580 in selling, general, and administrative expenses and $619 in research and development charges) in additional operating expenses, and ongoing operating expenses from the newly acquired companies added approximately $3,100 of operating expenses in 2006. Research and development charges increased $1,346 to $5,097 in 2006 due to added development costs associated with the addition of McDowell s R&D expenses and the amortization of intangible assets in 2006. In addition to the R&D line shown in Operating Expenses, we also consider our efforts for technology contracts included in our Design and Installation Services segment to be related to key product development efforts. Selling, general, and administrative expenses increased $3,894 to $15,303. Excluding the impact of expensing stock options, selling, general, and administrative expenses increased $2,701 primarily related to additional operating costs associated with the newly acquired entities, in addition to integration costs and the amortization of intangible assets in 2006. Overall, operating and other expenses as a percentage of sales were 22% in 2006, consistent with 2005.

Other Income (Expense). Interest expense (net) increased $662, from $636 for the year ended December 31, 2005 to $1,298 for the year ended December 31, 2006. This change was mainly related to interest on the $20,000 convertible note issued to partially finance the McDowell acquisition in July 2006, lower interest income on lower invested cash, and higher interest rates associated with our outstanding bank debt. During 2006, we recorded a $191 gain from an insurance settlement related to the finalization of an insurance claim for our U.K. operation. (See Note 13 for additional information.) Miscellaneous income/expense amounted to income of $311 in 2006 compared with an expense of $318 for 2005. This change resulted mainly from changes in foreign currency exchange rates, related primarily to the translation impact of our U.S. dollar-denominated loan with our UK subsidiary.

Income Taxes. We reflected a tax provision of $23,735 for the twelve-month period ended December 31, 2006 compared with $489 in the same period of 2005. At the end of 2004, based on our assessment, a deferred tax asset was recorded to the expected future tax benefit to be received relating to our U.S. operations. This was due to our profitable track record and expected continued profitability; the asset was recorded since it was determined to be more likely than not to be realized. We continually assess the carrying value of this asset based on relevant accounting standards. In the fourth quarter of 2006, our assessment concluded that we needed to reestablish a full valuation allowance against this deferred tax asset. The reestablishment of this valuation allowance generated a $24,116 non-cash charge to income taxes in the fourth quarter of 2006. As we reestablish a pattern of profitability, we will continue to reassess the need for a valuation allowance.

Included in the 2005 provision is a $1,456 impact from a change in the New York State income tax law in the second quarter of 2005, which caused a reduction to the associated deferred tax asset. In April 2005, legislation was enacted in New York State that changed the apportionment methodology for corporate income from a three factor formula comprised of payroll, property and sales, to one which uses only sales. This change is to be phased in beginning in 2006, and the change is fully effective for the tax year 2008 and thereafter. It is expected that this legislative change, when fully implemented, will result in a reduction in our New York State effective tax rate from approximately 2.46% to 0.03%. Excluding the New York State tax provision, the 2005 benefit related mainly from the year-to-date loss before income taxes for U.S. operations. (See Notes 1 and 8 for additional information.)

Net Loss. Net loss was $27,488, or $1.84 per basic and diluted common share, for the year ended December 31, 2006 compared with a net loss of $4,345, or $0.30 per basic and diluted common share, for the year ended December 31, 2005, primarily as a result of the non-cash charge to income taxes in 2006. Average common shares outstanding used to compute basic earnings per share increased from 14,551,000 in 2005 to 14,906,000 in 2006, mainly due to stock option and warrant exercises in 2006.

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), the most comparable financial measure under U.S. generally accepted accounting principles (U.S. GAAP).

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) 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.

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:

	Years ended December 31,		
	2007	2006	2005
Net income (loss)	$ 5,583	$ (27,488)	$ (4,345)
Add: interest expense, net	2,184	1,298	636
Add: income tax provision (benefit)	77	23,735	489
Add: depreciation expense	3,861	3,667	3,181
Add: amortization expense	2,317	1,199	
Add: stock-based compensation expense	2,149	1,480	
Less: gain on McDowell settlement	(7,550)		
Adjusted EBITDA	$ 8,621	$ 3,891	$ (39)

Liquidity and Capital Resources

Cash Flows and General Business Matters

As of December 31, 2007, cash and cash equivalents totaled $2,245. During the twelve months ended December 31, 2007, we generated $1,569 of cash from operating activities as compared to generating $151 of cash for the twelve months ended December 31, 2006. The cash from operating activities generated during 2007 was mainly attributable to our pre-tax income of $5,583, plus an addback for non-cash expenses of depreciation, amortization and stock-based compensation of $8,327, offset by a deduction of $7,550 for the non-cash gain from the McDowell settlement agreement. Approximately $6,114 of cash was used for working capital due mainly to an increase in inventories that resulted from sizeable orders for communications systems in the latter part of 2007. The cash generated from operating activities of $151 during 2006 was mainly attributable to a pre-tax loss of $3,753, offset by an addback for non-cash expenses of depreciation, amortization and stock-based compensation of $6,346. As discussed previously, we recorded a $23,735 charge in the fourth quarter of 2006 related to a full reserve for our deferred tax asset, which had no impact on cash. Changes in working capital in 2006 were modest, as increases in receivables and inventories were offset by increases in payables and other liabilities, net of the impact from acquisitions. The increase in receivables in 2006 was related to the timing of shipments toward the end of 2006, and the increase in payables was related to higher inventory levels needed to meet production requirements and timing of payments to suppliers.

In 2007, we used $10,751 of cash in investing activities, $2,073 of which was used to purchase fixed assets, and $8,678 of which was used in connection with the acquisitions of RedBlack and SPS, as well as a contingent purchase price payout related to the ABLE acquisition. During 2007, we generated $10,427 in net funds from financing activities. The financing activities included inflows of $13,936 from the issuance of stock and stock option exercises, including $12,622 that resulted from a limited public offering in November 2007 where we issued one million new shares of common stock, and $3,308 from revolver loan borrowings, offset by principal payments on our term loan, capital leases, and debt we assumed from acquisitions of $6,817.

Although we booked a full reserve for our deferred tax asset during the fourth quarter of 2006 and continue to carry this reserve as of December 31, 2007, we continue to have significant U.S. NOLs available to us to utilize as an offset to taxable income. As of December 31, 2007, none of our U.S. NOLs have expired. Over the next five years, the scheduled expirations of our U.S. NOLs are as follows: 2008 $2,428, 2009 $3,303, 2010 $2,034, 2011 $6,158, and 2012 $10,429. (See Note 8 in the Notes to the Consolidated Financial Statements for additional information.)

Inventory turnover for the year ended December 31, 2007 averaged 3.0 turns compared to 3.2 turns for 2006. The decline in this metric is mainly due to the timing of production and shipments, including maintaining a supply of raw materials for surge production for the U.S. military, and the impact from procuring premium priced inventory at our Waco operation in the latter part of 2006. In addition, our inventory turnover was impacted by delayed deliveries to our customers in the fourth quarter of 2007 due to a supply chain issue at our sole supplier for a key component of our advanced communications systems we had coordinated as we ramped-up of production at the end of 2007 to meet shipping schedules on certain large orders received during the fourth quarter. We expect this metric to improve during 2008 as our supply chain issues are resolved and we can ship products to our customer in a more timely fashion. Our Days Sales Outstanding

(DSOs) was an average of 55 days for 2007, an increase from the 2006 average of 50 days, as our customer base continues to expand and the credit terms for non-U.S. customers are generally more lenient than for U.S. customers.

