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ULTRALIFE BATTERIES INC  
Form 10-K/A  
April 14, 2003

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

FORM 10-K/A  
Amendment No. 1

/X/ Annual report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934 for the fiscal year ended June 30, 2002

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 (I.R.S. Employer  
incorporation or organization) Identification No.)

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

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

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

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

Title of Class  
-----  
Common Stock, par value \$0.10 per share

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  No

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.

On August 30, 2002, the aggregate market value of the Common Stock of Ultralife Batteries, Inc. held by non-affiliates of the Registrant was approximately \$36,000,000 based upon the closing price for such Common Stock as reported on the NASDAQ National Market System on August 30, 2002.

As of September 15, 2002, the Registrant had 13,142,829 shares of Common Stock outstanding, net of 27,250 treasury shares and 209,440 shares out of 700,000 shares owned by Ultralife Taiwan, Inc., a Taiwanese venture of which the Company owns approximately 30%.

DOCUMENTS INCORPORATED BY REFERENCE

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Part III Ultralife Batteries, Inc. Proxy Statement - With the exception of the items of the Proxy Statement relating to the December 12, 2002 Annual Meeting of Stockholders specifically incorporated by reference herein, the Proxy Statement is not deemed to be filed as part of this Report on Form 10-K.

### Introductory Note:

This Amendment No. 1 to Form 10-K for Ultralife Batteries, Inc. for the period ended June 30, 2002, dated as of April 11, 2003 is being filed to restate the financial statements and associated disclosures related to the manner in which the Company had previously accounted for its equity investment in Ultralife Taiwan, Inc. (UTI). The Items from the original Form 10-K filing that have been impacted are being filed in their entirety with this Amendment and are summarized in the following Table of Contents. (Refer to Note 2 to the consolidated financial statements included in Item 8 herein.)

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### ITEM 6.

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

	2002 (1)	2001	Year En
	-----	-----	---
	(As Restated)		
Statement of Operations Data:			
Revenues	\$ 32,515	\$ 24,163	\$
Cost of products sold	31,168	27,696	---
	-----	-----	---
Gross margin	1,347	(3,533)	---
	-----	-----	---
Research and development expenses	4,291	3,424	

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Selling, general and administrative expenses	7,949	8,009	
Impairment of long lived assets	14,318	--	
Loss on fires	--	--	
	-----	-----	
Total operating and other expenses	26,558	11,433	
Interest income, net	(291)	166	
Equity loss in UTI	(954)	(2,338)	
Gain on sale of securities	--	--	
Other income (expense), net	320	(124)	
	-----	-----	
Loss before income taxes	(26,136)	(17,262)	
Income taxes	--	--	
	-----	-----	
Net loss	\$ (26,136)	\$ (17,262)	\$ (
	=====	=====	=
Net loss per share, basic and diluted	\$ (2.11)	\$ (1.55)	\$
	=====	=====	=
Weighted average number of shares outstanding	12,407	11,141	
	=====	=====	
			Ju
	-----	-----	
	2002	2001	
	-----	-----	
Balance Sheet Data:			
Cash and available-for-sale securities	\$ 2,219	\$ 3,607	\$
Working capital	\$ 4,950	\$ 6,821	\$
Total assets	\$ 34,321	\$ 47,203	\$
Total long-term debt and capital lease obligations	\$ 103	\$ 2,648	\$
Stockholders' equity	\$ 25,422	\$ 37,453	\$

(1) Amounts have been restated. Refer to Note 2 to the consolidated financial statements included in Item 8 herein.

### 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 Annual 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 Annual 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 the Company's products and services, the successful commercialization of the Company's advanced rechargeable batteries, general economic conditions, government and environmental regulation, competition and customer strategies,

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technological innovations in the primary and rechargeable battery industries, changes in the Company's 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 the Company's 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 7.

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

### General

Ultralife Batteries, Inc. develops, manufactures and markets a wide range of standard and customized lithium primary (non-rechargeable) and rechargeable batteries for use in a wide array of applications. The Company believes that its technologies allow the Company to offer batteries that are flexibly configured, lightweight and generally achieve longer operating time than many competing batteries currently available. The Company has focused on manufacturing a family of lithium primary batteries for industrial, military and consumer applications, which it believes is one of the most comprehensive lines of lithium manganese dioxide primary batteries commercially available. The Company also supplies rechargeable and lithium ion batteries for use in portable electronic applications.

For several years, the Company has incurred net operating losses primarily as a result of funding research and development activities and, to a lesser extent, incurring manufacturing and selling, general and administrative costs. During fiscal 2002, the Company realigned its resources to bring costs more in line with revenues, moving the Company closer to its targets of operating cash breakeven and profitability. In addition, the Company refined its rechargeable strategy to allow it to be more effective in the marketplace.

The Company believes that its current growth strategy will be successful in the long-term. However, at the present time, the status of the Company's cash and credit situation is of serious concern, and much of the Company's ability to succeed in the near-term is dependent upon continued revenue growth and a favorable product mix that will generate cash. If the Company is unsuccessful in growing the business sufficiently in the near-term to generate adequate levels of cash, it will need to find alternative sources of funds to allow it to continue to operate in its current capacity. Some possible funding alternatives include obtaining additional debt, issuing equity or selling assets. While the Company has been successful at raising funds in the past and is optimistic that it will be able to do so again if necessary, there is no assurance that the Company will be able to do so under the current circumstances.

The Company reports its results in four operating segments: Primary Batteries, Rechargeable Batteries, Technology Contracts and Corporate. The Primary Batteries segment includes 9-volt, cylindrical and various other non-rechargeable specialty batteries. The Rechargeable Batteries segment includes the Company's lithium polymer and lithium ion rechargeable batteries. The Technology Contracts segment includes revenues and related costs associated with various government and military development contracts. The Corporate segment consists of all other items that do not specifically relate to the three other segments and are not considered in the performance of the other segments.

Currently, the Company does not experience significant seasonal trends in primary battery revenues and does not have enough sales history on the rechargeable batteries to determine if there is seasonality.

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### Results of Operations

Fiscal Year Ended June 30, 2002 Compared With the Fiscal Year Ended June 30, 2001 (As Restated; See Note 2)

Revenues. Total revenues of the Company increased \$8,352,000 from \$24,163,000 for the year ended June 30, 2001 to \$32,515,000 for the year ended June 30, 2002. Primary battery sales increased \$9,229,000, from \$22,105,000 for the year

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ended June 30, 2001 to \$31,334,000 for the year ended June 30, 2002. The increase in primary battery sales was primarily due to growth in cylindrical battery sales, particularly to military customers, and higher 9-volt battery sales. Rechargeable battery sales increased modestly from \$370,000 for the year ended June 30, 2001 to \$445,000 for the year ended June 30, 2002, as the Company broadened its strategy in the latter portion of fiscal 2002 from simply selling polymer batteries it manufactures to selling a rechargeable "solution" that encompasses sourcing cells from other lithium battery manufacturers and assembling them to meet customer needs. Technology contract revenues decreased \$952,000, from \$1,688,000 to \$736,000 due to the scheduled reduction of certain nonrenewable government contracts, which concluded in fiscal 2002.

Cost of Products Sold. Cost of products sold increased \$3,472,000, from \$27,696,000 for the year ended June 30, 2001 to \$31,168,000 for the year ended June 30, 2002. Consolidated cost of products sold as a percentage of total revenue improved from approximately 115% to 96% for the year ended June 30, 2002. Consolidated gross margins improved from a negative 15% in fiscal 2001 of sales to a positive 4% in fiscal 2002.

In October and November 2001, the Company realigned its resources to address changing market conditions and to better meet customer demand in areas of the business that were growing. A majority of employees affected by this realignment were re-deployed from the Rechargeable segment and support functions into open direct labor positions in the Primary segment, due to the significantly growing demand for primary batteries from the military. Again in February 2002, the Company took further actions to reduce costs in its ongoing effort to improve liquidity and to bring costs more in line with current and near-term anticipated revenues. These cost reductions included employee terminations and salary reductions, discontinuance of certain employee benefits and other cost savings initiatives in general and administrative areas. Overall, the Company reduced its workforce by more than 20% during the year. Approximately one-half of these cost savings reduced cost of products sold, with the other half reducing R&D and selling, general and administrative costs. Severance costs associated with these actions were incurred in the period of the force reductions, although they were not material. In total, the actions taken during fiscal 2002 generated total cost savings of more than \$2,000,000 per quarter from the expense run rate that the Company experienced during its first quarter of fiscal 2002.

In the Primary battery segment, the cost of batteries sold increased \$5,318,000, from \$21,094,000 2001 to \$26,412,000 in 2002, mainly related to increased sales volume. As a percent of total primary battery sales, cost of primary products sold improved from 95% for the year ended June 30, 2001 to 84% for the year ended June 30, 2002, reflecting improved manufacturing efficiencies related to higher volumes and the impact from certain of the cost savings initiatives referred to above, as well as the ongoing positive effects from the implementation of lean manufacturing disciplines.

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In the Rechargeable battery segment, the cost of products sold decreased \$972,000 in fiscal 2002 from \$5,065,000 in fiscal 2001 to \$4,093,000 in 2002. During fiscal 2001, in anticipation of significant increases in rechargeable sales volume, the Company added resources to prepare for this expected growth. As economic conditions changed during fiscal 2002, the Company reacted and reduced its resources accordingly by realigning its resources and reducing manpower as described above. In general, the decrease in costs from 2001 to 2002 primarily resulted from the cost savings initiatives that were implemented during the year.

Technology contracts cost of sales decreased \$874,000, or approximately 57%, from \$1,537,000 for the year ended June 30, 2001 to \$663,000 for the year ended June 30, 2002, in line with the decrease in revenues. Technology contracts cost of sales as a percentage of revenue was 10% in 2002, consistent with the prior year.

Operating and Other Expenses. In June 2002, the Company recorded a fixed asset impairment charge of \$14,318,000. This impairment charge related to a writedown of long-lived assets in the Company's rechargeable production operations, reflecting a change in the Company's strategy. Changes in external economic conditions culminated in June 2002, reflecting a slowdown in the mobile electronics marketplace and a realization that near-term business opportunities utilizing the high volume rechargeable production equipment had dissipated. These changes caused the Company to shift away from high volume polymer rechargeable battery production to higher value, lower volume opportunities. The Company's redefined strategy eliminates the need for its high volume production line that had been built mainly to manufacture Nokia cell phone replacement batteries. The new strategy is a three-pronged approach. First, the Company will manufacture in-house for the higher value, lower volume polymer rechargeable opportunities. Second, the Company will utilize its affiliate in Taiwan, Ultralife Taiwan, Inc., as a source for both polymer and liquid lithium cells. Third, the Company will look to other rechargeable cell manufacturers as sources for cells that the Company can then assemble into completed battery packs. In the future, the impairment of the rechargeable fixed assets will result in lower depreciation charges of approximately \$1,800,000 per year.

Total operating and other expenses increased \$15,125,000 from \$11,433,000 for the year ended June 30, 2001 to \$26,558,000 for the year ended June 30, 2002. Excluding the impairment charge, operating and other expenses increased

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\$807,000, from \$11,433,000 in 2001 to \$12,240,000 in 2002, mainly as a result of higher research and development expenses. Operating and other expenses as a percentage of revenue, excluding the impairment charge, improved from 47% for the year ended June 30, 2001 to 38% for the year ended June 30, 2002. Research and development costs increased \$867,000, or 25% from \$3,424,000 for the year ended June 30, 2001 to \$4,291,000 for the year ended June 30, 2002. This increase was mainly due to higher costs related to the development of new cylindrical batteries for the military applications, as the Company focused more extensively on this significant market opportunity. R&D expenditures related to rechargeable battery development diminished during the year as a result of the cost savings actions discussed previously. The Company anticipates that R&D costs overall will decline significantly in fiscal 2003 as compared with 2002 due to the sizeable reduction in rechargeable development efforts and the expected near-term transition of the new cylindrical battery development to manufacturing during fiscal 2003.

Selling, general and administration expenses decreased \$60,000, approximately 1%, from \$8,009,000 for the year ended June 30, 2001 to \$7,949,000

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for the year ended June 30, 2002, even though revenues rose 35%. Selling and marketing expenses declined \$404,000 from fiscal 2001 to fiscal 2002 as a result of a more targeted sales coverage strategy using fewer resources and lower marketing and advertising costs. General and administrative expenses, on the other hand, rose \$344,000 as a result of higher insurance expenses and certain severance costs pertaining to an executive employment agreement incurred in conjunction with the Company's resource realignment during the second fiscal quarter.

Other Income (Expense). Interest income decreased \$611,000 from \$702,000 for the year ended June 30, 2001 to \$91,000 for the year ended June 30, 2002. This decrease is mainly the result of lower average balances of cash and investment securities, as well as lower interest rates. Interest expense decreased \$154,000 from \$536,000 in 2001 to \$382,000 in 2002 as a result of lower average balances of debt. Equity loss in Ultralife Taiwan, Inc. (UTI) was \$954,000 (as restated - refer to Note 2 to the consolidated financial statements) in Fiscal 2002 compared with a loss of \$2,338,000 in Fiscal 2001. The Fiscal 2002 results included a \$1,096,000 favorable adjustment recorded in July 2001 to correct cumulative net gains pertaining to the manner in which the Company accounted for this equity investment in Fiscal 2001 and Fiscal 2000. The Company determined that this cumulative adjustment was not significant enough to warrant a restatement for those periods. Miscellaneous income (expense) changed from an expense of \$124,000 in 2001 to income of \$320,000 in 2002, primarily as a result of unrealized gains on foreign currency transactions due mainly to the strengthening of the U.K. pounds sterling relative to the U.S. dollar.

