

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2001

or

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

\_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-20852

ULTRALIFE BATTERIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

16-1387013

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer Identification No.)

2000 Technology Parkway, Newark, New York 14513

(Address of principal executive offices)  
(Zip Code)

(315) 332-7100

(Registrant's telephone number, including area code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, \$.10 par value - 12,318,956 shares outstanding as of January 31, 2002.

1

ULTRALIFE BATTERIES, INC.  
INDEX

Page

----

PART I FINANCIAL INFORMATION

Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets - December 31, 2001 and June 30, 2001.....	3
	Condensed Consolidated Statements of Operations - Three and six months ended December 31, 2001 and 2000.....	4
	Condensed Consolidated Statements of Cash Flows - Six months ended December 31, 2001 and 2000.....	5
	Notes to Consolidated Financial Statements.....	6

Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	11
Item 3.	Quantitative and Qualitative Disclosures About Market Risk.....	17
PART II OTHER INFORMATION		
Item 1.	Legal Proceedings.....	17
Item 4.	Submission of Matters to a Vote of Security Holders.....	18
Item 6.	Exhibits and Reports on Form 8-K.....	18
SIGNATURES .....		19

PART I FINANCIAL INFORMATION  
Item 1. Financial Statements

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

ASSETS	December 31, 2001 ----- (unaudited)	June 30, 2001 -----
Current assets:		
Cash and cash equivalents	\$ 706	\$ 494
Available-for-sale securities	968	2,573
Restricted cash	1,300	540
Trade accounts receivable (less allowance for doubtful accounts of \$285 at December 31, 2001 and \$262 at June 30, 2001)	4,426	3,379
Inventories	5,459	5,289
Prepaid expenses and other current assets	1,131	1,648
	-----	-----
Total current assets	13,990	13,923
	-----	-----
Property, plant and equipment	32,020	32,997
Other assets:		
Investment in affiliates	--	--
Technology license agreements (net of accumulated amortization of \$1,218 at December 31, 2001 and \$1,168 at June 30, 2001)	233	283
	-----	-----
	233	283
	-----	-----
Total Assets	\$ 46,243	\$ 47,203
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 955	\$ 1,065
Accounts payable	4,368	3,755
Other current liabilities	1,763	2,282
	-----	-----
Total current liabilities	7,086	7,102
Long-term liabilities:		
Long-term debt and capital lease obligations	2,202	2,648
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 - 12,578,186 at December 31, 2001 and 11,488,186 at June 30, 2001)	1,258	1,149
Capital in excess of par value	105,621	99,389
Accumulated other comprehensive loss	(835)	(1,058)
Accumulated deficit	(68,786)	(61,724)
	-----	-----
	37,258	37,756
Less--Treasury stock, at cost--27,250 shares	303	303
	-----	-----
Total shareholders' equity	36,955	37,453
	-----	-----
Total Liabilities and Shareholders' Equity	\$ 46,243	\$ 47,203
	=====	=====

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



ULTRALIFE BATTERIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Dollars in Thousands, Except Per Share Amounts)  
(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2001	2000	2001	2000
	----	----	----	----
Revenues	\$ 7,459	\$ 5,290	\$15,075	\$12,141
Cost of products sold	7,671	6,989	15,735	14,292
	-----	-----	-----	-----
Gross margin	(212)	(1,699)	(660)	(2,151)
Operating expenses:				
Research and development	972	948	2,154	1,508
Selling, general, and administrative	2,092	2,060	4,213	3,856
	-----	-----	-----	-----
Total operating expenses	3,064	3,008	6,367	5,364
Operating loss	(3,276)	(4,707)	(7,027)	(7,515)
Other income (expense):				
Interest income	16	276	85	502
Interest expense	(93)	(121)	(175)	(253)
Equity loss in affiliate	--	(1,258)	--	(1,590)
Miscellaneous	(67)	73	55	15
	-----	-----	-----	-----
Loss before income taxes	(3,420)	(5,737)	(7,062)	(8,841)
	-----	-----	-----	-----
Income taxes	--	--	--	--
	-----	-----	-----	-----
Net loss	\$(3,420)	\$(5,737)	\$(7,062)	\$(8,841)
	=====	=====	=====	=====
Net loss per share, basic and diluted	\$ (0.28)	\$ (0.51)	\$ (0.58)	\$ (0.80)
	=====	=====	=====	=====
Weighted average shares outstanding, basic and diluted	12,319	11,151	12,140	11,113
	=====	=====	=====	=====