Our order backlog at December 31, 2007 was approximately $141,850, of which approximately $115,506 related to recent orders for SATCOM-On-The-Move and other advanced communications systems. The majority of the backlog was related to orders that are expected to ship throughout 2008.

As of December 31, 2007, we had made commitments to purchase approximately $326 of production machinery and equipment, which we expect to fund through operating cash flows.

In October 2005, we received a contract valued at approximately $3,000 from the U.S. Defense Department to purchase equipment and enhance processes to reduce lead time and increase manufacturing efficiency to boost production surge capability of our BA-5390 battery during contingency operations. Under the contract, we have also purchased and pre-positioned critical long lead-time materials and subassemblies. During 2006 and 2007, we received approximately $2,852 for completing the first four milestones under the contract, primarily related to reimbursement for raw material inventory and the procurement of certain equipment.

We have had certain exigent non-bid contracts with the U.S. government that 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 December 31, 2007, there were no outstanding exigent contracts with the U.S. government. As part of its due diligence, the U.S. government has conducted post-audits of the completed exigent contracts to ensure that information used in supporting the pricing of exigent contracts did not differ materially from actual results. In September 2005, the Defense Contracting Audit Agency (DCAA) presented its findings related to the audits of three of the exigent contracts, suggesting a potential pricing adjustment of approximately $1,400 related to reductions in the cost of materials that occurred prior to the final negotiation of these contracts. 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 are cooperating with the DoD IG inquiry and have furnished 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 operation.

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 of 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. As of December 31, 2007, we have determined that our reserve for this potential liability continues to be reasonable. It is likely, however, that 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 is likely to take several years before the final resolution of outstanding workers compensation claims. We will continue to review this liability periodically and make adjustments accordingly as new information is collected.

In connection with our acquisition of ABLE on May 19, 2006, there was an additional $500 cash payment to be made to the sellers of ABLE upon the achievement of certain performance milestones, payable in separate $250 payments, when cumulative ABLE revenues from the date of acquisition attain $5,000 and $10,000, respectively. The contingent payments will be recorded as an addition to the purchase price when the performance milestones are attained. The first milestone payment was made during the fourth quarter of 2007.

In connection with our acquisition of McDowell, the purchase price of approximately $25,000 (consisting of $5,000 in cash and a $20,000 non-transferable convertible note to be held by the sellers) was subject to a post-closing adjustment based on a final valuation of trade accounts receivable, inventory and trade accounts payable that were acquired or assumed on the date of the closing, using a base value of $3,000. The final net value of these assets, under our contractual obligation under the acquisition agreement, was $6,389, resulting in a revised purchase price of approximately $28,448. In January 2007, we made a $1,500 payment to the sellers of McDowell as partial payment for the remaining obligation and we had accrued $1,889 for the remaining final post-closing adjustment of $3,389. On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell, which resolved various operational issues that arose during the first several months following the acquisition that significantly reduced our profit margins. The settlement agreement reduced the overall purchase price by approximately $7,900, by reducing the principal amount on the convertible note from $20,000 to $14,000, and eliminating a $1,889 liability related to the Purchase Price Adjustment formula. 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.

In connection with our acquisition of RedBlack on September 28, 2007, there is an additional cash payment of up to $2,000 to be made contingent upon the achievement of certain annual sales milestones through September 30, 2010. The additional cash consideration is payable in up to three annual payments and subject to possible adjustments as set forth in the stock purchase agreement.

In connection with our acquisition of Stationary Power Services on November 16, 2007, the purchase agreement specified an adjustment mechanism based upon SPS s closing date net worth balance relative to a previously-agreed amount of $500. This adjustment is still under review. In addition, there is a contingent payout of 100,000 shares of our common stock to be earned upon the achievement of certain post-acquisition sales milestones.

In connection with our acquisition of Reserve Power Systems on November 16, 2007, on the achievement of certain post-acquisition sales milestones, we will pay the sellers, in cash, 5% of sales up to the sales in the operating plan, and 10% of sales that exceed the sales in the operating plan, for the remainder of the calendar year 2007 and for calendar years 2008, 2009 and 2010. The additional contingent cash consideration is payable in annual installments, and excludes sales made to SPS, which historically have comprised substantially all of RPS s sales.

Debt and Lease Commitments

At December 31, 2007, we had outstanding capital lease obligations of $514.

Our primary credit facility, which was initiated in June 2004, consists of both a term loan component and a revolver component, and the facility is collateralized by essentially all of our assets, including those owned by our subsidiaries. The lenders of the credit facility are JP Morgan Chase Bank and Manufacturers and Traders Trust Company, with JP Morgan Chase Bank acting as the administrative agent. The current revolver loan commitment is $15,000. Availability under the revolving credit component is subject to meeting certain financial covenants. We are required to meet certain financial covenants under the facility, as amended, including a debt to earnings ratio, a fixed charge coverage ratio, and a current assets to total liabilities ratio. In addition, we are required to meet certain non-financial covenants. The rate of interest, in general, is based upon either a LIBOR rate or Prime, plus a Eurodollar spread (dependent upon a debt to earnings ratio within a predetermined grid).

On June 30, 2004, we drew down the full $10,000 term loan that was made available to us. The term loan is 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 is equal to the swap rate of 3.98% plus the Eurodollar spread stipulated in the predetermined grid associated with the term loan. On January 1, 2006, the adjusted rate was 6.98%. On February 14, 2007, the adjusted rate increased to 7.23%, on August 15, 2007, the adjusted rate decreased to 6.98%, and on November 7, 2007, the adjusted rate decreased to 5.98%. Derivative instruments are accounted for in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , which requires that all derivative instruments be recognized in the financial statements at fair value. The fair value of this arrangement at December 31, 2007 resulted in an asset of $4, all of which was reflected as a short-term asset.

There have been several amendments to the credit facility during the past few years, including amendments to authorize acquisitions and modify financial covenants. Effective February 14, 2007, we entered into Forbearance and Amendment Number Six to the Credit Agreement (Forbearance and Amendment) with the banks. The Forbearance and Amendment provided that the banks would forbear from exercising their rights under the credit facility arising from our failure to comply with certain financial covenants in the credit facility with respect to the fiscal quarter ended December 31, 2006. Specifically, we were not in compliance with the terms of the credit facility because we failed to maintain the required debt-to-earnings and EBIT-to-interest ratios provided for in the credit facility at that time. The banks agreed to forbear from exercising their respective rights and remedies under the credit facility until March 23, 2007 (Forbearance Period), unless we breached the Forbearance and Amendment or unless another event or condition occurred that constituted a default under the credit facility. Each bank agreed to continue to make revolving loans available to us during the Forbearance Period. Pursuant to the Forbearance and Amendment, the aggregate amount of the banks revolving loan commitment was reduced from $20,000 to $15,000. During the Forbearance Period, the applicable revolving interest rate and the applicable term interest rate, in each case as set forth in the credit agreement, both were increased by 25 basis points. In addition to a number of technical and conforming amendments, the Forbearance and Amendment revised the definition of Change in Control in the credit facility to provide that the acquisition of equity interests representing more than 30% of the aggregate ordinary voting power represented by the issued and outstanding equity interests of us shall constitute a Change in Control for purposes of the credit facility. Previously, the equity interest threshold had been set at 20%.