Net Losses. The consolidated net loss for the year ended June 30, 2002 was \$26,136,000, or \$2.11 per share. Excluding the \$14,318,000 impairment charge for long-lived assets, the consolidated net loss improved \$5,444,000 from a loss of \$17,262,000, or \$1.55 per share, for the year ended June 30, 2001 to a loss of \$11,818,000, or \$0.95 per share, for the year ended June 30, 2002, primarily as a result of the reasons described above.

Fiscal Year Ended June 30, 2001 Compared With the Fiscal Year Ended June 30, 2000

Revenues. Total revenues of the Company decreased \$351,000 from \$24,514,000 for the year ended June 30, 2000 to \$24,163,000 for the year ended June 30, 2001. Primary battery sales increased \$265,000 from \$21,840,000 for the year ended June 30, 2000 to \$22,105,000 for the year ended June 30, 2001. The increase in primary battery sales was primarily due to the introduction of new cylindrical products in fiscal 2001 and an increase in 9-volt battery shipments related to higher demand. These increases were offset by a decline in sales from the UK subsidiary due to the delay in renewing a government contract. Rechargeable battery sales increased \$345,000 from \$25,000 for the year ended June 30, 2000 to \$370,000 for the year ended June 30, 2001, mainly as a result of the commercial launch of the Company's polymer batteries in June 2000 and shipments of retail and custom-sized batteries. Technology contract revenues decreased \$961,000, from \$2,649,000 to \$1,688,000 due to the scheduled reduction of certain nonrenewable government contracts. The Company expects revenues from technology contracts to continue to decline in fiscal 2002.

Cost of Products Sold. Cost of products sold increased \$2,184,000 from \$25,512,000 for the year ended June 30, 2000 to \$27,696,000 for the year ended June 30, 2001. Cost of products sold as a percentage of revenue increased from approximately 104% to 115% for the year ended June 30, 2001. Cost of primary batteries sold decreased \$1,990,000 from \$23,084,000, or 106% of revenues, for the year ended June 30, 2000 to \$21,094,000, or 95% of revenues, for the year ended June 30, 2001. The decrease in cost of primary batteries sold as a percentage of revenues was principally the result of improvements in the

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manufacturing process due to the implementation of lean manufacturing practices. To date, lean manufacturing practices in the primary battery segment have resulted in the reduction of inventory, quicker manufacturing throughput times and improvements in operating efficiencies throughout the Company. In fiscal 2001, the improvements in gross margins in the primary segment were offset by losses in the rechargeable segment. Rechargeable battery cost of products sold increased \$5,040,000 in fiscal 2001 due to the launch of commercial production of polymer rechargeable batteries in June 2000, which resulted in initial expenditures necessary to start production of the polymer cells,

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including approximately \$2,000,000 in additional depreciation for the year, as equipment was placed in service. Prior to commencing production of polymer cells, most of these costs, including engineering, were charged to research and development. Technology contracts cost of sales decreased \$866,000, or approximately 36%, from \$2,403,000 for the year ended June 30, 2000 to \$1,537,000 for the year ended June 30, 2001. Technology contracts cost of sales as a percentage of revenue was consistent year over year.

Operating and Other Expenses. Operating and other expenses decreased \$1,258,000 from \$12,691,000 for the year ended June 30, 2000 to \$11,433,000 for the year ended June 30, 2001. Operating and other expenses as a percentage of revenue decreased from approximately 52% to 47% for the year ended June 30, 2001. Of the Company's operating and other expenses, research and development expenses decreased \$1,882,000, or 36% from \$5,306,000 for the year ended June 30, 2000 to \$3,424,000 for the year ended June 30, 2001. Research and development expenses decreased due to the commercial launch of polymer rechargeable in June 2000, which shifted costs to cost of sales. Selling, general and administration expenses increased \$624,000, approximately 8%, from \$7,385,000 for the year ended June 30, 2000 to \$8,009,000 for the year ended June 30, 2001. Selling and marketing expenses increased as a result of new sales people added to significantly enhance the Company's overall market coverage.

Other Income (Expense). Net interest income decreased \$743,000 from \$909,000 for the year ended June 30, 2000 to \$166,000 for the year ended June 30, 2001. The decrease in interest income is the result of lower average balances on cash and investment securities which were used for operations. The equity loss of \$2,338,000 in fiscal 2001 and \$818,000 in fiscal 2000 resulted from the Company's ownership interest in its venture in Taiwan. The increase in the equity loss includes compensation expense related to a stock distribution to UTI employees totaling \$2,500,000. The Company recognized approximately \$900,000 equity loss for the transaction representing its share of the total UTI expense. The gain on sale of securities of \$3,147,000 in fiscal 2000 resulted from the sale of the Company's investment in Intermagnetics General Corporation common shares. No similar sale of securities occurred in 2001.

Net Losses. Net losses increased \$7,020,000, or approximately 69%, from \$10,242,000, or \$0.94 per share, for the year ended June 30, 2000 to \$17,262,000, or \$1.55 per share, for the year ended June 30, 2001, primarily as a result of the reasons described above.

### Liquidity and Capital Resources

As of June 30, 2002, cash equivalents and available for sale securities totaled \$2,018,000, excluding restricted cash of \$201,000. During the year ended June 30, 2002, the Company used \$8,199,000 of cash in operating activities as compared to \$10,406,000 for the year ended June 30, 2001. Cash used in operations in 2002 was mainly a result of the Company's reported net loss, net of non-cash items such as depreciation and impairment charges. Also during 2002,



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accounts receivable rose \$2,680,000 due to higher shipments made at the end of fiscal 2002. Compared with 2001, the \$2,207,000 improvement in cash used in operations was primarily a result of decreasing net losses net of non-cash expenses, offset in part by higher cash usage attributable to changes in working capital related to higher volumes of business. In the year ended June 30, 2002, the Company used \$2,330,000 to purchase plant, property and equipment, which was offset by proceeds from a sale leaseback of \$995,000. Of the \$2,330,000 of equipment purchases, \$1,884,000 related to the acquisition of machinery and equipment for the Company's primary battery operations, \$333,000 related to rechargeable battery machinery and equipment and the balance was substantially for facilities upgrades.

Months cost of sales in inventory at June 30, 2002 was 1.9 months as compared to 2.6 months at June 30, 2001. This metric is indicative of the Company's continuing focus to improve purchasing procedures and inventory controls. The Company's Days Sales Outstanding (DSOs) was an average of 57 days for 2002, compared with an average of 55 days for 2001. This modest slowdown in collections is mainly attributable to increased business with non-U.S. customers who typically take longer to pay than the U.S. customers.

At June 30, 2002, the Company had a capital lease obligation outstanding of \$118,000 for the Company's Newark, New York offices and manufacturing facilities. In addition, the Company had a capital lease on computer equipment, which had an outstanding balance of \$65,000 at June 30, 2002.

As of June 30, 2002, the Company had made commitments to purchase approximately \$171,000 of production machinery and equipment.

In June 2000, the Company entered into a 3-year, \$20,000,000 secured credit facility with a lending institution. The financing agreement consisted of an initial \$12,000,000 term loan component and a revolving credit facility component for an initial \$8,000,000 based on eligible net accounts receivable (as defined) and eligible net inventory (as defined). The amount available under the term loan component amortizes over time. Principal and interest are paid monthly on

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outstanding amounts borrowed. Initially, \$4,000,000 was borrowed under the term loan component in June 2000, and this amount is being repaid over a five-year period. Debt issue costs amounting to \$198,000 were incurred in connection with the initiation of the agreement and are being amortized over the term of the loan.

In December 2000 and June 2001, the Company and its commercial lender agreed to revise downward the adjusted net worth covenant to better reflect the Company's equity position at that particular time. In October 2001, this lending institution informed the Company that its borrowing availability under its \$20,000,000 credit facility had been effectively reduced to zero as a result of a recent appraisal of its fixed assets. In February 2002, the Company and its primary lending institution amended the credit facility. The amended facility was reduced to a total of \$15,000,000, mainly due to the reduction in the appraised valuation of fixed assets that limited the borrowing capacity under the term loan component, as well as to minimize the cost of unused line fees. Certain definitions were also revised which increased the Company's available borrowing base. In addition, the minimum net worth covenant was effectively reduced to approximately \$19,200,000 after adjustments for fixed asset impairment charges. At June 30, 2002, the Company was in compliance with this covenant. The term loan component was revised to an initial \$2,733,000 based on the valuation of the Company's fixed assets (of which \$2,468,000 was outstanding

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on the term loan at June 30, 2002). The principal associated with the term loan is continuing to be repaid over a 5-year amortization period from the initial date of the credit facility in June 2000. The revolving credit component of the overall credit facility comprises the remainder of the total potential borrowing capacity. There was no balance outstanding on the revolving credit facility as of June 30, 2002. If the credit facility, which expires in June 2003, is not extended by agreement of both the Company and the lending institution, the remaining principal under the term loan, and any amounts outstanding under the revolving credit facility, would become due at that time. Therefore, the Company has reflected its debt associated with this facility as a short-term liability on the Consolidated Balance Sheet. If the Company is unsuccessful in renegotiating this credit facility or is unable to refinance this debt with another lending institution, this could have a material adverse effect on the Company's business and financial position.

The loans bear interest at prime-based or LIBOR-based rates, at the discretion of the Company. At June 30, 2002, the rate was 5.75%. The Company also pays a facility fee on the unused portion of the commitment. The loan is secured by substantially all of the Company's assets and the Company is precluded from paying dividends under the terms of the agreement. The total amount available under the term loan component is reduced by outstanding letters of credit. The Company had \$3,800,000 outstanding on a letter of credit as of June 30, 2002, supporting the Company's \$4,000,000 equipment lease. The Company's additional borrowing capacity under the revolver component of the credit facility as of June 30, 2002 was approximately \$1,000,000.

In March 2001, the Company initiated a \$2,000,000 lease line of credit with a third party leasing agency. Under this arrangement, the Company had various options to acquire manufacturing equipment, including sales / leaseback transactions and operating leases. In October 2001, the Company expanded its leasing arrangement with a third party leasing agency. The revision increased the amount of the lease line from \$2,000,000 to \$4,000,000. The increase in the line was used to fund capital expansion plans for manufacturing equipment that has allowed increased capacity within the Company's Primary business unit. At June 30, 2002, the lease line had been fully utilized. The Company's quarterly lease payment is approximately \$226,000. In conjunction with this lease, the Company is required to maintain a \$3,800,000 letter of credit. The letter of credit was issued by the Company's primary lending institution, which diminishes the Company's overall borrowing availability under the revolver component of the overall credit facility. The Company is working to see if it can find alternatives to collateralize this letter of credit in order to alleviate this restriction. There can be no assurance that the Company will be successful in this pursuit.

While the Company is optimistic about its long-term future prospects and growth potential, the timing aspect of near-term revenue and profitability is unclear. The Company's future liquidity depends on its ability to successfully generate positive cash flows from operations and to achieve operational savings. At this time based on the current financial outlook, it appears that the Company may not generate the revenues necessary to allow it to continue to meet the current net worth covenant of the credit facility. To date, the Company and its lending institution have maintained a good relationship, and thus the Company is optimistic that it will be able to negotiate a further revision of the net worth covenant to better reflect the Company's current situation. There can be no assurance, however, that the Company will be successful in its endeavor to do so, and therefore, this situation could have a material adverse effect on the Company's financial position.

During the fiscal year ended June 30, 2002, the Company raised capital through two private equity transactions. First, in July 2001, the Company completed a \$6,800,000 private placement of 1,090,000 shares of its common stock at \$6.25 per share. In conjunction with the offering, warrants to acquire up to

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109,000 shares of common stock were granted. The exercise price of the warrants is \$6.25 per share and the warrants have a five-year term. The second transaction occurred in April 2002, when the Company closed on a \$3,000,000 private placement consisting of common equity and a \$600,000 convertible note. Initially, 801,333 shares were issued. The note, which was issued to one of the Company's directors, will

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convert automatically into an additional 200,000 shares if the Company's shareholders vote to approve the conversion of the note into common shares at the Company's Annual Meeting in December 2002. If shareholder approval is not obtained, the Company is obligated to repay the note on December 31, 2002, with accrued interest at 10% per year. All shares will be issued at \$3.00 per share.

The Company also is continuing to explore other sources of capital, including utilizing its unleveraged assets as collateral for additional borrowing capacity, selling assets that are not core to the Company's long-term strategic initiatives, and raising equity through a private or public offering. Although the Company is confident that it will be successful in arranging adequate financing, there can be no assurance that the Company will have sufficient cash flows to meet its working capital and capital expenditure requirements during the course of fiscal 2003. Therefore, this could have a material adverse effect on the Company's business, financial position and results of operations.