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

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

	Six Months Ended 2001 ----	December 31, 2000 ----
<b>OPERATING ACTIVITIES</b>		
Net loss	\$(7,062)	\$ (8,841)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,134	1,912
Equity loss in affiliate	--	1,590
Changes in operating assets and liabilities:		
Accounts receivable	(1,047)	78
Inventories	(170)	244
Prepaid expenses and other current assets	517	(333)
Accounts payable and other current liabilities	94	562
	-----	-----
Net cash used in operating activities	(5,534)	(4,788)
	-----	-----
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(1,538)	(2,916)
Proceeds from sale leaseback	544	--
Purchase of securities	(9,090)	(21,048)
Sales of securities	9,935	14,128
Maturities of securities	--	10,230
	-----	-----
Net cash (used in) provided by investing activities	(149)	394
	-----	-----
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock	6,341	606
Principal payments on long-term debt and capital lease obligations	(556)	(380)
	-----	-----
Net cash provided by financing activities	5,785	226
	-----	-----
Effect of exchange rate changes on cash	110	(174)
	-----	-----
Increase (Decrease) in cash and cash equivalents	212	(4,342)
Cash and cash equivalents at beginning of period	494	5,712
	-----	-----
Cash and cash equivalents at end of period	\$ 706	\$ 1,370
	=====	=====
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Unrealized gain on securities	\$ --	\$ 1
	=====	=====
Interest paid	\$ 108	\$ 69
	=====	=====

ULTRALIFE BATTERIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollar Amounts in Thousands - Except Share and Per Share Amounts)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the condensed consolidated financial statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2001.

2. NET LOSS PER SHARE

Net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Common stock options and warrants have not been included as their inclusion would be antidilutive; as a result, basic earnings per share is the same as diluted earnings per share.

3. COMPREHENSIVE INCOME (LOSS)

The components of the Company's total comprehensive loss were:

	(unaudited)			
	Three months ended		Six months ended	
	December 31, 2001	December 31, 2000	December 31, 2001	December 31, 2000
Net loss	\$(3,420)	\$(5,737)	\$(7,062)	\$(8,841)
Unrealized (loss) gain on securities	--	(1)	--	1
Foreign currency translation adjustments	94	(221)	223	(176)
Total comprehensive loss	\$(3,326)	\$(5,959)	\$(6,839)	\$(9,016)
	=====	=====	=====	=====

4. INVENTORIES

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

	(unaudited)	
	December 31, 2001	June 30, 2001
Raw materials	\$2,811	\$2,595
Work in process	1,930	1,233
Finished goods	1,075	1,872
	-----	-----
	5,816	5,700
Less: Reserve for obsolescence	357	411
	-----	-----
	\$5,459	\$5,289
	=====	=====

## 5. PROPERTY, PLANT AND EQUIPMENT

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

	(unaudited)	
	December 31, 2001	June 30, 2001
	-----	-----
Land	\$ 123	\$ 123
Buildings and Leasehold Improvements	1,608	1,608
Machinery and Equipment	38,449	37,891
Furniture and Fixtures	311	291
Computer Hardware and Software	1,406	1,375
Construction in Progress	3,538	2,984
	-----	-----
	44,985	44,272
Less: Accumulated Depreciation	13,415	11,275
	-----	-----
	\$32,020	\$32,997
	=====	=====

## 6. COMMITMENTS AND CONTINGENCIES

As of December 31, 2001, the Company had \$1,300 in restricted cash with two lending institutions. \$250 of this amount was for a letter of credit against a building and equipment operating lease. The remaining \$1,050 represents funds restricted by the Company's primary lending institution to cover outstanding letters of credit in excess of eligible assets. The Company is in the process of restructuring the terms of the credit facility with the lending institution to increase the amount of eligible assets.