Effective March 23, 2007, we entered into Extension of Forbearance and Amendment Number Seven to Credit Agreement (Extension and Amendment) with the banks. The Extension and Amendment provided that the banks agreed to extend the Forbearance Period until May 18, 2007. The Extension and Amendment also acknowledged that we continued not to be in compliance with the financial covenants identified above for the fiscal quarter ended December 31, 2006 and did not contemplate being in compliance for the fiscal quarter ending March 31, 2007.

Effective May 18, 2007, we entered into Extension of Forbearance and Amendment Number Eight to Credit Agreement (Second Extension and Amendment) with the banks. The Second Extension and Amendment provided that the banks agreed to extend the Forbearance Period until August 15, 2007. The Second Extension and Amendment also acknowledged that we continued not to be in compliance with the financial covenants identified above for the fiscal quarter ended March 31, 2007 and did not contemplate being in compliance for the fiscal quarter ending June 30, 2007.

Effective August 15, 2007, we entered into Amendment Number Nine to Credit Agreement (Amendment Nine) with the banks. Amendment Nine effectively ended the Forbearance Period and extended the term of the revolving credit component of the facility to January 31, 2009 and the term of the term loan component of the facility to July 1, 2009. Amendment Nine also added several definitions and modified or replaced certain covenants. As of December 31, 2007, we were in compliance with all of the credit facility covenants, as amended.

As of December 31, 2007, we had $3,167 outstanding under the term loan component of our credit facility with our primary lending bank and $11,200 was outstanding under the revolver component. At December 31, 2007, the interest rate on the revolver component was 7.25%. The revolver arrangement currently provides for up to $15,000 of borrowing capacity, including outstanding letters of credit. At December 31, 2007, we had no outstanding letters of credit related to this facility, as amended August 15, 2007, leaving $3,800 of additional borrowing capacity.

Our wholly-owned U.K. subsidiary, Ultralife Batteries (UK) Ltd. (Ultralife UK), has an agreement for a revolving credit facility with a commercial bank in the U.K. This credit facility provides our U.K. operation with additional financing flexibility for its working capital needs. Any borrowings against this credit facility are collateralized with Ultralife UK s outstanding accounts receivable balances. The maximum credit available to that subsidiary under the facility is approximately $899 as of December 31, 2007. The rate of interest is based upon prime plus 2.25% (7.75% at December 31, 2007). At December 31, 2007, there was nothing outstanding under this facility.

In connection with our acquisition of RedBlack, we assumed approximately $900 in debt, of which we immediately paid off approximately $875 after closing. In connection with our acquisition of SPS and RPS, we assumed approximately $1,400 in debt, of which we immediately paid off approximately $1,200 after closing.

We are continually in discussion with our primary lending banks to enhance the flexibility of our credit facility structure. While we believe relations with our lenders are good and we have received waivers as necessary in the past, there can be no assurance that such waivers can always be obtained. In such case, we believe we have, in the aggregate, sufficient cash, cash generation capabilities from operations, working capital, and financing alternatives at our disposal, including but not limited to alternative borrowing arrangements and other available lenders, to fund operations in the normal course and repay the debt outstanding under our credit facility that is subject to Amendment Nine.

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. As this grant/loan requires us to not only meet, but maintain our employment levels for a pre-determined time period, we currently reflect the funds that we received as a current liability, in the Other Current Liabilities line on our Consolidated Balance Sheet. Our employment levels met the specified levels as of December 31, 2007. In the event our employment levels are not maintained at the specified levels at December 31, 2008, we may be required to pay back these funds.

Equity Transactions

During 2007, 2006 and 2005, we issued 204,000, 200,000, and 452,000 shares of common stock, respectively, as a result of exercises of stock options and warrants. We received approximately $1,314 in 2007, $1,231 in 2006 and $2,488 in 2005 in cash proceeds as a result of these transactions.

During 2007 and 2006, we issued restricted stock awards of 51,548 and 85,668 shares of our common stock, respectively, to certain officers and directors, with various vesting schedules related to time and performance. At December 31, 2007, 45,313 shares had vested.

In November 2007, we completed a limited public offering, whereby 1,000,000 shares of our common stock were issued. Total net proceeds from the offering were approximately $12,600, of which $6,000 was used for the SPS cash payment, $3,500 was used as a prepayment on the subordinated convertible notes that were issued as partial consideration for the McDowell acquisition, and $1,000 was used as a repayment of borrowings outstanding under our credit facility used to fund the RedBlack acquisition. The remainder of the proceeds was used for general working capital purposes.

In connection with our May 2006 stock purchase of ABLE New Energy Co., Ltd., we issued a combination of shares and warrants exercisable for shares of our common stock to the previous owners of ABLE New Energy Co., Ltd. as part of the purchase price. The equity portion of the purchase price consisted of 96,247 shares of our common stock valued at $1,000, based on the closing price of the stock on the closing date of the acquisition, and 100,000 stock warrants with a five-year term valued at $526, for a total equity consideration of $1,526. In January 2008, 82,000 warrants were exercised.

In connection with our July 2006 acquisition of substantially all of the assets of McDowell Research, Ltd., we issued to McDowell Research, Ltd. a non-transferable, subordinated convertible promissory note in the principal amount of $20,000 as part of the purchase price. The $20,000 convertible note carried a five-year term, an annual interest rate of 4% and was convertible at $15 per share into 1.33 million shares of our common stock, with a forced conversion feature, at our option, at any time after the 30-day average closing price of our common stock exceeds $17.50 per share. The conversion price was subject to adjustment as defined in the subordinated convertible promissory note. Interest was payable quarterly in arrears, with all unpaid accrued interest and outstanding principal due in full on July 3, 2011. In April 2007, in connection with its dissolution, McDowell Research, Ltd. distributed the convertible note to its members in proportion to their membership interests, resulting in six separate convertible notes aggregating to $20,000. On November 16, 2007, we finalized a settlement agreement with the sellers of McDowell Research, Ltd., which resolved various operational issues that arose during the first several months following the acquisition that significantly reduced our profit margins. The settlement agreement reduced the overall purchase price by approximately $7,900, by reducing the principal amount on the convertible notes from $20,000 to $14,000, and eliminating the $1,889 liability related to the 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. In January 2008, the convertible notes were converted in full into 700,000 shares of our common stock.

In connection with our November 2007 acquisition of all of the issued and outstanding shares of common stock of Stationary Power Services, Inc., we issued, to the seller, a subordinated convertible promissory note in the principal amount of $4,000 as part of the purchase price. The $4,000 convertible note carries a three-year term, an annual interest rate of 5% and is convertible at $15 per share into 266,667 shares of our common stock, with a forced conversion feature at $17.00 per share. The conversion price is subject to adjustment as defined in the subordinated convertible promissory note. Interest is payable quarterly in arrears, with all unpaid accrued interest and outstanding principal due in full on November 16, 2010. In addition, on the achievement of certain post-acquisition sales milestones, we will issue up to an aggregate amount of 100,000 shares of our common stock.