As described in Part I, Item 3, "Legal Proceedings", the Company is involved in certain environmental matters with respect to its facility in Newark, New York. Although the Company has reserved for expenses related to this, there can be no assurance that this will be the maximum amount. 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.

The Company typically offers warranties against any defects due to product malfunction or workmanship for a period up to one year from the date of purchase. The Company also offers a 10-year warranty on its 9-volt batteries that are used in ionization-type smoke detector applications. The Company provides 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 the Company's experiences a significant increase in warranty claims, there is no assurance that the Company's reserves are sufficient. This could have a material adverse effect on the Company's business, financial condition and results of operations.

### Outlook

Looking ahead for the full fiscal year of 2003, the Company is optimistic about its sales prospects and the status of the manufacturing operations. At this time, the Company expects to achieve revenue growth in a range comparable to the 35% growth rate it achieved during fiscal 2002. The Company is projecting growth in virtually all major product areas within its business - 9-volt, cylindrical and rechargeable. The growth in each of the quarters, however, is subject to significant fluctuations as the timing of customer orders is not easily predictable. In particular, 9-volt revenues are dependent upon continued demand from the Company's customers, some of which are dependent upon retail sell-through. Similarly, revenues from sales of cylindrical products, primarily to military customers, are dependent upon a variety of factors, including the timing of the battery solicitation process within the military, the Company's ability to successfully win contract awards, successful qualification of the

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Company's products in the applicable military applications, and the timing of order releases against such contracts. Some of these factors are outside of the Company's direct control.

For instance, in June 2002, the Company was awarded the top award, 60%, of the U.S. Army's Next Gen II 5-year procurement of Small Cylindrical Batteries. Orders on this contract, though, have yet to begin, and it is difficult to determine when such orders may start. In July 2002, the Company also submitted a proposal on the Large Cylindrical Battery procurement under the Next Gen II procurement. The Large Rectangular Battery solicitation for bids has yet to be issued by the U.S. Army. It is difficult to determine at this time when the U.S. Army will issue the solicitations or make any award decisions. While the Company is optimistic about its chances of winning a substantial portion of the contracts with this program, the ultimate outcome is uncertain. This solicitation process is significantly behind the original schedule mainly as a result of the U.S. government's diversion relating to the terrorist attacks on September 11, 2001. A significant portion of the Company's growth projections is dependent upon its success and participation in this Next Gen II program.

The Company believes that quarterly revenues of approximately \$9,000,000 to \$9,500,000 will allow it to achieve operating cash breakeven, depending on the Company's overall product mix. The Company also believes that quarterly revenues in the range of \$10,500,000 should allow the Company to be able to report a profit. While the Company has been able to significantly reduce costs during fiscal 2002, it still maintains a fairly substantial fixed cost infrastructure to support its overall operations. Increasing volumes of sales and production will generate very favorable returns to scale, but similarly, decreasing volumes will result in the opposite effect.

In June 2002, the Company reported a \$14,318,000 impairment charge. This impairment charge related to a writedown of long-lived assets in the Company's rechargeable production operations, reflecting a change in the Company's strategy. Changes in external economic conditions culminated in June 2002, reflecting a slowdown in the mobile electronics marketplace and a realization that near-term business opportunities utilizing the high volume rechargeable

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production equipment had dissipated. These changes caused the Company to shift away from high volume polymer rechargeable battery production to higher value, lower volume opportunities. The Company's redefined strategy eliminates the need for its high volume production line that had been built mainly to manufacture Nokia cell phone replacement batteries. The new strategy is a three-pronged approach. First, the Company will manufacture in-house for the higher value, lower volume polymer rechargeable opportunities. Second, the Company will utilize its affiliate in Taiwan, Ultralife Taiwan, Inc., as a source for both polymer and liquid lithium cells. Third, the Company will look to other rechargeable cell manufacturers as sources for cells that the Company can then assemble into completed battery packs. The Company is optimistic that this broadened strategy can be a successful, although modest, aspect of its growth for fiscal 2003.

As a result of the cost savings actions taken during fiscal 2002 that significantly impacted the Rechargeable segment, and the decline of development efforts related to new cylindrical batteries for military applications as those products move into anticipated volume production, the Company expects that its costs related to research and development will decline substantially in fiscal 2003 when compared with fiscal 2002.

The Company expects that spending for capital projects in fiscal 2003 will

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be relatively modest. The Company carefully evaluates such projects and will only make capital investments when necessary and when there is typically a very quick payback. Some of the capital equipment acquisitions during the upcoming fiscal year will be financed by the capital equipment grant/loan the Company recently finalized.

### Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company will adopt SFAS No. 143 in the fiscal year beginning July 1, 2002 and is currently evaluating the effect, if any, on the Company's financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". SFAS No. 144 applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principle Board Opinion No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The Company will adopt SFAS No. 144 in the fiscal year beginning July 1, 2002. The Company does not believe adoption of this pronouncement will have a material adverse effect on its financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. The Company will adopt SFAS No. 146 in the fiscal year beginning July 1, 2002. The Company does not believe the adoption of this pronouncement will have a material adverse effect on its financial statements.

### Risk Factors

#### Dependence on Continued Demand for the Company's Existing Products

A substantial portion of the Company's business depends on the Continued demand for products sold by OEMs using the Company's batteries. Therefore, the Company's success is substantially dependent upon the success of the OEMs' products in the marketplace. The Company is subject to many risks beyond its control that influence the success or failure of a particular product manufactured by an OEM, including: competition faced by the OEM in its particular industry, market acceptance of the OEM's product, the engineering, sales, marketing and management capabilities of the OEM, technical challenges unrelated to the Company's technology or products faced by the OEM in developing its products, and the financial and other resources of the OEM.

For instance, in fiscal 2002, 59% of the Company's revenues were comprised of sales of its 9-volt batteries, and of this, approximately 30% pertained to sales to smoke alarm OEMs in the U.S. If the retail demand for long-life smoke detectors decreases significantly, this could have a material adverse effect on the Company's business, financial condition and results of operations.

Similarly, in fiscal 2002, 19% of the Company's revenues was comprised of sales of cylindrical batteries, and of this, approximately 62% pertained to sales made directly or indirectly to the U.S. military. If the demand for cylindrical batteries from the U.S. military were to decrease significantly, this could have a material adverse effect on the Company's business, financial condition and results of operations.

#### Uncertainty of the Company's Rechargeable Battery Business

Although the Company is in production of certain rechargeable cells and batteries, it has not achieved wide market acceptance. The Company cannot assure that volume acceptance of its rechargeable products will occur due to the highly competitive nature of the business. There are many new company and technology entrants into the marketplace and the Company must continually reassess the market segments in which its products can be successful and seek to engage customers in these segments who will adopt the Company's products for use in their products. In addition, these companies must be successful with their products in their markets for the Company to gain increased business. Increased competition, failure to gain customer acceptance of products or failure of the Company's customers in their markets could have a further adverse affect on the Company's rechargeable battery business.

#### Risks Relating to Growth and Expansion

Rapid growth of the Company's battery business could significantly strain management, operations and technical resources. If the Company is successful in obtaining rapid market growth of its batteries, the Company will be required to deliver large volumes of quality products to customers on a timely basis at a reasonable cost to those customers. For example, significantly large orders from the U.S. military for the Company's cylindrical products may strain the current capacity capabilities of the Company and would require time to install additional equipment and build a sufficient support infrastructure. The Company cannot assure, however, that business will rapidly grow or that its efforts to expand manufacturing and quality control activities will be successful or that the Company will be able to satisfy commercial scale production requirements on a timely and cost-effective basis. The Company will also be required to continue to improve its operations, management and financial systems and controls. The failure to manage growth effectively could have an adverse effect on business, financial condition and results of operations.

#### Dependence on U.S. Military Procurement of Batteries

The Company will continue to develop both primary and rechargeable battery products to meet the needs of the U.S. military forces. The Company believes it has a high probability for success in solicitations for these batteries. Any delay of solicitations by, or failure of, the U.S. government to purchase batteries manufactured by the Company could have a material adverse effect on the Company's business, financial condition and results of operations.

#### Risks Related to Competition and Technological Obsolescence

The Company also competes with large and small manufacturers of alkaline, carbon-zinc, seawater, high rate and primary batteries as well as other

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manufacturers of lithium batteries. The Company cannot assure that it will successfully compete with these manufacturers, many of which have substantially greater financial, technical, manufacturing, distribution, marketing, sales and other resources.

The market for the Company's products is characterized by changing technology and evolving industry standards, often resulting in product obsolescence or short product lifecycles. Although the Company believes that its batteries, particularly the 9-volt and advanced rechargeable batteries, are comprised of state-of-the-art technology, there can be no assurance that competitors will not develop technologies or products that would render the Company's technology and products obsolete or less marketable.

**Primary Batteries** - The primary (non-rechargeable) battery industry is characterized by intense competition with a number of companies offering or seeking to develop products similar to the Company's. The Company is subject to competition from manufacturers of primary batteries, such as carbon-zinc, alkaline and lithium batteries in various configurations, including 9-volt, AAA, AA, C, D, 2/3 A and other cell sizes. Manufacturers of primary batteries include The Gillette Company (Duracell), Energizer Holdings, Inc., Rayovac Corp., Sanyo Electric Co. Ltd., Sony Corp., and

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Matsushita Electric Industrial Co., Ltd. (Panasonic). Manufacturers of specialty lithium batteries include Saft, Eagle Picher Industries and Friwo Silberkraft GmbH.

Many of these companies have substantially greater resources than the Company, and some have the capacity and volume of business to be able to produce their products more efficiently than the Company at the present time. In addition, these companies are developing batteries using a variety of battery technologies and chemistries that are expected to compete with the Company's technology. If these companies successfully market their batteries before the introduction of the Company's products, there could be a material adverse effect on its business, financial condition and results of operations.

**Rechargeable Batteries** - The rechargeable battery industry is also characterized by intense competition with a large number of companies offering or seeking to develop technology and products similar to the Company's. The Company is subject to competition from manufacturers of traditional rechargeable batteries, such as nickel-cadmium batteries, from manufacturers of rechargeable batteries of more recent technologies, such as nickel-metal hydride, lithium ion liquid electrolyte and lithium polymer batteries, as well as from companies engaged in the development of batteries incorporating new technologies. Manufacturers of nickel-cadmium and/or nickel-metal hydride batteries include Sanyo Electric Co. Ltd., Sony Corp., Toshiba Corp., Saft and Matsushita Electric Industrial Co., Ltd. (Panasonic), among others. Manufacturers of lithium ion liquid electrolyte batteries currently include Saft-Soc des ACC, Sony Corp., Toshiba Corp., Matsushita Electric Industrial Co., Ltd., Sanyo Electric Co. Ltd., Sony Corp., E-One Moli Energy Ltd., BYD Co. Ltd., Samsung SDI Co., Ltd., Shenzhen B&K Electronic Co. Ltd., and Ultralife Taiwan, Inc., among others. Manufacturers of lithium polymer batteries currently include Valence Technology, Inc., Sony Corp., Amperex Technology Ltd., Danionics A/S, Finecell Co. Ltd., LG Chemical, Ltd., SKC, Samsung SDI Co., Ltd., Ultralife Taiwan, Inc., and Kokam Engineering Co., Ltd.

Many companies with substantially greater resources are developing a variety of battery technologies, including liquid electrolyte lithium and solid electrolyte lithium batteries, which are expected to compete with the Company's

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technology. Other companies undertaking research and development activities of solid-polymer batteries have already developed prototypes and are constructing commercial scale production facilities. If these companies successfully market their batteries before the introduction of the Company's products, there could be a material adverse effect on its business, financial condition and results of operations.

### Dependence on Key Personnel

Because of the specialized, technical nature of the business, the Company is highly dependent on certain members of management, marketing, engineering and technical staff. The loss of these services or these members, could have a material adverse effect on the business, financial condition and results of operations. In addition to developing manufacturing capacity to produce high volumes of our advanced rechargeable batteries, the Company must attract, recruit and retain a sizeable workforce of technically competent employees. The Company's ability to pursue effectively its 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. The Company cannot assure that it will be able to retain or recruit this type of personnel.

### Safety Risks; Demands of Environmental and Other Regulatory Compliance

Due to the high energy density inherent in lithium batteries, the Company's batteries can pose safety certain risks, including the risk of fire. Although the Company incorporates safety procedures in research, development and manufacturing processes that are designed to minimize safety risks, the Company cannot assure that accidents will not occur. Although the Company currently carries 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. These types of losses could have a material adverse effect on the business, financial condition and results of operations.

National, state and local laws impose various environmental controls on the manufacture, storage, use and disposal of lithium batteries and/or of certain chemicals used in the manufacture of lithium batteries. Although the Company believes that its 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 the present or former facilities or at facilities to which it has sent waste for disposal, there can be no assurance that changes in such laws and regulations will not impose costly compliance requirements on the Company or otherwise subject it to future liabilities. Moreover, state and local governments may enact additional restrictions relating to the disposal of lithium batteries used by customers which could have a material adverse effect on business, financial condition and

results of operations. In addition, the U.S. Department of Transportation and certain foreign regulatory agencies that consider lithium to be a hazardous material regulate the transportation of batteries which contain lithium metal. The Company currently ships lithium batteries in accordance with regulations established by the U.S. Department of Transportation. 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



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regulations will affect the Company or its customers.