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 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. Because of these developments with the insurance carrier, the Company may cancel the settlement agreement and allow the stockholders to proceed with their appeal.

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. Test sampling occurred in the fourth quarter of fiscal 2001 and the engineering report was submitted to the New York State Department of Environmental Conservation (NYSDEC) for review. NYSDEC has reviewed the report and in January 2002 recommended additional testing. The Company has responded by submitting a proposed work plan to NYSDEC and is waiting further review. 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.

#### 7. BUSINESS SEGMENT INFORMATION (unaudited)

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 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.

Three Months Ended December 31, 2001

	Primary Batteries	Rechargeable Batteries	Technology Contracts	Corporate	Total
Revenues	\$ 7,020	\$ 153	\$286	\$ --	\$ 7,459
Segment contribution	712	(1,926)	30	(2,092)	(3,276)
Interest, net				(77)	(77)
Equity loss in affiliate				--	--
Miscellaneous expense				(67)	(67)
Income taxes				--	--
Net loss					\$(3,420)
Total assets	\$20,535	\$19,827	\$309	\$ 5,572	\$46,243

Three Months Ended December 31, 2000

	Primary Batteries	Rechargeable Batteries	Technology Contracts	Corporate	Total
Revenues	\$ 4,667	\$ 44	\$579	\$ --	\$ 5,290
Segment contribution	6	(2,680)	56	(2,089)	(4,707)
Interest income, net				155	155
Equity loss in affiliate				(1,258)	(1,258)
Miscellaneous				73	73
Income taxes				--	--
Net loss					\$(5,737)
Total assets	\$17,884	\$22,504	\$288	\$15,556	\$56,232

Six Months Ended December 31, 2001

	Primary Batteries	Rechargeable Batteries	Technology Contracts	Corporate	Total
Revenues	\$14,294	\$ 288	\$493	\$ --	\$15,075
Segment contribution	1,439	(4,304)	51	(4,213)	(7,027)
Interest, net				(90)	(90)
Equity loss in affiliate				--	--
Miscellaneous income				55	55
Income taxes				--	--
Net loss					\$(7,062)
Total assets	\$20,535	\$19,827	\$309	\$ 5,572	\$46,243

Six Months Ended December 31, 2000

	Primary Batteries	Rechargeable Batteries	Technology Contracts	Corporate	Total
Revenues	\$10,909	\$ 164	\$1,068	\$ --	\$12,141
Segment contribution	17	(3,766)	90	(3,856)	(7,515)
Interest income				249	249
Equity loss in affiliate				(1,590)	(1,590)
Miscellaneous				15	15
Income taxes				--	--
Net loss					\$(8,841)
Total assets	\$17,884	\$22,504	\$ 288	\$15,556	\$56,232

8. OTHER MATTERS

On July 20, 2001, the Company completed a \$6,800 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 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.

In October 2001, the Company was informed by its primary lending institution that its borrowing availability under the \$20,000 credit facility had been effectively reduced to zero as a result of a recent appraisal of its fixed assets. Accordingly, the Company's liquidity depends on the Company's ability to successfully generate positive cash flow from operations and achieve adequate operational savings. The Company is also exploring opportunities for new or additional equity or debt financing. Notwithstanding

the foregoing, there can be no assurance that the Company will have sufficient cash flows to meet its working capital and capital expenditure requirements.