In connection with our November 2007 acquisition of all of the issued and outstanding shares of common stock of Reserve Power Systems, Inc., we issued 100,000 shares of our common stock valued at $1,383.

We utilized securities as consideration in these transactions in part to reduce the need to draw on the liquidity provided by our cash and cash equivalents and revolving credit facility.

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Other Matters

We continue to be optimistic about our future prospects and growth potential. 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.

Our plan to achieve operational profitability and reduce our negative cash flows from operations includes successfully resolving our supply chain issue for a key component that caused a delay in shipping certain advanced communications systems to fulfill certain large orders, implementing measures in our operations to reduce scrap and improve manufacturing efficiencies, and reducing our inventory levels by balancing our production activity and sales orders more effectively. Additionally, we believe we have adequate third party financing available to fund our operations or we could obtain other financing, if needed.

If we are unable to achieve our plans or unforeseen events occur, we may need to implement alternative plans. 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.

As described in Part I, Item 3, 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.

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. We offer a four-year warranty on certain communications accessories products. 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 this potential warranty expense, which is based on an analysis of historical warranty issues. There is no assurance that future warranty claims will be consistent with past history, and in the event we experience a significant increase in warranty claims, there is no assurance that our reserves would be sufficient. Any such insufficiency could have a material adverse effect on our business, financial condition and results of operations.

Contractual Obligations

	Payments due by period				
Contractual Obligations:	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Debt Obligations	$ 29,133	$ 13,313	$ 5,277	$ 10,543	$
Expected Interest Payments	3,126	1,352	1,498	276	
Capital Lease Obligations	514	110	226	178	
Operating Lease Obligations	3,068	944	1,303	665	156
Purchase Obligations	100,794	100,794			
Total	$ 136,635	$ 116,513	$ 8,304	$ 11,662	$ 156

Expected interest payments are calculated assuming a 5.98% annual rate on outstanding debt principal, 7.25% annual rate on the outstanding revolver balance, plus associated fees related to the our credit facility; the applicable annual interest rates ranging from 0.00% to 7.13% for various notes payable for equipment and vehicles; and a 5.00% annual rate on the outstanding principal related to the subordinated convertible notes payable. Purchase obligations consist of commitments for property, plant and equipment, open purchase orders for materials and supplies, and other general commitments for various service contracts.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Outlook

For 2008, we are projecting full year revenues of at least $238,000, which includes revenues from shipments on the $24,000 SATCOM-On-The-Move contract that were delayed in the fourth quarter of 2007. The achievement of our forecast is highly dependent on the receipt of key components to complete orders for advanced communications systems.

Critical Accounting Policies and Estimates

The above discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the U.S. The preparation of these financial statements requires management to make estimates and assumptions that affect amounts reported therein. The estimates and assumptions that require management s most difficult, subjective or complex judgments are described below.

Revenue recognition:

Product Sales In general, revenues from the sale of products are recognized when products are shipped. When products are shipped with terms that require transfer of title upon delivery at a customer s location, revenues are recognized on date of delivery. A provision is made at the time the revenue is recognized for warranty costs expected to be incurred. Customers, including distributors, do not have a general right of return on products shipped.

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

Technology Contracts We recognize revenue using the proportional method, measured by the percentage of actual costs incurred to date to the total estimated costs to complete the contract. Elements of cost include direct material, labor and overhead. If a loss on a contract is estimated, the full amount of the loss is recognized immediately. We allocate costs to all technology contracts based upon actual costs incurred including an allocation of certain research and development costs incurred.

Valuation of Inventory:

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out (FIFO) method. Our inventory includes raw materials, work in process and finished goods. We record provisions for excess, obsolete or slow moving inventory based on changes in customer demand, technology developments or other economic factors. The factors that contribute to inventory valuation risks are our purchasing practices, material and product obsolescence, accuracy of sales and production forecasts, introduction of new products, product lifecycles, product support and foreign regulations governing hazardous materials (see Item 1A Risk Factors for further information on foreign regulations). We manage our exposure to inventory valuation risks by maintaining safety stocks, minimum purchase lots, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing certain inventory minimization strategies such as vendor-managed inventories. We believe that the accounting estimate related to valuation of inventories is a critical accounting estimate because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors ranging from purchasing, to sales, to production, to after-sale support. If actual demand, market conditions or product lifecycles are adversely different from those estimated by management, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs and a decrease to gross margins.

Warranties:

We maintain provisions related to normal warranty claims by customers. We evaluate these reserves quarterly based on actual experience with warranty claims to date and our assessment of additional claims in the future.

There is no assurance that future warranty claims will be consistent with past history, and in the event we experience a significant increase in warranty claims, there is no assurance that our reserves would be sufficient.

Impairment of Long-Lived Assets:

We regularly assess all of our long-lived assets for impairment when events or circumstances indicate their carrying amounts may not be recoverable. This is accomplished by comparing the expected undiscounted future cash flows of the assets with the respective carrying amount as of the date of assessment. Should aggregate future cash flows be less than the carrying value, a write-down would be required, measured as the difference between the carrying value and the fair value of the asset. Fair value is estimated either through the assistance of an independent valuation or as the present value of expected discounted future cash flows. The discount rate used by us in our evaluation approximates our weighted average cost of capital. If the expected undiscounted future cash flows exceed the respective carrying amount as of the date of assessment, no impairment is recognized.

Environmental Issues:

Environmental expenditures that relate to current operations are expensed or capitalized, as appropriate, in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 96-1, Environmental Remediation Liabilities . Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

Goodwill and Other Intangible Assets:

In accordance with SFAS No. 141, Business Combinations, the purchase price paid to effect an acquisition is allocated to the acquired tangible and intangible assets and liabilities at fair value. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we do not amortize goodwill and intangible assets with indefinite lives, but instead measure these assets for impairment at least annually, or when events indicate that impairment exists. We amortize intangible assets that have definite lives so that the economic benefits of the intangible assets are being utilized over their weighted-average estimated useful life.

Stock-Based Compensation:

Effective January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R) requiring that compensation cost relating to share-based payment transactions be recognized in the financial statements. The cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity award). We adopted SFAS 123R using the modified prospective method and, accordingly, did not restate prior periods presented in this report to reflect the fair value method of recognizing compensation cost. Under the modified prospective approach, SFAS 123R applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. 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. Prior to 2006, the computation of expected volatility was based solely on historical volatility. The change to a blended volatility measure was based on a thorough review of assumptions underlying the valuation of our stock options, in conjunction with additional information and guidance that became more widely available as we prepared to implement SFAS 123R in 2006. A blended volatility factor was deemed to be more appropriate as we believe that implied volatility, a forward-looking measure, provides a more market-driven valuation related to investors expectations of the volatility of our business, and provides a balance against focusing only on a historical measure. 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.

Prior to January 1, 2006, we applied Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations which require compensation costs to be recognized based on the difference, if any, between the quoted market price of the stock on the grant date and the exercise price. We had adopted the disclosure-only provision of SFAS No. 148, Accounting for Stock-Based Compensation . As all options granted to employees under such plans had an exercise price at least equal to the market value of the underlying common stock on the date of grant, and given the fixed nature of the equity instruments, no stock-based employee compensation cost relating to stock options was reflected in net income (loss).