In connection with our purchase/lease of the Newark, New York facility in 1998, 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. The Company retained an engineering firm which estimated that the cost of remediation should be in the range of \$230,000. This cost, however, is merely an estimate and the cost may in fact be much higher. In February 1998, the Company entered into an agreement with a third party which provides that the Company 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 the Company for fifty percent of the cost of correcting the environmental concern on the Newark property. The Company has fully reserved for its portion of the estimated liability. Test sampling was completed in the spring of 2001. The next step is for the Company to submit a remediation plan for approval. Upon approval, the Company would have the authority to remediate the property. Because this is a voluntary remediation, there is no requirement for the Company to complete the project within any specific time frame. The Company cannot assure that it will not face claims resulting in substantial liability which would have a material adverse effect on the business, financial condition and results of operations in the period in which such claims are resolved.

### Limited Sources of Supply

Certain materials used in products are available only from a single or a limited number of suppliers. Additionally, the Company may elect to develop relationships with a single or limited number of suppliers for materials that are otherwise generally available. Although the Company believes that alternative suppliers are available to supply materials that could replace materials currently used and that, if necessary, the Company would be able to redesign its 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 the business, financial condition and results of operations. Although the Company has experienced interruptions of product deliveries by sole source suppliers, these interruptions have not had a material adverse effect on the business, financial condition and results of operations. The Company cannot guarantee that it will not experience a material interruption of product deliveries from sole source suppliers.

### Dependence on Proprietary Technologies

The Company's success depends more on the knowledge, ability, experience and technological expertise of its employees than on the legal protection of patents and other proprietary rights. The Company claims proprietary rights in various unpatented technologies, know-how, trade secrets and trademarks relating to products and manufacturing processes. The Company 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 the Company's technology. The Company protects its proprietary rights in its 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. The Company, however, has had patents issued and patent applications pending in the U.S. and elsewhere. The Company cannot assure (i) that patents will be issued from any pending applications, or that the claims allowed under any patents will be sufficiently broad to protect its technology, (ii) that any patents issued to the Company will not be challenged, invalidated or circumvented, or (iii) as to the degree or adequacy of protection any patents or patent applications may or

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will afford. If the Company is found to be infringing third party patents, there can be no assurance that it 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.

### Dependence on Technology Transfer Agreements

The Company's research and development of advanced rechargeable battery technology and products utilizes internally-developed technology, acquired technology and certain patents and related technology licensed by the Company pursuant to non-exclusive, technology transfer agreements. There can be no assurance that competitors will not develop, independently or through the use of similar technology transfer agreements, rechargeable battery

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technology or products that are substantially equivalent or superior to the technologies and products currently under research and development.

### Risks Related to China Joint Venture Program

In July 1992, the Company entered into several agreements related to the establishment of a manufacturing facility in Changzhou, China, for the production and distribution in and from China of 2/3A lithium primary batteries. Changzhou Ultra Power Battery Co., Ltd., a company organized in China ("China Battery"), purchased certain technology, equipment, training and consulting services relating to the design and operation of a lithium battery manufacturing plant. China Battery was required to pay approximately \$6.0 million to the Company over the first two years of the agreement, of which approximately \$5.6 million has been paid. The Company has been attempting to collect the balance due under this contract. China Battery has indicated that it will not make these payments until certain contractual issues have been resolved. Due to China Battery's questionable willingness to pay, the Company wrote off in fiscal 1997 the entire balance owed as well as its investment aggregating \$805,000. Since China Battery has not purchased technology, equipment, training or consulting services to produce batteries other than 2/3 A lithium batteries, the Company does not believe that China Battery has the capacity to become a competitor. The Company does not anticipate that the manufacturing or marketing of 2/3 A lithium batteries will be a substantial portion of its product line in the future. However, in December 1997, China Battery sent a letter demanding reimbursement of an unspecified amount of losses they have incurred plus a refund for certain equipment that was sold to China Battery. The Company has attempted to initiate negotiations to resolve the dispute. However, an agreement has not yet been reached. Although China Battery has not taken any additional steps, there can be no assurance that China Battery will not further pursue such a claim which, if successful, could have a material adverse effect on the business, financial condition and results of operations. The Company believes that such a claim is without merit.

### Ability to Insure Against Losses

Because certain of the Company's primary batteries are used in a variety of security and safety products and medical devices, it may be exposed to liability claims if such a battery fails to function properly. The Company maintains what it believes to be sufficient liability insurance coverage to protect against potential claims; however, there can be no assurance that the liability insurance will continue to be available, or that any such liability insurance would be sufficient to cover any claim or claims.

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### Quarterly Fluctuations in Operating Results and Possible Volatility of Stock Price

The Company's future operating results may vary significantly from quarter to quarter depending on factors such as the timing and shipment of significant orders, new product introductions, delays in customer releases of purchase orders, the mix of distribution channels through which the Company sells its products and general economic conditions. Frequently, a substantial portion of the Company's revenues in each quarter is generated from orders booked and shipped 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 the Company has a sizeable base of fixed overhead costs that do not vary much with the changes in revenue. In addition to the uncertainties of quarterly operating results, future announcements concerning the Company or its competitors, including technological innovations or commercial products, litigation or public concerns as to the safety or commercial value of one or more of its products, may cause the market price of its Common Stock to fluctuate substantially for reasons which may be unrelated to 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.

### Risks Related to Product Warranty Claims

The Company typically offers warranties against any defects due to product malfunction or workmanship for a period up to one year from the date of purchase. The Company also offers a 10-year warranty on its 9-volt batteries that are used in ionization-type smoke detector applications. The Company provides 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 the Company's experiences a significant increase in warranty claims, there is no assurance that the Company's reserves are sufficient. This could have a material adverse effect on the Company's business, financial condition and results of operations.

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### Risks Related to Company's Ability to Finance Ongoing Operations and Projected Growth

While the Company believes that its revenue growth projections and its ongoing cost controls will allow it to generate cash and achieve profitability in the foreseeable future, there is no assurance as to when or if the Company will be able to achieve its projections. The Company's future cash flows from operations, combined with its accessibility to cash and credit, may not be sufficient to allow the Company to finance ongoing operations or to make required investments for future growth. The Company may need to seek additional credit or access capital markets for additional funds. There is no assurance that the Company would be successful in this regard.

### Risks Related to Maintaining Debt Obligations

The Company has certain debt covenants that must be maintained, most notably a requirement with its primary lending institution to meet certain levels of net worth. There is no assurance that the Company will be able to continue to meet these debt covenants in the future. If the Company defaults on any of its debt covenants and it is unable to renegotiate credit terms in order to comply with such covenants, this could have a material adverse effect on the

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business, financial condition and results of operations.

In June 2003, the Company's credit facility with its primary lending institution is scheduled to expire. There is no assurance that the Company will be successful in refinancing this credit facility.

### Risks Related to Arthur Andersen LLP Being our Past Auditors

There may be no effective remedy against Arthur Andersen LLP in connection with a material misstatement or omission in the financial statements audited by them, due to the fact that Arthur Andersen LLP was convicted on June 15, 2002 of federal obstruction of justice arising from the government's investigation of Enron Corp.

Arthur Andersen LLP consented to the inclusion of their report in the annual reports and registration statements we filed prior to June 30, 2002. Our inability to include in future registration statements or reports financial statements for one or more years audited by Arthur Andersen LLP or to obtain Arthur Andersen LLP's consent to the inclusion of their report on our 2000 and 2001 financial statements may impede our access to the capital markets.

Should we seek to access the public capital markets, Securities and Exchange Commission (SEC) rules will require us to include or incorporate by reference in any prospectus three years of audited financial statements. Until our audited financial statements for the fiscal year ending June 30, 2004 become available, the SEC's current rules would require us to present audited financial statements for one or more fiscal years audited by Arthur Andersen LLP. Prior to that time, the SEC may cease accepting financial statements audited by Arthur Andersen LLP, in which case we would be unable to access the public capital markets unless PricewaterhouseCoopers LLP, our current independent accounting firm, or another independent accounting firm, is able to audit the financial statements originally audited by Arthur Andersen LLP. In addition, as a result of the departure of our former engagement team leaders, Arthur Andersen LLP is no longer in a position to consent to the inclusion or incorporation by reference in any prospectus of their report on our audited financial statements for the years ended June 30, 2000 and June 30, 2001, and investors in any subsequent offerings for which we use their audit report will not be entitled to recovery against them under Section 11 of the Securities Act of 1933 for any material misstatements or omissions in those financial statements. Consequently, our financing costs may increase or we may miss attractive market opportunities if either our annual financial statements for 2000 and 2001 audited by Arthur Andersen LLP should cease to satisfy the SEC's requirements or those statements are used in a prospectus but investors are not entitled to recovery against our auditors for material misstatements or omissions in them.

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### 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 17.

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### Report of Independent Accountants

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

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Ultralife Batteries, Inc. and its subsidiary at June 30, 2002, and the results of their operations and their cash flows for the period ended June 30, 2002 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index 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 audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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 audit provides a reasonable basis for our opinion. The financial statements of the Company as of June 30, 2001 and for each of the two years in the period ended June 30, 2001 were audited by other independent accountants who have ceased operations. Those independent accountants expressed an unqualified opinion on those financial statements in their report dated August 16, 2001 (except with respect to the matter discussed in Note 14, as to which the date is December 12, 2001).

As discussed in Note 2 in the accompanying consolidated financial statements, the Company has restated its financial statements for the year ended June 30, 2002 related to its equity investment in UTI.

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Our original report dated August 2, 2002, contained a paragraph explaining that the Company's recurring losses from operations raised substantial doubt about the Company's ability to continue as a going concern. Subsequent to the date of our original report, the Company's financial outlook has improved significantly. Accordingly, our reissued report on the June 30, 2002 financial statements, as presented herein, does not contain such a paragraph.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Rochester, New York  
August 2, 2002, except for Note 2 for which the  
date is March 28, 2003

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THE FOLLOWING REPORT IS A COPY OF A REPORT PREVIOUSLY ISSUED BY ARTHUR ANDERSEN LLP. THIS REPORT HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP AND ARTHUR ANDERSEN LLP DID NOT CONSENT TO THE USE OF THIS REPORT IN THIS FORM 10-K. (THE REFERENCE TO NOTE 14 IN ARTHUR ANDERSEN'S DUAL DATING OF THEIR REPORT WAS A REFERENCE TO A "RECENT DEVELOPMENTS" FOOTNOTE IN THE FINANCIAL STATEMENTS INCLUDED IN THE FORM 10-K FOR WHICH THAT REPORT WAS ISSUED. SUCH FOOTNOTE IS NO LONGER APPLICABLE AND HAS BEEN OMITTED FROM THIS FORM 10-K.)

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Ultralife Batteries, Inc.:

We have audited the accompanying consolidated balance sheets of Ultralife Batteries, Inc. (a Delaware corporation) and subsidiary as of June 30, 2001 and 2000, and the related consolidated statements of operations, changes in shareholders' equity and accumulated other comprehensive income (loss) and cash flows for each of the three years in the period ended June 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ultralife Batteries, Inc. and subsidiary as of June 30, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

/s/ ARTHUR ANDERSEN LLP

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Rochester, New York

August 16, 2001 (except with respect to the matter discussed in Note 14, as to which the date is December 12, 2001)

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

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## ASSETS

### Current assets:

Cash and cash equivalents  
Restricted cash  
Available-for-sale securities  
Trade accounts receivable (less allowance for doubtful accounts  
of \$272 and \$262 at June 30, 2002 and 2001, respectively)  
Other receivables  
Inventories  
Prepaid expenses and other current assets

Total current assets

Property, plant and equipment

### Other assets:

Investment in affiliates  
Technology license agreements (net of accumulated  
amortization of \$1,268 and \$1,168 at June 30, 2002 and 2001,  
respectively)

Total Assets

## LIABILITIES AND SHAREHOLDERS' EQUITY

### Current liabilities:

Current portion of debt and capital lease obligations  
Accounts payable  
Accrued compensation  
Accrued vacation  
Other current liabilities

Total current liabilities

Long - term liabilities:

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Debt and capital lease obligations

Commitments and contingencies (Note 6)

### Shareholders' Equity :

Preferred stock, par value \$0.10 per share, authorized 1,000,000 shares;  
none outstanding

Common stock, par value \$0.10 per share, authorized 40,000,000 shares;  
issued - 13,379,519 and 11,488,186 at June 30, 2002 and 2001, respectively

Capital in excess of par value

Accumulated other comprehensive income (loss)

Accumulated deficit

Less -- Treasury stock, at cost -- 27,250 shares

Total shareholders' equity

Total Liabilities and Shareholders' Equity

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

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

---

	2002 ----- (As Restated; See Note 2)
Revenues	\$ 32,515
Cost of products sold	31,168 -----
Gross margin	1,347
Operating and other expenses (income):	
Research and development	4,291
Selling, general, and administrative	7,949
Impairment of Long Lived Assets	14,318 -----
Total operating and other expenses, net	26,558
Operating loss	(25,211)
Other income (expense):	
Interest income	91



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Interest expense	(382)
Equity loss in UTI	(954)
Gain on sale of securities	--
Miscellaneous (expense) income	320
	-----
Loss before income taxes	(26,136)
Income taxes	--
	-----
Net loss	\$ (26,136)
	=====
Net loss per share, basic and diluted	\$ (2.11)
	=====
Weighted average number of shares outstanding, basic and diluted	12,407
	=====