In October and November 2001, the Company realigned its resources to address the changing market conditions and to better meet customer demand in areas of the business that are growing. The realignment did not significantly change any of the Company's existing operations nor were any product lines discontinued. 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. Less than 7% of the Company's total employees were terminated. The realignment did not result in any significant severance costs. The Company expects to realize cost savings from the measures being taken of approximately \$1,500 per quarter. These quarterly savings are comprised of approximately \$1,100 of reduced labor costs, approximately \$200 of reduced material usage, and approximately \$200 of lower administrative expenses. The Company anticipates the full amount of the realignment to be realized in the third fiscal quarter.

Additionally, in October 2001, the Company expanded its leasing arrangement with a third party leasing agency. The revision increased the amount of the lease line to \$4,000, from a previous amount of \$2,000. The additional line will be used to fund capital expansion plans for manufacturing equipment which will allow increased capacity within the Company's Primary business unit. Once the lease line has been fully utilized the Company's quarterly lease payment will approximate \$226.

In November 2001, the Company received approval for two grants from New York State and a federally sponsored small cities program in the aggregate amount of \$1,050. The grants will assist in funding current capital expansion plan which the Company expects will lead to job creation. The Company will be reimbursed for approved capital as it incurs the cost. Additionally, the Company is obligated under the terms of the grants to achieve a certain level of new jobs over the next five years. If the Company does not meet its employment quota, it will be required to pay back a portion or all of the amount of the grant depending on the lapsed time.

#### 9. NEW ACCOUNTING PRONOUNCEMENT

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business (as previously defined in that Opinion). The Company is required to adopt SFAS No. 144 for fiscal years beginning after July 1, 2002. The Company is currently assessing the financial impact of SFAS No. 144 on its financial statements.

#### 10. SUBSEQUENT EVENT

On February 11, 2002, in its ongoing effort to improve liquidity to bring costs more in line with revenues, the Company took further action to reduce costs. The cost reductions included employee terminations and salary reductions, discontinuance of certain employee benefits and other cost saving initiatives in general and administrative areas. As part of these actions, the Company temporarily suspended the Company's match on the 401k plan. The Company anticipates an approximately \$800 reduction in expenses per quarter because of this action. Nearly two-thirds of the savings will reduce cost of products sold and one-third will reduce general and administrative costs. The Company expects to

realize approximately half of the savings in the third fiscal quarter and 100% in the fourth fiscal quarter. Severance costs associated with this action will be incurred in the third fiscal quarter and are not material. This action plus the prior actions taken by the Company as outlined above will aggregate to an anticipated cost savings of approximately \$2,300 per quarter.

## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. This report contains certain forward-looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to management. The statements contained in this report relating to matters that are not historical facts are forward-looking statements that involve risks and uncertainties, including, but not limited to, future demand for the Company's products and services, the successful commercialization of the Company's advanced rechargeable batteries, general economic conditions, world events, government and environmental regulation, competition and customer strategies, 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 fire, 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.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained herein and the Company's consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K as of and for the year ended June 30, 2001.

### General

Ultralife Batteries, Inc. develops, manufactures and markets a wide range of standard and customized primary lithium and polymer rechargeable batteries for use in a wide array of applications. The Company believes that its proprietary technologies allow the Company to offer batteries that are ultra-thin, lightweight and generally achieve longer operating time than many competing batteries currently available. To date, the Company has focused on manufacturing a family of lithium primary batteries for consumer, industrial, and military applications which it believes is one of the most comprehensive lines of lithium manganese dioxide primary batteries commercially available. The Company has introduced its advanced rechargeable batteries which are based on its proprietary technology for use in portable electronic applications.

The Company has incurred net operating losses primarily as a result of funding research and development activities and, to a lesser extent, manufacturing and general and administrative costs. To date, the Company has devoted a substantial portion of its resources to the research and development of its products and technology, particularly its proprietary polymer rechargeable technology. The Company's results of operations may vary significantly from quarter to quarter depending upon the number of orders received and the pace of the Company's research and development activities. 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.