Income Taxes:
We apply SFAS No. 109, Accounting for Income Taxes , in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that may be in effect when the differences are expected to reverse.

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We recorded a deferred tax asset in December 2004 arising from our conclusion that it was more likely than not that we would be able to utilize our U.S. net operating loss carryforwards (NOLs) that had accumulated over time. The recognition of a deferred tax asset resulted from our evaluation of all available evidence, both positive and negative, including: a) recent historical net income, and income on a cumulative three-year basis, as well as anticipated future profitability based in part on recent military contracts; b) a financial evaluation that modeled the future utilization of anticipated deferred tax assets under three alternative scenarios; and c) the award of a significant contract with the U.S. Defense Department in December 2004 for various battery types that could reach a maximum value of $286,000 in revenues over the next five years. The amount of the net deferred tax assets was considered realizable. As of December 31, 2005, we continued to recognize a deferred tax asset arising from our conclusion that it was more likely than not that we would be able to utilize our U.S. NOLs that had accumulated over time. In December 2006, we placed a full valuation allowance on our deferred tax assets arising from our conclusion that it was more likely than not that we would not be able to utilize our U.S. NOLs that had accumulated over time. The recognition of the full valuation allowance on our deferred tax asset resulted from our evaluation of all available evidence, both positive and negative, including: a) recent historical net income/losses, and income/losses on a cumulative three-year basis; and b) a financial evaluation that modeled the future utilization of anticipated deferred tax assets under three alternative scenarios. As of December 31, 2007, we continue to recognize a full valuation allowance on our deferred tax assets, based on a consistent evaluation methodology that was used for 2006 and arising from our conclusion that it is more likely than not that we would not be able to utilize our U.S. NOLs that have accumulated over time. We have significant NOLs related to past years cumulative losses, and as a result can be subject to U.S. alternative minimum tax where NOLs can offset only 90% of alternative minimum taxable income. Because evidence such as our operating results during the most recent historical periods is afforded more weight than forecasted results for future periods, our cumulative loss during our most recent three-year period represents sufficient negative evidence regarding the need for a full valuation allowance under SFAS No. 109. Achieving business plan targets, particularly those relating to revenue and profitability, is integral to our assessment regarding the recoverability of our net deferred tax asset. (See Note 8 in the Notes to the Consolidated Financial Statements for additional information.)

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141R), which replaces SFAS 141. The statement 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. SFAS No. 141R 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 impact of adopting SFAS No. 141R will be dependent on the future business combinations that we may pursue after its effective date.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51 , 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. SFAS No. 160 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 impact of adopting SFAS No. 160 will be dependent on the structure of future business combinations or partnerships that we may pursue after its effective date.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for an entity s first fiscal year beginning after November 15, 2007. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In December 2006, FASB issued FASB Staff Position (FSP) EITF 00-19-2 which addresses an issuer s accounting for registration payment arrangements for financial instruments such as equity shares, warrants or debt instruments. This FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB SFAS No. 5, Accounting for Contingencies and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss. The financial instrument(s) subject to the registration payment arrangement shall be recognized and measured in accordance with other applicable Generally Acceptable Accounting Principles, (GAAP) without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. An entity should recognize and measure a registration payment arrangement as a separate unit of account from the financial instrument(s) subject to that arrangement. Adoption of this FSP may require additional disclosures relating to the nature of the registration payment, settlement alternatives, current carrying amount of the liability representing the issuer s obligations and the maximum potential amount of consideration, undiscounted that the issuer could be required to transfer. This FSP shall be effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to the date of issuance of this FSP. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of this FSP, this guidance shall be effective for financial statements issued for fiscal years beginning after December 15, 2006. The adoption of this pronouncement had no impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements , which establishes a framework for measuring fair value and requires expanded disclosure about the information used to measure fair value. The statement applies whenever other statements require, or permit, assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption encouraged. In February 2008, FASB issued FSP FASB No 157-2, which delays the effective date of FASB No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, with early adoption encouraged. We do not expect the adoption of this pronouncement to have a significant impact on our financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109 (FIN 48). This statement clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 were effective for fiscal years beginning after December 15, 2006. The adoption of this pronouncement had no significant impact on our financial statements. See Note 8 for additional information related to the effect of the adoption of FIN 48.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets , an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS No. 156). SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits for subsequent measurement using either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement No. 140. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. SFAS No. 156 was effective for an entity s first fiscal year beginning after September 15, 2006. The adoption of this pronouncement had no impact on our financial statements.

In January 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155). SFAS No. 155 amended SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 also resolved issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS No. 155 eliminated the exemption from applying SFAS No. 133 to interests in securitized financial assets so that similar instruments are accounted for in the same manner regardless of the form of the instruments. SFAS No. 155 allows a preparer to elect fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis. SFAS No. 155 was effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that began after September 15, 2006. The fair value election provided for in paragraph 4(c) of SFAS No. 155 may also be applied upon adoption of SFAS No. 155 for hybrid financial instruments that had been bifurcated under paragraph 12 of SFAS No. 133 prior to the adoption of this Statement. Earlier adoption was permitted as of the beginning of an entity s fiscal year, provided the entity had not yet issued financial statements, including financial statements for any interim period for that fiscal year. Provisions of SFAS No. 155 may be applied to instruments that an entity holds at the date of adoption on an instrument-by-instrument basis. The adoption of this pronouncement had no significant impact on our financial statements.

In June 2005, the FASB issued FASB Staff Position No. FAS 143-1 (FSP FAS 143-1), Accounting for Electronic Equipment Waste Obligations. FSP FAS 143-1 addresses the accounting for obligations associated with the Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the Directive) adopted by the European Union (EU). FSP FAS 143-1 was effective the latter of the first reporting period that ended after June 8, 2005 or the date that the EU-member country adopts the law. Effective January 2, 2007, the United Kingdom, the only EU-member country in which we have significant operations, adopted the law. The adoption of this law had no significant impact on our financial statements.

ITEM 7A. 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 obligation. 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 is adjusted accordingly for a Eurodollar spread incorporated in the agreement. As of December 31, 2007, a one basis point change in the Eurodollar spread would have a less than $1 value change.