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)

	Common Stock		Capital in excess of Par Value	Accumulated Other Comprehensive Income (Loss)	
	Number of Shares	Amount		Foreign Currency Translation Adjustment	Unrealized Net Gain on Securities
Balance as of June 30, 1999	10,512,386	\$ 1,051	\$ 93,605	\$ (101)	\$ 368
Comprehensive loss:					
Net loss					
Other comprehensive loss, net of tax:					
Foreign currency translation adjustments				(590)	
Unrealized net loss on securities					(366)
Other comprehensive loss					
Comprehensive loss					

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Shares issued to affiliate	700,000	70	3,168		
Shares issued under stock option plans and other stock options	197,900	20	2,017		
-----	-----	-----	-----	-----	-----
Balance as of June 30, 2000	11,410,286	\$ 1,141	\$ 98,790	\$ (691)	\$ 2
-----	-----	-----	-----	-----	-----

Comprehensive loss:

Net loss					
Other comprehensive loss, net of tax:					
Foreign currency translation adjustments				(368)	
Unrealized net loss on securities					(1)
Other comprehensive loss					

Comprehensive loss

Shares issued under stock option plans and other stock options	77,900	8	599		
-----	-----	-----	-----	-----	-----
Balance as of June 30, 2001	11,488,186	\$ 1,149	\$ 99,389	\$ (1,059)	\$ 1
-----	-----	-----	-----	-----	-----

Comprehensive loss:

Net loss					
Other comprehensive loss, net of tax:					
Foreign currency translation adjustments				202	
Unrealized net loss on securities					
Other comprehensive loss					

Comprehensive loss

Shares issued under private stock offerings	1,891,333	189	8,502		
UTI change in ownership transactions and other			5,212		
-----	-----	-----	-----	-----	-----
Balance as of June 30, 2002	13,379,519	\$ 1,338	\$113,103	\$ (857)	\$ 1
-----	-----	-----	-----	-----	-----

\* As Restated; See Note 2.

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

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(Dollars in Thousands)

	2002 ----- (As Restated See Note 2)
OPERATING ACTIVITIES	
Net loss	\$(26,136)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	4,265
Gain on sale of securities	--
Equity loss in UTI	954
Impairment to Long Lived Assets	14,318
Provision for loss on accounts receivable	10
Provision for inventory obsolescence	(4)
Changes in operating assets and liabilities:	
Accounts receivable	(2,680)
Inventories	660
Prepaid expenses and other current assets	803
Accounts payable and other current liabilities	(389)
	-----
Net cash used in operating activities	(8,199)
	-----
INVESTING ACTIVITIES	
Purchase of property, plant and equipment	(2,330)
Proceeds from Sale Leaseback	995
Purchase of securities	(8,424)
Sales of securities	11,334
Maturities of securities	--
	-----
Net cash provided by investing activities	1,575
	-----
FINANCING ACTIVITIES	
Proceeds from issuance of common stock	8,691
Proceeds from issuance of debt	600
Principal payments under long-term debt and capital leases	(1,062)
	-----
Net cash (used in) provided by financing activities	8,229
	-----
Effect of exchange rate changes on cash	(83)
	-----
Change in cash and cash equivalents	1,522
	-----
Cash and cash equivalents at beginning of period	494
	-----
Cash and cash equivalents at end of period	\$ 2,016
	=====
SUPPLEMENTAL CASH FLOW INFORMATION:	
Cash paid for interest	\$ 374
Cash paid for taxes	\$ --

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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

Ultralife Batteries, Inc. (the "Company") develops, manufactures and markets a wide range of standard and customized lithium primary (non-rechargeable) and rechargeable batteries for use in a wide array of applications. The Company believes that its technologies allow the Company to offer batteries that are flexibly configured, lightweight and generally achieve longer operating time than many competing batteries currently available. The Company has focused on manufacturing a family of lithium primary batteries for industrial, military and consumer applications, which it believes is one of the most comprehensive lines of lithium manganese dioxide primary batteries commercially available. The Company also supplies rechargeable and lithium ion batteries for use in portable electronic applications.

For several years, the Company has incurred net operating losses primarily as a result of funding research and development activities and, to a lesser extent, incurring manufacturing and selling, general and administrative costs. During fiscal 2002, the Company realigned its resources to bring costs more in line with revenues, moving the Company closer to its targets of operating cash breakeven and profitability. In addition, the Company refined its rechargeable strategy to allow it to be more effective in the marketplace.

The Company believes that its current growth strategy will be successful in the long-term. However, at the present time, the status of the Company's cash and credit situation is of serious concern, and much of the Company's ability to succeed in the near-term is dependent upon continued revenue growth and a favorable product mix that will generate cash. If the Company is unsuccessful in growing the business sufficiently in the near-term to maintain its viability, it may need to find alternative sources of funds to allow it to continue to operate in its current capacity, such as obtaining additional debt or equity or selling assets. While the Company has been successful at raising funds in the past, there is no assurance that it will be able to do so under the current circumstances.

##### 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 the Company and its wholly owned subsidiary, Ultralife Batteries UK, Ltd. ("Ultralife UK"). Intercompany accounts and transactions have been eliminated in consolidation. Investments in entities in which the Company does not have a controlling interest are accounted for using the equity 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

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disclosure of contingent assets and liabilities at year end and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### d. Cash Flows

For purposes of the Consolidated Statements of Cash Flows, the Company considers all demand deposits with financial institutions and financial instruments with original maturities of three months or less to be cash equivalents.

### e. Restricted Cash

The Company is required to maintain certain levels of escrowed cash in order to comply with the terms of some of its debt and lease agreements. All cash is retained for application against required escrows for debt obligations, including certain letters of credit supporting lease obligations and any excess borrowings from the Company's revolving credit facility. A portion of the restricted cash pertaining to certain lease obligations is released periodically as payments are made to reduce outstanding debt. With respect to the Company's revolving credit

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facility, the Company's primary lending institution will restrict cash if the borrowing base (consisting of receivables and inventory) does not sufficiently cover the outstanding borrowings on any particular day. As of June 30, 2002, the Company had \$201 in restricted cash with a certain lending institution primarily for letters of credit supporting leases for a building and some computer equipment. There was no cash restricted at June 30, 2002 pertaining to the Company's revolving credit facility.

### f. Available-for-Sale Securities

Management determines the appropriate classification of securities at the time of purchase and re-evaluates such designation as of each balance sheet date. Marketable equity securities and debt securities are classified as available-for-sale. These securities are carried at fair value, with the unrealized gains and losses, net of tax, included as a component of accumulated other comprehensive income.

The amortized cost of debt securities classified as available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization is included in interest income. The cost of securities sold is based on the specific identification method. Interest on securities classified as available-for-sale is included in interest income. Realized gains and losses, and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in the determination of net income (loss) as gains (losses) on sale of securities.

### g. Inventories

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

### h. Property, Plant and Equipment

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

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Buildings	20 years
Machinery and Equipment	5 - 10 years
Furniture and Fixtures	3 - 7 years
Computer Hardware and Software	3 - 5 years
Leasehold Improvements	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 sold, the cost and accumulated depreciation applicable to assets retired are removed from the accounts and the gain or loss on disposition is recognized in other income (expense).

### i. Long-Lived Assets and Intangibles

In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", the Company reviews its long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable on an undiscounted cash flow basis. The statement also requires that when an impairment has occurred, long-lived assets and certain identifiable intangibles to be disposed of be reported at the lower of carrying amount or fair value, less cost to sell. The Company recorded an asset impairment of \$14,318 in connection with the fixed assets in its rechargeable business (see Note 3). The Company did not record any impairments of long-lived assets in 2001 or 2000.

### j. Technology License Agreements

Technology license agreements consist of the rights to patented technology and related technical information. The Company acquired a technology license agreement for an initial payment of \$1,000 in May 1994. Royalties are payable at a rate of 8% of the fair market value of each battery using the technology if the battery is sold or otherwise put into use by the Company. The royalties can be reduced under certain circumstances based on the terms of this agreement. The agreement is amortized using the straight-line method over 10 years. Amortization expense was \$100, \$100, and \$100 in 2002, 2001, and 2000, respectively.

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### k. Translation of Foreign Currency

The financial statements of the Company's foreign affiliates are translated into U.S. dollar equivalents in accordance with Statement of Financial Accounting Standards (SFAS) No. 52, "Foreign Currency Translation". Exchange gains or losses included in net loss for the years ended June 30, 2002, 2001 and 2000 were \$320, \$(155), and \$97, respectively.

### l. Revenue Recognition

Battery Sales - Revenues from the sale of batteries are recognized when products are shipped. A provision is made at that time for warranty costs expected to be incurred.

Technology Contracts - The Company recognizes revenue using the percentage of completion method based on the relationship of costs incurred to date to the total estimated cost to complete the contract. Elements of cost include direct

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material, labor and overhead. If a loss on a contract is estimated, the full amount of the loss is recognized immediately. The Company allocates costs to all technology contracts based upon actual costs incurred including an allocation of certain research and development costs incurred. Under certain research and development arrangements with the U.S. Government, the Company may be required to transfer technology developed to the U.S. Government. The Company has accounted for the contracts in accordance with SFAS No. 68, "Research and Development Arrangements". The Company, where appropriate, has recognized a liability for amounts that may be repaid to third parties, or for revenue deferred until expenditures have been incurred.

In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 101 "Revenue Recognition in Financial Statements". This guidance summarizes the SEC staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. This staff bulletin had no significant impact on the Company's revenue recognition policy or results of operations.

### m. Shipping and Handling Costs

Costs incurred by the Company related to shipping and handling are included in Cost of products sold. Amounts charged to customers pertaining to these costs are reflected as a contra-expense in Cost of products sold.

### 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 \$213, \$335 and \$64 for the years ended June 30, 2002, 2001 and 2000, respectively.

### o. Research and Development

Research and development expenditures are charged to operations as incurred.

### 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.

### q. Income Taxes

The 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 bases 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. The Company recorded no income tax benefit relating to the net operating loss generated during the years ended June 30, 2002, 2001 and 2000, and as such, the loss was offset by a valuation allowance. 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.

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### r. Concentration of Credit Risk

In fiscal 2002, three customers - Kidde Safety, the U.S. Army/CECOM, and UNICOR - accounted for approximately \$9.4 million of sales, which amounted to approximately 29% of total revenues of the Company. Sales of 9-volt batteries to Kidde Safety for use in long-life smoke detector applications amounted to \$3,400 in 2002, \$3,300 in 2001 and \$2,900 in 2000. The 2002 sales to Kidde represented more than 10% of the Company's consolidated revenues. Sales of BA-5368 batteries to UNICOR for use in pilot survival radio applications amounted to \$4,000 in 2002, \$1,200 in 2001 and none in 2000. The 2002 sales to UNICOR also represented more than 10% of the Company's consolidated revenues. Sales of BA-5372 batteries to the U.S. Army/CECOM, which are used as backup batteries in the military's communications radios, amounted to \$2,000 in 2002, \$1,200 in 2001 and \$500 in 2000. The Company believes that the loss of any of these customers could have a material adverse effect on the Company. The Company's relationship with these customers is good.

Currently, the Company does not experience significant seasonal trends in primary battery 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 Company sales to this market segment. The smoke detector OEM market segment comprised approximately 19% of total primary revenues in 2002. Additionally, a lower demand from the U.S. Government could result in lower sales to government users.

The Company generally does not distribute its 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. The Company does not normally obtain collateral on trade accounts receivable.

### 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 June 30, 2002, 2001 and 2000. Fair values have been determined through information obtained from market sources.

### t. Earnings Per Share

The Company accounts for net 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 calculated using the treasury stock method, if any. No dilution for common share equivalents is included in fiscal 2002, 2001 and 2000 as the effects would be anti-dilutive. For all years reported, diluted earnings per share were the equivalent of basic earnings per share due to the net loss. There were 2,562,640, 2,278,800, and 2,202,380 outstanding stock options and warrants as of June 30, 2002, 2001 and 2000, respectively, that were not included in EPS for those periods as the effect would be anti-dilutive. (See Note 8.)

### u. Stock-Based Compensation

The Company applies Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," which requires 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.



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In March 2000, the FASB issued Interpretation (FIN) No. 44 "Accounting for Certain Transactions Involving Stock Compensation", which clarifies the application of APB Opinion No. 25 for certain issues. The interpretation was effective July 1, 2000, except for the provisions that relate to modifications that directly or indirectly reduce the exercise price of an award and the definition of an employee, which were effective after December 15, 1998. The adoption of FIN No. 44 had no significant impact on the Company's financial statements.

### v. Segment Reporting

The Company reports segment information in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". The Company has four operating segments. The basis for determining the Company's operating segments is the manner in which financial information is used by the Company in its operations.

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Management operates and organizes itself according to business units that comprise unique products and services across geographic locations.

### w. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company will adopt SFAS No. 143 in the fiscal year beginning July 1, 2002 and is currently evaluating the effect, if any, on the Company's financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". SFAS No. 144 applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principle Board Opinion No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The Company will adopt SFAS No. 144 in the fiscal year beginning July 1, 2002. The Company does not believe adoption of this pronouncement will have a material adverse effect on its financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. The Company will adopt SFAS No. 146 in the fiscal year beginning July 1, 2002. The Company does not believe the adoption of this

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pronouncement will have a material adverse effect on its financial statements.

### x. Reclassifications

The Company has reclassified restricted cash and accrued vacation in the 2001 Consolidated Balance Sheet to conform to the current year presentation.

### Note 2 - Restatement of Prior Period Financial Results

In assessing the partial unwind of the Company's investment in UTI on October 23, 2002, the Company determined that it had incorrectly accounted for certain activities with regard to its equity investment in UTI. Specifically, the Company should have adjusted its proportionate share of the UTI net losses to reflect the Company's carrying value of its UTI investment, and the Company should have recorded certain increases to its investment in UTI arising from change in interest transactions at the UTI level occurring in November 2000, August 2001, and July 2002. The impact of not accounting for the negative basis difference was that the Company's reported equity losses were overstated for the Company's fiscal years ended June 30, 2002, 2001 and 2000. The primary impact of the Company not recognizing the UTI change in interest transactions was that the Company's UTI investment and additional paid-in capital captions were understated, primarily in fiscal year 2002. Further, the Company's equity losses for fiscal year 2002, even with the beneficial amortization effect noted above, were understated, as the additional basis created by the change in interest accounting that should have taken place would have created additional basis sufficient to absorb additional equity losses which had not been recognized previously (as the Company's equity investment had been reduced to zero).

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The Company has determined that the impacts relating to fiscal years 2001 and 2000 were not material and therefore these previously issued financial statements have not been restated. The financial statements for the fiscal year ended June 30, 2002, have been restated as follows:

Financial Statement Caption	June 30, 2002	
	As Previously Reported	As Restated
Equity Loss in UTI	\$ --	\$ (954)
Net Loss	\$ (25,182)	\$ (26,136)
Investment in Affiliates	\$ --	\$ 4,258
Total Assets	\$ 30,063	\$ 34,321
Stockholders' Equity	\$ 21,164	\$ 25,422
Net Loss per Share	\$ (2.03)	\$ (2.11)

### Note 3 - Investments

The following is a summary of available-for-sale securities:

June 30, 2002	Cost	Unrealized Gain	Estimated Fair Value
Commercial Paper and other .....	\$ 2	\$ --	\$ 2
	=====	=====	=====
June 30, 2001	Cost	Unrealized Gain	Estimated Fair Value
Commercial Paper and other .....	\$ 613	\$ --	\$ 613

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U.S. corporate bonds .....	2,499	1	2,500
	-----	-----	-----
	\$3,112	\$ 1	\$3,113
	=====	=====	=====

The Company has instructed its investment fund managers to invest in conservative, investment grade securities with average maturities of less than three years. In fiscal 2000, the Company realized a gain on sales of securities of \$3,147 relating to the sale of portions of the Company's investment in Intermagnetics General Corporation.

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties or the Company may sell the securities to meet their ongoing and potential future cash needs.

The following is a summary of the cost, which approximates fair value, of the Company's available-for-sale securities by contractual maturity:

	June 30,	
	-----	
At Cost:	2002	2001
	-----	-----
Less than one year	\$ 2	\$1,112
More than one year	--	2,000
	-----	-----
Total	\$ 2	\$3,112
	=====	=====

### Note 4 - Impairment of Long-Lived Assets

In June 2002, the Company reported a \$14,318 impairment charge. This impairment charge related to a writedown of long-lived assets in the Company's rechargeable production operations, reflecting a change in the Company's strategy. Changes in external economic conditions culminated in June 2002, reflecting a slowdown in the mobile electronics marketplace and a realization that near-term business opportunities utilizing the high volume rechargeable production equipment had dissipated. These changes caused the Company to shift away from high volume polymer battery production to higher value, lower volume opportunities. The Company's redefined strategy eliminates the need for its high volume production line that had been built mainly to manufacture Nokia cell phone replacement

batteries. The new strategy is a three-pronged approach. First, the Company will manufacture in-house for the higher value, lower volume polymer rechargeable opportunities. Second, the Company will utilize its affiliate in Taiwan, Ultralife Taiwan, Inc., as a source for both polymer and liquid lithium cells. And third, the Company will look to other rechargeable cell manufacturers as sources for cells that the Company can then assemble into completed battery packs.

The impairment charge was accounted for under Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", which requires evaluating the assets' carrying value based on future cash flows. As a result of the impairment of the Company's fixed assets, depreciation charges will be reduced by approximately \$1,800 per year.

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### Note 5 - Supplemental Balance Sheet Information

The composition of inventories was:

	June 30,	
	-----	-----
	2002	2001
	----	----
Raw materials .....	\$ 2,680	\$ 2,595
Work in process .....	1,338	1,233
Finished products .....	1,022	1,872
	-----	-----
	5,040	5,700
Less: Reserve for obsolescence .....	407	411
	-----	-----
	\$ 4,633	\$ 5,289
	=====	=====

The composition of property, plant and equipment was:

Land .....	\$ 123	\$ 123
Buildings and Leasehold Improvements .....	1,619	1,608
Machinery and Equipment .....	26,308	37,891
Furniture and Fixtures .....	312	291
Computer Hardware and Software .....	915	1,375
Construction in Progress .....	2,531	2,984
	-----	-----
	31,808	44,272
Less: Accumulated Depreciation .....	15,674	11,275
	-----	-----
	\$16,134	\$32,997
	=====	=====

### Note 6 - Operating Leases

The Company leases various buildings, machinery, land, automobiles and office equipment. Rental expenses for all operating leases were approximately \$801, \$500 and \$333 for the years ended June 30, 2002, 2001 and 2000, respectively. Future minimum lease payments under non-cancelable operating leases as of June 30, 2002 are as follows: 2003 - \$1,172, 2004 - \$1,168, 2005 - \$1,156, 2006 - \$1,149, and thereafter - \$1,984.

In March 2001, the Company entered into a \$2,000 lease for certain new manufacturing equipment with a third party leasing agency. Under this arrangement, the Company had various options to acquire manufacturing equipment, including sales / leaseback transactions and operating leases. In October 2001, the Company expanded its leasing arrangement with this third party leasing agency, increasing the amount of the lease line from \$2,000 to \$4,000. The increase in the line was used to fund capital expansion plans for manufacturing equipment that increased capacity within the Company's Primary business unit. At June 30, 2002, the lease line had been fully utilized. The Company's lease payment is \$226 per quarter. In conjunction with this lease, the Company has a letter of credit of \$3,800 outstanding.

### Note 7 - Debt and Capital Leases

New York Power Authority

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In May 1999, the Company borrowed approximately \$150 from New York Power Authority (NYPA) that was used toward the construction of a solvent recovery system. The annual interest rate on the loan is 6%. The loan was being repaid in 24 equal monthly payments and expired in July 2001.

### Convertible Note to Director

In conjunction with the Company's private placement offering in April 2002, a note was issued to one of the Company's directors. The note will convert automatically into 200,000 shares of the Company's common stock if the Company's shareholders vote to approve the conversion of the note at the Company's Annual Meeting in December 2002. If shareholder approval is not obtained, the Company is obligated to repay the note on December 31, 2002, with accrued interest at 10% per year. All shares will be issued at \$3.00 per share.

### Credit Facility

In June 2000, the Company entered into a 3-year, \$20,000 secured credit facility with a lending institution. The financing agreement consisted of an initial \$12,000 term loan component and a revolving credit facility component for an initial \$8,000, based on eligible net accounts receivable (as defined) and eligible net inventory (as defined). The amount available under the term loan component amortizes over time. Principal and interest are paid monthly on outstanding amounts borrowed. Debt issue costs amounting to \$198 were incurred in connection with the initiation of the term of the agreement and are being amortized over the life of the agreement.

In October 2001, this lending institution informed the Company that its borrowing availability under its \$20,000 credit facility had been effectively reduced to zero as a result of a recent appraisal of its fixed assets. In February 2002, the Company and its primary lending institution amended the credit facility. The amended facility was reduced to \$15,000 mainly due to the reduction in the valuation of fixed assets that limited the borrowing capacity under the term loan component, as well as to minimize the cost of unused line fees. The term loan component was revised to an initial \$2,733 based on the valuation of the Company's fixed assets (of which \$2,468 was outstanding on the term loan at June 30, 2002). The principal associated with the term loan is being repaid over a 5-year amortization period. However, since the initial term of the three-year credit facility agreement expires in June 2003, and it is subject to extension by the concurrence of both the Company and the lending institution, the remaining principal under the term loan is reflected as a short-term liability as of June 30, 2002. It is the Company's intention at this time to extend this agreement.

The revolving credit facility component comprises the remainder of the total potential borrowing capacity under the overall credit facility. There was no balance outstanding on the revolving credit facility as of June 30, 2002. Certain definitions were revised with the February 2002 amendment, resulting in an increase in the Company's available borrowing base. In addition, the minimum net worth covenant was effectively reduced to approximately \$19,200, after adjustments for fixed asset impairment charges. At June 30, 2002, the Company is in compliance with this covenant.

The loans bear interest at prime-based or LIBOR-based rates, at the discretion of the Company. At June 30, 2002, the rate was 5.75%. The Company also pays a facility fee on the unused portion of the commitment. The loan is secured by substantially all of the Company's assets and the Company is precluded from paying dividends under the terms of the agreement. The total amount available under the revolver component is reduced by outstanding letters of credit. The Company had \$3,800 outstanding on a letter of credit as of June 30, 2002, supporting the Company's \$4,000 equipment lease. The Company's

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additional borrowing capacity as of June 30, 2002 was approximately \$1,000.

### Capital Leases

The Company has two capital leases. The first is a capital lease commitment for the Newark, New York facility which provides for payments (including principal and interest) of \$50 per year through December 2001 and \$28 per year from December 2002 through 2007. Remaining interest on the lease is approximately \$51. At the end of this lease term, the Company is required to purchase the facility for one dollar. The second capital lease is for computer equipment. The lease expires in 2003 and requires monthly payments of approximately \$13.

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### Payment Schedule

Principal payments under the current amount outstanding of the long-term debt and capital leases is as follows:

	Credit Facility	Note to Director	Capital Leases		Total
			Building	Equipment	
Fiscal 2003	\$2,468	\$ 600	\$ 15	\$ 65	\$3,148
2004	--	--	16	--	16
2005	--	--	18	--	18
2006	--	--	20	--	20
2007 and thereafter	--	--	49	--	49
	2,468	600	118	65	3,251
Less: Current portion	2,468	600	15	65	3,148
	\$ --	\$ --	\$ 103	\$ --	\$ 103
Long-term	\$ --	\$ --	\$ 103	\$ --	\$ 103

### Letters of Credit

In conjunction with the purchase/lease agreement to acquire the Company's Newark, New York facilities, the Company has a letter of credit in the amount of \$151, which expires in 2007. Additionally, the Company maintains a \$50 letter of credit for computer equipment, which expires in 2002. Lastly, in connection with the \$4,000 operating lease line that the Company initiated in March 2001, the Company maintains a \$3,800 letter of credit, which expires in July 2007. Each of these letters of credit decline gradually at certain points over time as the obligations they are associated with diminish.

### Note 8 - Commitments and Contingencies

#### a. China Program

In July 1992, the Company entered into several agreements related to the establishment of a manufacturing facility in China for the production and distribution of batteries. The Company made an investment of \$284 of a total anticipated investment of \$405 which would represent a 15% interest in the China Program and accounted for this investment using the cost method. Changzhou Ultra Power Battery Co., Ltd., a company organized in China ("China Battery"), purchased from the Company certain technology, equipment, training and consulting services relating to the design and operation of a lithium battery

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manufacturing plant. China Battery was required to pay approximately \$6,000 to the Company over the first two years of the agreement, of which approximately \$5,600 has been paid. The Company has been attempting to collect the balance due under this contract. China Battery has indicated that these payments will not be made until certain contractual issues have been resolved. Due to the Chinese partner's questionable willingness to pay, the Company wrote off in fiscal 1997 the entire balance owed to the Company as well as the Company's investment. In December 1997, China Battery sent to the Company a letter demanding reimbursement of losses they have incurred plus a refund for certain equipment that the Company sold to China Battery. Although China Battery has not taken any additional steps, there can be no assurance that China Battery will not further pursue such a claim, which, if successful, would have a material adverse effect on the Company's business, financial condition and results of operations. The Company believes that such a claim is without merit.

### b. Indemnity Agreement

The Company has an Indemnity Agreement with each member of its Board of Directors and corporate officers. The agreement provides that the Company will reimburse directors or officers for all expenses, to the fullest extent permitted by law and the Company by-laws, arising out of their performance as agents or trustees of the Company.

### c. Purchase Commitments

As of June 30, 2002, the Company has made commitments to purchase approximately \$171 of production machinery and equipment.

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### d. Royalty Agreement

Technology underlying certain products of the Company are based in part as non-exclusive transfer agreements. The Company made an original payment for such technology and is required to make royalty and other payments in the future which incorporate the licensed technology.

### e. Government Grants/Loans

The Company has been able to obtain certain grants/loans from governments agencies to assist with various funding needs.