We are subject to foreign currency risk, due to fluctuations in currencies relative to the U.S. dollar. In the year ended December 31, 2007, approximately 81% of our sales were denominated in U.S. dollars. The remainder of our sales was denominated in U.K. pounds sterling, euros, Australian dollars, Canadian dollars and Chinese yuan renminbi. A 10% change in the value of the pound sterling, the euro, Australian dollar, Canadian dollar or the yuan renminbi to the U.S. dollar would have impacted our revenues in that period by less than 2%. 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 consolidated financial statements. A 10% change in local currency relative to the U.S. dollar would have impacted our consolidated income before taxes by approximately $315, or approximately 6%.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and schedules listed in Item 15(a)(1) and (2) are included in this Report beginning on page 47.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Ultralife Batteries, Inc.
Newark, New York

We have audited the accompanying consolidated balance sheets of Ultralife Batteries, Inc. as of December 31, 2007 and 2006 and the related consolidated statements of operations, shareholders equity and accumulated other comprehensive income (loss), and cash flows for the years ended December 31, 2007 and 2006. We have also audited the schedule listed in the accompanying index for the years ended December 31, 2007 and 2006. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ultralife Batteries, Inc. at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years ended December 31, 2007 and 2006**,** in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the schedule, when considered in relation to the basic consolidated financial statements taken as a whole, for the years ended December 31, 2007 and 2006 presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 7 to the consolidated financial statements, the Company changed its method of accounting for share-based compensation on January 1, 2006 by adopting Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Ultralife Batteries, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 19, 2008, expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP
Troy, Michigan
March 19, 2008

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Ultralife Batteries, Inc.:

In our opinion, the consolidated statements of operations, shareholders equity and accumulated other comprehensive income (loss) and cash flows for the year ended December 31, 2005 present fairly, in all material respects, the results of operations and cash flows for Ultralife Batteries, Inc. and its subsidiaries for the year ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for the year ended December 31, 2005 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Rochester, New York
March 22, 2006

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

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,245	$ 720
Trade accounts receivable, net of allowance for doubtful accounts of $485 and $447, respectively	26,540	24,197
Inventories	35,098	27,360
Due from insurance company	152	780
Deferred tax asset current	309	75
Prepaid expenses and other current assets	3,949	2,748
Total current assets	68,293	55,880
Property, plant and equipment, net	19,365	19,396
Other assets:		
Goodwill	21,180	13,344
Intangible assets, net	13,113	9,072
Security deposits	97	66
	34,390	22,482
Total Assets	$ 122,048	$ 97,758
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of debt and capital lease obligations	$ 13,423	$ 12,246
Accounts payable	18,326	15,925
Accrued compensation	974	547
Accrued vacation	928	755
Other current liabilities	8,181	8,337
Total current liabilities	41,832	37,810
Long-term liabilities:		
Debt and capital lease obligations	16,224	20,043
Other long-term liabilities	985	316

Total long-term liabilities	17,209	20,359
Commitments and contingencies (Note 6)		
Shareholders equity:		
Preferred stock, par value $0.10 per share, authorized 1,000,000 shares; none issued and outstanding		
Common stock, par value $0.10 per share, authorized 40,000,000 shares; issued - 17,208,862 and 15,853,306, respectively	1,712	1,578
Capital in excess of par value	152,070	134,736
Accumulated other comprehensive income (loss)	69	(321)
Accumulated deficit	(88,443)	(94,026)
	65,408	41,967
Less Treasury stock, at cost - 728,690 and 727,250 shares outstanding, respectively	2,401	2,378
Total shareholders equity	63,007	39,589
Total Liabilities and Shareholders Equity	$ 122,048	$ 97,758

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

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

	Year Ended December 31,		
	2007	2006	2005
Revenues	$ 137,596	$ 93,546	$ 70,501
Cost of products sold	108,822	76,103	58,243
Gross margin	28,774	17,443	12,258
Operating expenses:			
Research and development (including $1,027, $619 and $0 of amortization of intangible assets, respectively)	7,000	5,097	3,751
Selling, general, and administrative (including $1,290, $580 and $0 of amortization of intangible assets, respectively)	21,973	15,303	11,409
Total operating expenses	28,973	20,400	15,160
Operating income (loss)	(199)	(2,957)	(2,902)
Other income (expense):			
Interest income	50	126	185
Interest expense	(2,234)	(1,424)	(821)
Gain on insurance settlement		191	
Gain on McDowell settlement	7,550		
Miscellaneous income (expense)	493	311	(318)
Income (loss) before income taxes	5,660	(3,753)	(3,856)
Income tax provision current			3
Income tax provision deferred	77	23,735	486
Total income taxes provision	77	23,735	489
Net income (loss)	$ 5,583	$ (27,488)	$ (4,345)
Earnings (loss) per share basic	$ 0.36	$ (1.84)	$ (0.30)
Earnings (loss) per share diluted	$ 0.36	$ (1.84)	$ (0.30)
Weighted average shares outstanding basic	15,316	14,906	14,551

Weighted average shares outstanding diluted	15,557	14,906	14,551

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

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

	Common Stock Number of Shares	Common Stock Amount	Capital in excess of Par Value	Accumulated Other Comprehensive Income (Loss) Foreign Currency Translation Adjustment	Accumulated Other Comprehensive Income (Loss) Other Unrealized Net Gain (Loss)	Accumulated Deficit	Treasury Stock	Total
Balance as of December 31, 2004	15,019,262	$ 1,502	$ 127,299	$ (505)	$ (100)	$ (62,193)	$ (2,378)	$ 63,625
Comprehensive loss:								
Net loss						(4,345)		(4,345)
Other comprehensive income (loss), net of tax:								
Foreign currency translation adjustments				(609)				(609)
Unrealized gain on interest rate swap arrangements					160			160
Other comprehensive loss								(449)
Comprehensive loss								(4,794)
Tax benefits applicable to exercise of stock options			788					788
Shares issued under employee stock grant	42		1					1

Shares issued under stock option and warrant exercises	452,142	45	2,442					2,487
Balance as of December 31, 2005	15,471,446	$ 1,547	$ 130,530	$ (1,114)	$ 60	$ (66,538)	$ (2,378)	$ 62,107
Comprehensive loss:								
Net loss						(27,488)		(27,488)
Other comprehensive income (loss), net of tax:								
Foreign currency translation adjustments				743				743
Unrealized loss on interest rate swap arrangements					(10)			(10)
Other comprehensive income								733
Comprehensive loss								(26,755)
Stock-based compensation related to stock options			1,320					1,320
Shares issued and compensation under restricted stock grants	85,668	1	159					160
Shares and stock warrants issued in connection with ABLE acquisition	96,247	10	1,516					1,526
Shares issued under stock option and warrant exercises	199,945	20	1,211					1,231

Balance as of December 31, 2006	15,853,306	$ 1,578	$ 134,736	$ (371)	$ 50	$ (94,026)	$ (2,378)	$ 39,589
Comprehensive income:								
Net income						5,583		5,583
Other comprehensive income (loss), net of tax:								
Foreign currency translation adjustments				437				437
Unrealized loss on interest rate swap arrangements					(47)			(47)
Other comprehensive income								390
Comprehensive income:								5,973
Stock-based compensation related to stock options			1,648					1,648
Shares issued and compensation under restricted stock grants	51,548	4	497				(23)	478
Shares issued in connection with RPS acquisition	100,000	10	1,373					1,383
Shares issued in connection with limited public offering, net of expenses	1,000,000	100	12,522					12,622
Shares issued under stock option exercises	204,008	20	1,294					1,314
Balance as of December 31, 2007	17,208,862	$ 1,712	$ 152,070	$ 66	$ 3	$ (88,443)	$ (2,401)	$ 63,007