In March 1998, the Company received a \$500 grant from the Empire State Development Corporation to fund certain equipment purchases. The grant was contingent upon the Company achieving and maintaining minimum employment levels for a period of five years. If annual levels of employment are not maintained, a portion of the grant might become repayable. Through the first four years of the grant period, the Company has met the requirements. The Company has recognized revenue over the grant period ratably, dependent upon its status the employment criteria. The remaining unamortized balance of \$50 relating to the grant is included in other current liabilities in the accompanying Consolidated Balance Sheet as of June 30, 2002. It is possible that the Company may not meet the employment criteria at the end of the fifth year, and thus the Company may be required to repay one-fifth of the overall grant.

In November 2001, the Company received approval for a \$750 grant/loan from a federally sponsored small cities program. The grant/loan will assist in funding current capital expansion plans that the Company expects will lead to job creation. The Company will be reimbursed for approved capital as it incurs the cost. In August 2002, the \$750 small cities grant/loan documentation was

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finalized and the Company was reimbursed approximately \$400 for costs it had incurred to date for equipment purchases applicable under this grant/loan. The remaining \$350 under this grant/loan will be reimbursed as the Company incurs additional expenses and submits requests for reimbursement. Certain employment levels are required to be met and maintained for a period of three years. If the Company does not meet its employment quota, it may adversely affect reimbursement requests, or the grant may be converted to a loan that will be repaid over a five-year period. The Company will initially record the proceeds from this grant/loan as a long-term liability, and will only amortize these proceeds into income as the certainty of meeting the employment criteria become definitive.

Also in November 2001, the Company received approval for a \$300 grant/loan from New York State. The grant/loan will fund capital expansion plans that the Company expects will lead to job creation. In this case, the Company will be reimbursed after the full completion of the particular project. This grant/loan also required the Company to meet and maintain certain levels of employment. However, since the Company does not meet the beginning employment threshold, it is unlikely at this time that the Company will be able to gain access to these funds.

### f. Employment Contracts

The Company has employment contracts with certain of its key employees with automatic one-year renewals unless terminated by either party. These agreements provide for minimum salaries, as adjusted for annual increases, and may include incentive bonuses based upon attainment of specified management goals. In addition, these agreements provide for severance payments in the event of specified termination of employment.

### g. Legal Matters

The Company is subject to legal proceedings and claims which arise in the normal course of business. The Company believes that the final disposition of such matters will not have a material adverse effect on the financial position or results of operations of the Company.

In August 1998, the Company, its Directors, and certain underwriters were named as defendants in a complaint filed in the United States District Court for the District of New Jersey by certain shareholders, purportedly on behalf of a class of shareholders, alleging that the defendants, during the period April 30, 1998 through June 12, 1998, violated various provisions of the federal securities laws in connection with an offering of 2,500,000 shares of the Company's Common Stock. The complaint alleged that the Company's offering documents were materially incomplete, and as a result misleading, and that the purported class members purchased the Company's Common Stock at artificially inflated prices and were damaged thereby. Upon a motion made on behalf of the Company, the Court dismissed the shareholder action, without prejudice, allowing the complaint to be refiled. The shareholder action was subsequently refiled,

asserting substantially the same claims as in the prior pleading. The Company again moved to dismiss the complaint. By Opinion and Order dated September 28, 2000, the Court dismissed the action, this time with prejudice, thereby barring plaintiffs from any further amendments to their complaint and directing that the case be closed. Plaintiffs filed a Notice of Appeal to the Third Circuit Court of Appeals and the parties submitted their briefs. Subsequently, the parties notified the Court of Appeals that they had reached an agreement in principle to resolve the outstanding appeal and settle the case upon terms and conditions



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which require submission to the District Court for approval. Upon application of the parties and in order to facilitate the parties' pursuit of settlement, the Court of Appeals issued an Order dated May 18, 2001 adjourning oral argument on the appeal and remanding the case to the District Court for further proceedings in connection with the proposed settlement.

Subsequent to the parties entering into the settlement agreement, the Company's insurance carrier commenced liquidation proceedings. The insurance carrier informed the Company that in light of the liquidation proceedings, it would no longer fund the settlement. In addition, the value of the insurance policy is in serious doubt. In April 2002, the Company and the insurance carrier for the underwriters offered to proceed with the settlement. Plaintiff's counsel has accepted the terms of the proposed settlement, amounting to \$175 for the Company, and the matter must now be approved by the Court and by the shareholders comprising the class. Based on the terms of the proposed settlement, the Company has established reserves for its share of the settlement costs and associated expenses.

In the event settlement is not reached, the Company will continue to defend the case vigorously. The amount of alleged damages, if any, cannot be quantified, nor can the outcome of this litigation be predicted. Accordingly, management cannot determine whether the ultimate resolution of this litigation could have a material adverse effect on the Company's financial position and results of operations.

In conjunction with the Company's purchase/lease of its Newark, New York facility in 1998, the Company entered into a payment-in-lieu of tax agreement which provides the Company with real estate tax concessions upon meeting certain conditions. In connection with this agreement, the Company received an environmental assessment, which revealed contaminated soil. The assessment indicated potential actions that the Company may be required to undertake upon notification by the environmental authorities. The assessment also proposed that a second assessment be completed and provided an estimate of total potential costs to remediate the soil of \$230. However, there can be no assurance that this will be the maximum cost. The Company entered into an agreement whereby a third party has agreed to reimburse the Company for fifty percent of the costs associated with this matter. The Company has fully reserved for its portion of the estimated liability. Test sampling was completed in the spring of 2001. The next step is for the Company to submit a remediation plan to the New York State Department of Environmental Conservation for approval. Upon approval, the Company would have the authority to remediate the property. Because this is a voluntary remediation, there is no requirement for the Company to complete the project within any specific time frame. 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.

A retail end-user of a product manufactured by one of Ultralife's customers (the "Customer"), has made a claim against the Customer wherein it is asserted that the Customer's product, which is powered by an Ultralife battery, does not operate according to the Customer's product specification. No claim has been filed against Ultralife. However, in the interest of fostering good customer relations, in September 2002, Ultralife has agreed to lend technical support to the Customer in defense of its claim. Additionally, Ultralife will honor its warranty by replacing any batteries that may be determined to be defective. In the event a claim is filed against Ultralife and it is ultimately determined that Ultralife's product was defective, replacement of batteries to this Customer or end-user may have a material adverse effect on the Company's financial position and results of operations.

### Note 9 - Shareholders' Equity

#### a. Preferred Stock

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The Company has authorized 1,000,000 shares of preferred stock, with a par value of \$0.10 per share. At June 30, 2002, no preferred shares were issued or outstanding.

### b. Common Stock

In July 2001, the Company completed a \$6,800 private placement of 1,090,000 shares of its common stock at \$6.25 per share.

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In April 2002, the Company issued 801,333 shares of its common stock at \$3.00 per share in a private placement offering. In conjunction with this offering, another 200,000 shares will be issued in December 2002 subject to shareholder approval of a convertible note with one of the Company's directors (see Note 7).

In December 2000, the shareholders approved an increase in the number of authorized shares of common stock from 20,000,000 to 40,000,000.

### c. Stock Options

The Company sponsors several stock-based compensation plans, all of which are accounted for under the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation expense for its stock-based compensation plans has been recognized in the Company's Consolidated Statements of Operations. The Company has adopted the disclosure-only provision of SFAS No. 123, "Accounting for Stock-Based Compensation". If the Company had elected to recognize compensation expense for all of the Company's stock-based compensation based on the fair value of the options at grant date as prescribed by SFAS No.123, the Company's net loss would have been \$27,427, \$19,597 and \$12,333 for the years ended June 30, 2002, 2001 and 2000, compared with the reported losses of \$26,136, \$17,262 and \$10,242, respectively. Loss per share would have been \$2.21, \$1.75 and \$1.13 in the years ended June 30, 2002, 2001 and 2000, respectively, as compared to reported loss per share of \$2.11, \$1.55 and \$0.94, respectively. The effect of SFAS No. 123 in the pro forma disclosures may not be indicative of future amounts.

For purposes of this disclosure, the fair value of each fixed option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in fiscal 2002, 2001, and 2000:

	2002	2001	2000
Risk-free interest rate	3.6%	4.8%	6.4%
Volatility factor	75.8%	75.8%	74.1%
Weighted average expected life (years)	4	4	6
Weighted average fair value of options granted	\$2.13	\$3.56	\$5.48

The shareholders of the Company have approved four stock option plans that permit the grant of options. In addition, the shareholders of the Company have approved the grant of options outside of these plans. Under the 1991 stock option plan, 100,000 shares of Common Stock were reserved for grant to key employees and consultants of the Company. These options expired on September 13, 2001, at which date the plan terminated. All options granted under the 1991 plan were Non-Qualified Stock Options ("NQSOs").

The shareholders of the Company have also approved a 1992 stock option

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plan that is substantially the same as the 1991 stock option plan. The shareholders approved reservation of 1,150,000 shares of Common Stock for grant under the plan. During 1997, the Board of Directors approved an amendment to the plan increasing the number of shares of Common Stock reserved by 500,000 to 1,650,000. Options granted under the 1992 plan are either Incentive Stock Options ("ISOs") or NQSOs. Key employees are eligible to receive ISOs and NQSOs; however, directors and consultants are eligible to receive only NQSOs. As of June 30, 2002, there are 28,410 shares available for grant.

Effective March 1, 1995, the Company established the 1995 stock option plan and granted the former Chief Executive Officer ("CEO") options to purchase 100,000 shares at \$14.25 per share under this plan. Of these shares, 60,000 vested prior to his termination and subsequently expired on March 1, 2001. There were no other grants under the 1995 stock option plan. In October 1992, the Company granted, to the former CEO, options to purchase 225,000 shares of Common Stock at \$9.75 per share outside of any of the stock option plans. The options vested through June 1997 and expire in October 2002.

Effective July 12, 1999, the Company granted the current CEO options to purchase 500,000 shares of Common Stock at \$5.19 per share outside of any of the stock option plans. Of these, 50,000 options were exercisable on the grant date, and the remaining options are exercisable in annual increments of 90,000 over a five-year period commencing July 12, 2000 through July 12, 2004, and expire on July 12, 2005.

Effective December 2000, the Company established the 2000 stock option plan which is substantially the same as the 1991 stock option plan. The shareholders approved reservation of 500,000 shares of Common Stock for grant under the plan. Options granted under the 2000 plan are either ISOs or NQSOs. Key employees are eligible to receive

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ISOs and NQSOs; however, directors and consultants are eligible to receive only NQSOs. As of June 30, 2002, there are 94,900 shares available for grant.

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

	2002 -----	Weighted Average Exercise Price Per Share -----	2001 -----	Weighted Average Exercise Price Per Share -----
	Number of Shares -----		Number Of Shares -----	
Shares under option at beginning of year ...	2,266,300	\$7.95	2,189,880	\$ 8.68
Options granted .....	461,000	3.78	341,600	7.06
Options exercised .....	--	--	(77,900)	7.77
Options canceled .....	(286,160)	9.92	(187,280)	14.28
	-----	-----	-----	-----
Shares under option at end of year .....	2,441,140	\$6.90	2,266,300	\$ 7.95
	-----	-----	-----	-----
Options exercisable at end of year .....	1,289,200	\$8.13	675,480	\$10.09

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The following table represents additional information about stock options outstanding at June 30, 2002:

Options Outstanding				Options
Range of Exercise Prices	Number Outstanding at June 30, 2002	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at June 30, 2002
\$3.15 - \$5.13	500,400	5.17	\$ 3.78	80,500
\$5.19 - \$6.50	742,600	3.33	\$ 5.45	340,300
\$6.55 - \$9.00	639,050	3.19	\$ 7.69	353,500
\$9.75 - \$17.88	559,090	0.93	\$10.71	514,800
\$3.15 - \$17.88	2,441,140	3.12	\$6.90	1,289,200

### d. Warrants

In March 1998, the Company issued warrants to purchase 12,500 shares of its common stock to the Empire State Development Corporation in connection with a \$500 grant. Proceeds of the grant were used to fund certain equipment purchases and are contingent upon the Company achieving and maintaining minimum employment levels. The warrants may be exercised through December 31, 2002 at an exercise price equal to 60% of the average closing price for the 10 trading days preceding the exercise date, but not less than the average closing price of the Company's common stock during the 20 trading days prior to the grant.

In July 2001, the Company issued warrants to purchase 109,000 shares of its common stock to H.C. Wainwright & Co., Inc. and other affiliated individuals that participated as investment bankers in the \$6,800 private placement of 1,090,000 shares of common stock that was completed at that time. The warrants have an exercise price of \$6.25 per share and the term of the warrants is five years.

### e. Reserved Shares

The Company has reserved 2,685,950 shares of common stock under the various stock option plans and warrants as of June 30, 2002, and 2,588,200 and 2,266,225 as of June 30, 2001 and 2000, respectively.

### Note 10 - Income Taxes (As Restated; See Note 2)

Foreign and domestic loss carryforwards totaling approximately \$76,950 are available to reduce future taxable income. Foreign loss carryforwards of \$12,118 can be carried forward indefinitely. The domestic net operating loss carryforward of \$64,832 expires through 2022. If it is determined that a change in ownership as defined under Internal Revenue Code Section 382 has occurred, the net operating loss carryforward will be subject to an annual limitation.

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting

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purposes and the amount used for income tax purposes. The Company increased its valuation allowance by approximately \$9,856, \$3,143 and \$2,445 for the years ended June 30, 2002, 2001 and 2000, respectively, to offset the deferred tax assets based on the Company's estimates of its future earnings and the expected timing of temporary difference reversals.

Significant components of the Company's deferred tax liabilities and assets as of June 30 are as follows:

	2002	2001
	----	----
Deferred tax liabilities:		
Investments .....	\$ 348	\$ 1
Property, plant and equipment .....	2,766	913
	-----	-----
Total deferred tax liabilities .....	3,114	914
Deferred tax assets:		
Impairment of long-lived assets .....	4,868	--
Net operating loss carryforward .....	25,678	18,560
Other .....	526	456
	-----	-----
Total deferred tax assets .....	31,072	19,016
Valuation allowance for deferred tax assets .....	(27,958)	(18,102)
	-----	-----
Net deferred tax assets .....	3,114	914
	-----	-----
Net deferred tax assets / liabilities .....	\$ --	\$ --

There were no income taxes paid for the years ended June 30, 2002, 2001 and 2000. For financial reporting purposes, income (loss) from continuing operations before income taxes included the following:

	2002	June 30, 2001	2000
	----	----	----
United States .....	\$(23,848)	\$(13,999)	\$ (7,658)
Foreign .....	(2,288)	(3,263)	(2,584)
	-----	-----	-----
Total .....	\$(26,136)	\$(17,262)	\$(10,242)

There are no undistributed earnings of Ultralife UK, the Company's foreign subsidiary, at June 30, 2002.

The Company's effective tax benefit is lower than would be expected if the statutory rate was applied to the pretax loss because the Company has recorded an increase in the valuation allowance for deferred tax assets equal to the tax benefit of the current year net operating loss carryforwards due to the uncertainty of future operating results. Accordingly, the effective tax rate is 0.0% for each of the years ended June 30, 2002, 2001 and 2000.

### Note 11 - 401(k) Plan

The Company maintains a defined contribution 401(k) plan covering substantially all employees. Employees can contribute a portion of their salary or wages as prescribed under Section 401(k) of the Internal Revenue Code and,

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subject to certain limitations, the Company may, at the Board of Directors discretion, authorize an employer contribution based on a portion of the employees' contributions. Effective January 1, 2001, the Board of Directors approved Company matching of employee contributions up to a maximum of 4% of the employee's income. Prior to this, the maximum contribution for participants was 3%. For the years ended June 30, 2002, 2001 and 2000, the Company contributed \$162, \$234 and \$150, respectively. In January 2002, the employer match was suspended in an effort to conserve cash.

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### Note 12 - Related Party Transactions

During 2000, the Company sold the majority of its investment in Intermagnetics General Corporation (IGC) common stock and realized a gain on sale of securities of \$3,147. IGC was considered a related party since certain directors of the Company served as officers or directors of IGC.

In conjunction with the Company's private placement offering in April 2002, a note was issued to one of the Company's directors. The note will convert automatically into 200,000 shares of the Company's common stock if the Company's shareholders vote to approve the conversion of the note at the Company's Annual Meeting in December 2002. If shareholder approval is not obtained, the Company is obligated to repay the note on December 31, 2002, with accrued interest at 10% per year. All shares will be issued at \$3.00 per share.

### Note 13 - Business Segment Information

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", the Company reports its results in four operating segments: Primary Batteries, Rechargeable Batteries, Technology Contracts and Corporate. The Primary Batteries segment includes 9-volt batteries, cylindrical batteries and various specialty batteries. The Rechargeable Batteries segment consists of the Company's polymer rechargeable batteries. The Technology Contracts segment includes revenues and related costs associated with various government and military development contracts. The Corporate segment consists of all other items that do not specifically relate to the three other segments and are not considered in the performance of the other segments.

2002 (As Previously Reported)

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	Primary Batteries	Rechargeable Batteries	Technol Contract
Revenues	\$ 31,334	\$ 445	\$ 73
Segment contribution	3,276	(20,612)	7
Interest income, net			
Other income (expense), net			
Income taxes			
 Net loss			
 Long-lived assets	 11,761	 3,198	 -
Total assets	21,351	4,256	3

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Capital expenditures	1,884	333	—
Depreciation and amortization expense	1,425	2,312	—

2002 (As Restated; See Note 2)

	Primary Batteries	Rechargeable Batteries	Technol Contract
Revenues	\$ 31,334	\$ 445	\$ 73
Segment contribution	3,276	(20,612)	7
Interest income, net			
Other income (expense), net			
Income taxes			
Net loss			
Long-lived assets	11,761	3,198	—
Total assets	21,351	4,256	3
Capital expenditures	1,884	333	—
Depreciation and amortization expense	1,425	2,312	—

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2001

	Primary Batteries	Rechargeable Batteries	Technol Contract
Revenues	\$ 22,105	\$ 370	\$ 1,68
Segment contribution	443	(7,551)	15
Interest income, net			
Other income (expense), net			
Income taxes			
Net loss			
Long-lived assets	11,628	19,490	28
Total assets	18,609	21,166	30
Capital expenditures	2,241	1,382	—
Depreciation and amortization expense	1,159	2,153	—

2000

	Primary	Rechargeable	Technol
--	---------	--------------	---------

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	Batteries	Batteries	Contract
Revenues	\$ 21,840	\$ 25	\$ 2,64
Segment contribution	(1,244)	(5,306)	24
Interest income, net			
Other income (expense), net			
Income taxes			
Net loss			
Long-lived assets	10,892	19,985	28
Total assets	19,171	20,632	49
Capital expenditures	1,377	1,012	-
Depreciation and amortization expense	1,128	591	

Geographical Information

	2002	Revenues 2001	2000
United States	\$ 21,208	\$ 15,715	\$ 13,587
United Kingdom	3,853	1,797	2,874
Hong Kong	3,330	3,347	3,211
Europe, excluding United Kingdom	2,518	1,572	2,812
Other	1,606	1,732	2,030
Total	\$ 32,515	\$ 24,163	\$ 24,514

Note 14 - Investment in Affiliate

In December 1998, the Company announced the formation of a venture with PGT Energy Corporation (PGT), together with a group of investors, to produce Ultralife's polymer rechargeable batteries in Taiwan. During fiscal 2000, Ultralife provided the venture, named Ultralife Taiwan, Inc. (UTI), with its proprietary technology and 700,000 shares of Ultralife Common Stock, in exchange for approximately a 46% ownership interest. Ultralife holds half the seats on UTI's board of directors. PGT and the group of investors funded UTI with \$21,250 in cash and hold the remaining seats on the board.

Due to subsequent sales of UTI common stock to third parties to raise additional capital, the Company's equity interest was reduced to approximately 33% as of June 30, 2002. As a result of these "change in interest" transactions, the Company's share of UTI's underlying net assets actually increased, creating gains on the transactions that were recorded as adjustments in additional paid in capital on the balance sheet. These increases in additional paid in capital amounted

to \$5,212 in Fiscal 2002. (The Company was precluded from recognizing gains from



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these "change in interest" transactions in its consolidated statement of income because UTI was a development stage company.)

The Company accounts for its investment in UTI using the equity method of accounting. The Company recorded equity losses in UTI in the Company's consolidated statement of income of \$954, \$2,338, and \$818 in Fiscal 2002, 2001 and 2000, respectively.

Summarized financial statement information for the unconsolidated venture is as follows:

Condensed Statements of Operations	(unaudited) Year Ended June 30,		
2002 -----	2001 -----	2000 -----	
Net revenue	\$ 101	\$ --	\$ --
Cost of Sales	(1,573)	--	--
Operating loss	(8,360)	(7,540)	(1,897)
Net loss	(8,784)	(6,637)	(1,778)
Condensed Balance Sheets	June 30,		
	2002 -----	2001 -----	
Current assets	\$ 5,902	\$11,577	
Non-current assets	60,271	35,238	
	-----	-----	
	\$66,173	\$46,815	
	=====	=====	
Current liabilities	\$12,372	\$ 2,663	
Non-current liabilities	16,260	6,362	
Shareholders' equity	37,541	37,790	
	-----	-----	
	\$66,173	\$46,815	
	=====	=====	

### Note 15 - Selected Quarterly Information (unaudited)

The following table presents reported net revenues, gross margin (net sales less cost of products sold), net loss and net loss per share, basic and diluted, for each quarter during the past two years:

Fiscal 2002	Quarter ended		
	Sept. 30, 2001 -----	Dec. 31, 2001 -----	March 31 2002 -----
Revenues	\$ 7,616	\$ 7,459	\$ 8,862
Gross margin	(448)	(212)	922
Net loss (As Previously Reported)	(3,642)	(3,420)	(2,292)
Net loss (As Restated; See Note 2)	(3,006)	(3,831)	(2,793)
Net loss per share, basic and diluted (As Previously Reported)	(0.30)	(0.28)	(0.19)
Net loss per share, basic and diluted (As Restated; See Note 2)	(0.25)	(0.31)	(0.23)

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Fiscal 2001	Quarter ended		
	Sept. 30, 2000	Dec. 31, 2000	March 31, 2001
Revenues	\$ 6,851	\$ 5,290	\$ 5,817
Gross margin	(452)	(1,699)	(731)
Net loss	(3,104)	(5,737)	(3,921)
Net loss per share, basic and diluted	(0.28)	(0.51)	(0.35)

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Documents filed as part of this Report:

1. Financial Statements

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

2. Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts See Item 15 (d)

(b) Reports on Form 8-K

On June 7, 2002, the Company filed a Form 8-K with the Securities and Exchange Commission indicating that Arthur Lieberman, member of the Board of Directors, tendered his resignation from the Board effective June 4, 2002, citing business and personal demands on available time resources.

On July 24, 2002, the Company filed a Form 8-K with the Securities and Exchange Commission indicating that the Company had dismissed its independent public accountants, Arthur Andersen LLP ("Andersen"), and engaged PricewaterhouseCoopers LLP ("PwC") as its new independent public accountants, effective immediately, for the fiscal year ending June 30, 2002. This decision was approved by the Company's Board of Directors, based on the recommendation of its Audit Committee. The decision was based on interviews with large public accounting firms and reflected the Audit Committee's judgment as to which firm was best suited to deliver external audits to the Company. PwC replaces the Company's previous audit firm, Andersen, who had been the Company's auditors since 1996.

(c) Exhibits. The following Exhibits are filed as a part of this Report:

Exhibit Index	Description of Document	Incorporated By Reference to:
23.1	Consent of PricewaterhouseCoopers LLP	Filed herewith
99	CEO and CFO Certifications	Filed herewith

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(d) Financial Statement Schedules.

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

Schedule II - Valuation and Qualifying Accounts

	June 30, 2001 -----	Additions ----- Charged to Expense -----	Charge Othe Accou -----
Allowance for doubtful accounts	\$ 262	\$ 30	\$
Inventory reserves	411	1,038	
Warranty reserves	253	222	
Deferred tax valuation allowance	18,102	9,856	

	June 30, 2000 -----	Additions ----- Charged to Expense -----	Charge Othe Accou -----
Allowance for doubtful accounts	\$ 268	\$ 11	\$
Inventory reserves	399	825	
Warranty reserves	384	292	
Deferred tax valuation allowance	14,959	3,143	

	June 30, 1999 -----	Additions ----- Charged to Expense -----	Charge Othe Accou -----
Allowance for doubtful accounts	\$ 429	\$ 45	\$
Inventory reserves	295	1,035	
Warranty reserves	169	300	
Deferred tax valuation allowance	12,514	2,445	

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities

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Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ULTRALIFE BATTERIES, INC.

Date: April 11, 2003

By: /s/ John D. Kavazanjian

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John D. Kavazanjian  
President and Chief  
Executive Officer  
(Principal Executive Officer)

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

Date: April 11, 2003

/s/ John D. Kavazanjian

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John D. Kavazanjian  
President, Chief Executive Officer  
and Director

Date: April 11, 2003

/s/ Robert W. Fishback

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Robert W. Fishback  
Vice President - Finance and Chief  
Financial Officer  
(Principal Financial Officer)

Date: April 11, 2003

/s/ Joseph C. Abeles

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Joseph C. Abeles (Director)

Date: April 11, 2003

/s/ Joseph N. Barrella

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Joseph N. Barrella (Director)

Date:

-----  
Patricia C. Barron (Director)

Date: April 11, 2003

/s/ Daniel W. Christman

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Daniel W. Christman (Director)

Date: April 11, 2003

/s/ Carl H. Rosner

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Carl H. Rosner (Director)

Date: April 11, 2003

/s/ Ranjit C. Singh

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Ranjit C. Singh (Director)

I, John D. Kavazanjian, certify that:

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1. I have reviewed this annual report on Form 10-K of Ultralife Batteries, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: April 11, 2003

/s/ John D. Kavazanjian

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John D. Kavazanjian  
President and Chief Executive Officer

I, Robert W. Fishback, certify that:

1. I have reviewed this annual report on Form 10-K of Ultralife Batteries, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: April 11, 2003

/s/ Robert W. Fishback

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Robert W. Fishback  
Vice President of Finance and  
Chief Financial Officer