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

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

	Year Ended December 31,		
	2007	2006	2005
OPERATING ACTIVITIES			
Net income (loss)	$ 5,583	$ (27,488)	$ (4,345)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization of financing fees	3,861	3,667	3,181
Amortization of intangible assets	2,317	1,199	
Loss on asset disposal	37	152	22
Gain on insurance settlement		(191)	
Foreign exchange (gain) loss	(425)	(285)	330
Gain on McDowell settlement	(7,550)		
Non-cash stock-based compensation	2,149	1,480	
Changes in deferred income taxes	77	23,735	489
Provision for loss on accounts receivable	101	74	208
Provision for inventory obsolescence	1,323	90	221
Provision for warranty charges	210	131	205
Provision for workers compenstion obligation		350	
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	83	(8,866)	(2,734)
Inventories	(7,348)	(2,366)	(6,115)
Prepaid expenses and other current assets	(1,157)	143	(793)
Insurance receivable relating to fires	682	602	659
Income taxes payable		19	
Accounts payable and other liabilities	1,626	7,705	3,085
Net cash provided by (used in) operating activities	1,569	151	(5,587)
INVESTING ACTIVITIES			
Purchase of property and equipment	(2,073)	(1,455)	(3,309)
Proceeds from asset disposal			25
Proceeds from sales of securities			1,000
Payment for acquired companies, net of cash acquired	(8,678)	(7,013)	
Net cash used in investing activities	(10,751)	(8,468)	(2,284)
FINANCING ACTIVITIES			
Net change in revolving credit facilities	3,308	6,475	195
Proceeds from issuance of common stock	13,936	1,231	2,488
Principal payments on debt and capital lease obligations	(6,817)	(2,046)	(2,020)
Net cash provided by in financing activities	10,427	5,660	663

Effect of exchange rate changes on cash	280	163	(107)
Change in cash and cash equivalents	1,525	(2,494)	(7,315)
Cash and cash equivalents at beginning of period	720	3,214	10,529
Cash and cash equivalents at end of period	$ 2,245	$ 720	$ 3,214
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid for interest	$ 2,175	$ 992	$ 545
Cash paid for income taxes	$	$ 5	$ 22
Noncash investing and financing activities:			
Issuance of common stock and stock warrants for acquired companies	$ 1,383	$ 1,526	$
Issuance of convertible notes payable for acquired companies	$ 4,000	$ 20,000	$
Purchase of property and equipment via capital lease payable	$ 545	$	$

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

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Notes to Consolidated Financial Statements
(Dollars in Thousands, Except Per Share Amounts)

Note 1 Summary of Operations and Significant Accounting Policies

a. *Description of Business*

We offer products and services ranging from portable and standby power solutions to communications and electronics systems. Through our engineering and collaborative approach to problem solving, we serve government, defense and commercial customers across the globe. We design, manufacture, install and maintain power and communications systems including: portable and 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.

b. *Principles of Consolidation*

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States and include the accounts of Ultralife Batteries, Inc. and our wholly owned subsidiaries, Ultralife Batteries (UK) Ltd., ABLE New Energy Co., Limited, and its wholly-owned subsidiary ABLE New Energy Co., Ltd., McDowell Research Co., Inc., RedBlack Communications, Inc. (formerly Innovative Solutions Consulting, Inc.), Stationary Power Services, Inc. and Reserve Power Systems, Inc. Intercompany accounts and transactions have been eliminated in consolidation. Investments in entities in which we do not have a controlling interest are accounted for using the equity method, if our interest is greater than 20%. Investments in entities in which we have less than a 20% ownership interest are accounted for using the cost method.

c. *Management s Use of Judgment and Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at year end and the reported amounts of revenues and expenses during the reporting period. Key areas affected by estimates include: (a) reserves for deferred tax assets, excess and obsolete inventory, warranties, and bad debts; (b) profitability on development contracts; (c) various expense accruals; (d) stock-based compensation; and, (e) carrying value of goodwill and intangible assets. Actual results could differ from those estimates.

d. *Reclassifications*

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

e. *Cash and Cash Equivalents*

For purposes of the Consolidated Statements of Cash Flows, we consider all demand deposits with financial institutions and financial instruments with original maturities of three months or less to be cash equivalents. For purposes of the Consolidated Balance Sheet, the carrying value approximates fair value because of the short maturity of these instruments.

f. *Accounts Receivable and Allowance for Doubtful Accounts*

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

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Changes in our allowance for doubtful accounts during the years ended December 31, 2007, 2006 and 2005 were as follows:

	2007	2006	2005
Balance at beginning of year	$447	$458	$284
Amounts charged (credited) to expense	101	74	208
Amounts charged to other accounts	6		
Uncollectible accounts written-off, net of recovery	(69)	(85)	(34)
Balance at end of year	$485	$447	$458

g. *Inventories*

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

h. *Property, Plant and Equipment*

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

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

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

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

We regularly assess all of our long-lived assets for impairment when events or circumstances indicate that their carrying amounts may not be recoverable. This is accomplished by comparing the expected undiscounted future cash flows of the assets with the respective carrying amount as of the date of assessment. Should aggregate future cash flows be less than the carrying value, a write-down would be required, measured as the difference between the carrying value and the fair value of the asset. Fair value is estimated either through the assistance of an independent valuation or as the present value of expected discounted future cash flows. The discount rate used by us in our evaluation approximates our weighted average cost of capital. If the expected undiscounted future cash flows exceed the respective carrying amount as of the date of assessment, no impairment is recognized. We did not record any impairment of long-lived assets in the calendar years ended December 31, 2007, 2006 or 2005.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, we do not amortize goodwill and intangible assets with indefinite lives, but instead measure these assets for impairment at least annually, or when events indicate that impairment exists. We amortize intangible assets that have definite lives so that the economic benefits of the intangible assets are being utilized over their weighted-average estimated useful life.

Based on the current preliminary valuations for amortizable intangible assets acquired in the RedBlack and SPS acquisitions during 2007, and the final valuations for amortizable intangible assets acquired in the ABLE and McDowell acquisitions during 2006, we project our amortization expense will be approximately $2,085, $1,393, $1,011, $818 and $649 for the fiscal years ending December 31, 2008 through 2012, respectively.

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j. *Translation of Foreign Currency*

The financial statements of our foreign affiliates are translated into U.S. dollar equivalents in accordance with SFAS No. 52, Foreign Currency Translation . Exchange gains (losses) included in net income (loss) for the years ended December 31, 2007, 2006 and 2005 were $425, $285, and $(330), respectively.

k. *Revenue Recognition*

Product Sales In general, revenues from the sale of products are recognized when products are shipped. When products are shipped with terms that require transfer of title upon delivery at a customer s location, revenues are recognized on date of delivery. A provision is made at the time the revenue is recognized for warranty costs expected to be incurred. Customers, including distributors, do not have a general right of return on products shipped.

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

Technology Contracts We recognize revenue using the proportional effort method based on the relationship of costs incurred to date to the total estimated cost to complete the contract. Elements of cost include direct material, labor and overhead. If a loss on a contract is estimated, the full amount of the loss is recognized immediately. We allocate costs to all technology contracts based upon actual costs incurred including an allocation of certain research and development costs incurred.

l. *Warranty Reserves*

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

m. *Shipping and Handling Costs*

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

n. *Advertising Expenses*

Advertising costs are expensed as incurred and are included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations. Such expenses amounted to $443, $320, and $248 for the years ended December 31, 2007, 2006 and 2005, respectively.

o. *Research and Development*

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

p. *Environmental Costs*

Environmental expenditures that relate to current operations are expensed or capitalized, as appropriate, in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 96-1, Environmental Remediation Liabilities . Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

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q. *Income Taxes*

The asset and liability method, prescribed by SFAS No. 109, Accounting for Income Taxes , is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. For the year ended December 31, 2007, we continued to recognize a full valuation allowance on our net deferred tax asset, based on a consistent evaluation methodology that was used for 2006 and due to the determination that it was more likely than not that we would not be able to utilize these benefits in the future. A valuation allowance is required when it is more likely than not that the recorded value of a deferred tax asset will not be realized. Because evidence, such as our operating results during the most recent historical periods excluding the gain on the McDowell settlement, is afforded more weight than forecasted results for future periods, our cumulative loss during our most recent three-year period represents sufficient negative evidence regarding the need for a full valuation allowance under SFAS No. 109. For the year ended December 31, 2006, we recorded a full valuation allowance on our net deferred tax asset, due to the determination that it was more likely than not that we would not be able to utilize these benefits in the future. For the year ended December 31, 2005, our balance sheet reflected a balance of $23,729 associated with our net deferred tax asset, arising from our conclusion that it was more likely than not that we would be able to utilize our U.S. NOLs that had accumulated over time. A valuation allowance was required for the years ended December 31, 2007, 2006 and 2005 related to our U.K. subsidiary and the history of losses at that facility.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109 (FIN 48). This statement clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 were effective for fiscal years beginning after December 15, 2006. The adoption of this pronouncement on January 1, 2007 had no significant impact on our financial statements.

r. *Concentration Related to Customers and Suppliers*

We have three major customers, the U.S. Department of Defense, that comprised 14%, 20%, and 25% of our revenue in the years ended December 31, 2007, 2006 and 2005, respectively, the U.K. Ministry of Defence, that comprised 12%, 7%, and 6% of our revenue in the years ended December 31, 2007, 2006 and 2005, respectively, and Raytheon Company, that comprised 13%, 3%, and 1% of our revenue in the years ended December 31, 2007, 2006 and 2005, respectively. There were no other customers that comprised greater than 10% of our total revenues in those years.

We have two customers that comprised 42% of our trade accounts receivables as of December 31, 2007. There were no other customers that comprised greater than 10% of our total trade accounts receivables as of December 31, 2007. We have one customer that comprised 22% of our trade accounts receivable as of December 31, 2006. There were no other customers that comprised greater than 10% of our total trade accounts receivable as of December 31, 2006.

Currently, we do not experience significant seasonal trends in non-rechargeable product revenues. However, a downturn in the U.S. economy, which affects retail sales and which could result in fewer sales of smoke detectors to consumers, could potentially result in lower sales for us to this market segment. The smoke detector OEM market segment comprised approximately 12% of total non-rechargeable revenues in 2007. Additionally, a lower demand from the U.S., U.K. and other foreign governments could result in lower sales to military and government users.

We generally do not distribute our products to a concentrated geographical area nor is there a significant concentration of credit risks arising from individuals or groups of customers engaged in similar activities, or who have similar economic characteristics. While sales to the U.S. Department of Defense have been substantial during 2007, 2006 and 2005, we do not consider this customer to be a significant credit risk. We do not normally obtain collateral on trade accounts receivable.

Certain materials and components used in our products are available only from a single or a limited number of suppliers. As such, some materials and components could become in short supply resulting in limited availability and/or increased costs. Additionally, we may elect to develop relationships with a single or limited number of suppliers for materials and components that are otherwise generally available. Although we believe that alternative suppliers are available to supply materials and components that could replace materials and components currently used and that, if necessary, we would be able to redesign our products to make use of such alternatives, any interruption in the supply from any supplier that serves as a sole source could delay product shipments and have a material adverse effect on our business, financial condition and results of operations. We have experienced interruptions of product deliveries by sole source suppliers in the past. For example, in the fourth quarter of 2007, we ramped up production levels in our Communications Systems business to meet increased order volumes. A sole-source supplier of a key component was unable to meet an agreed-upon delivery schedule which caused a delay in shipments of our products to our customers.

s. *Fair Value of Financial Instruments*

SFAS No. 107, Disclosure About Fair Value of Financial Instruments , requires disclosure of an estimate of the fair value of certain financial instruments. The fair value of financial instruments pursuant to SFAS No. 107 approximated their carrying values at December 31, 2007 and 2006. Fair values have been determined through information obtained from market sources.

t. *Derivative Financial Instruments*

Derivative instruments are accounted for in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities which requires that all derivative instruments be recognized in the financial statements at fair value. The fair value of our interest rate swap at December 31, 2007 and 2006 resulted in an asset of $4 and $76, respectively, all of which was reflected as short term.

u. *Earnings (Loss) Per Share*

We account for earnings (loss) per common share in accordance with the provisions of SFAS No. 128, Earnings Per Share . SFAS No. 128 requires the reporting of basic and diluted earnings per share (EPS). Basic EPS is computed by dividing reported earnings available to common shareholders by weighted average shares outstanding for the period. Diluted EPS includes the dilutive effect of securities, if any, calculated using the treasury stock method. There were 1,573,325 outstanding stock options, warrants and restricted stock awards as of December 31, 2007 that were not included in EPS as the effect would be anti-dilutive. We also had 966,667 shares of common stock at December 31, 2007 reserved under convertible notes payable, which were not included in EPS as the effect would be anti-dilutive. The dilutive effect of 392,041 outstanding stock options, warrants and restricted stock awards was included in the dilution computation for the year ended December 31, 2007. There were 1,915,471 and 1,516,906 outstanding stock options, warrants and restricted stock awards as of December 31, 2006 and 2005, respectively, that were not included in EPS as the effect would be anti-dilutive. We also had 1,333,333 and -0- shares of common stock at December 31, 2006 and 2005, respectively reserved under convertible notes payable, which were not included in EPS as the effect would be anti-dilutive. For these periods, diluted earnings (loss) per share were the equivalent of basic earnings (loss) per share due to the net loss. (See Note 7)

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

	Year Ended December 31,		
	2007	2006	2005
Net Income (Loss) (a)	$ 5,583	$(27,488)	$ (4,345)
Effect of Dilutive Securities:			
Stock Options / Warrants			
Restricted Stock Awards			
Net Income (Loss) Adjusted (b)	$ 5,583	$(27,488)	$ (4,345)
Average Shares Outstanding Basic (c)	15,316	14,906	14,511
Effect of Dilutive Securities:			
Stock Options / Warrants	222		
Restricted Stock Awards	19		
Average Shares Outstanding Diluted (d)	15,557	14,906	14,551
EPS Basic (a/c)	$ 0.36	$ (1.84)	$ (0.30)
EPS Diluted (b/d)	$ 0.36	$ (1.84)	$ (0.30)

v. *Stock-Based Compensation*

We have various stock-based employee compensation plans, which are described more fully in Note 7. Effective January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R) requiring that compensation cost relating to share-based payment transactions be recognized in the financial statements. The cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity award). We adopted

SFAS 123R using the modified prospective method and, accordingly, did not restate prior periods presented in this Form 10-K to reflect the fair value method of recognizing compensation cost. Under the modified prospective approach, SFAS 123R applies to new awards, awards that were unvested as of January 1, 2006 and to awards that were outstanding on Ja