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 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.

## Results of Operations

Three months ended December 31, 2001 and 2000

Consolidated revenues increased 41% or \$2,169,000 to \$7,459,000 for the second three months of fiscal 2002, compared to the same quarter in fiscal 2001. Primary battery sales increased \$2,353,000, or 50%, from \$4,667,000 last year to \$7,020,000 this year. In December 2000, the Company began production and shipments of the BA-5368 battery used by the military in survival radios for pilots, and this new small cylindrical battery resulted in approximately \$1,400,000 in sales in the second quarter of fiscal 2002. Also adding to the notable increase in revenues was an increase of \$733,000 or 100% in sales of the High Rate and assembled batteries due to increased demand from the UK military as compared to prior year. These increases were offset in part by a decline in Technology Contract revenues. As expected, Technology Contract revenues declined \$293,000, from \$579,000 to \$286,000 due to the scheduled reduction of certain non-renewable government contracts.

Cost of products sold amounted to \$7,671,000 for the three-month period ended December 31, 2001, an increase of \$682,000, or 10% over the same three month period a year ago. The gross margin on total revenues for the quarter was a loss of 3%, compared to a loss of 32% in the prior year. The improvement in gross margins was attributed to greater sales, significant efficiencies attained in the manufacturing process and an inventory valuation adjustment made in the prior year on rechargeable batteries. Primary gross margins increased \$968,000 over the prior year from a 0% gross margin in fiscal 2001 to a 14% gross margin in fiscal 2002. This improvement in margins is principally the result of increased sales and enhancements in the manufacturing process due to the implementation of lean manufacturing practices. To date, lean manufacturing practices in the Primary battery segment have resulted in quicker manufacturing throughput times, greater operating efficiencies and a reduction of inventory. Cost of products sold in the Rechargeable segment decreased \$433,000 over the prior year period due to the inventory adjustment of \$400,000 made in the comparable quarter in the prior year to reduce the market value of the inventory. The Rechargeable business remains a large opportunity but one that the Company expects to realize over the long term. By focusing on this opportunity and broadening its offerings, the Company believes that it has a good prospect of realizing this growth potential.

Operating and other expenses were \$3,064,000 the three months ended December 31, 2001 compared to \$3,008,000 in the prior year, an increase of \$56,000, or 2%. The increase is largely driven by an increase in administrative costs related to severance costs incurred during the quarter as a result of the resource realignment.

Interest income decreased \$260,000, or 94%, from \$276,000 in the second quarter of fiscal 2001 to \$16,000 in the second quarter of fiscal 2002. The reduction in interest income is principally the result of lower average cash balances and the reduction of rates of return on investments. Interest expense declined \$28,000 due to lower average balances outstanding on the credit facility and lower borrowing rates. Equity loss in affiliate was \$1,258,000 for its equity interests in Ultralife Taiwan, Inc. (UTI) for the quarter ended December 31, 2001. No losses have been recorded in fiscal 2002 as the investment on the balance sheet has been written down to zero under the equity method of accounting. Additionally, in August 2001, the Company's ownership in UTI was reduced to 33% as a result of additional capital raised by UTI for its ongoing expansion. Miscellaneous income (expense) relates primarily to foreign currency transaction gains and losses for the period reported.

Net losses were \$3,420,000, or \$0.28 per share, for the second three months of fiscal 2002 compared to \$5,737,000, or \$0.51 per share, for the same quarter last year primarily as a result of the reasons described above.

Six months ended December 31, 2001 and 2000

Consolidated revenues reached a new six month record of \$15,075,000 for the first half of fiscal 2002, an increase of \$2,934,000, or 24%, over the comparable quarter in fiscal 2001. Primary battery sales increased \$3,385,000, or 31%, from \$10,909,000 last year to \$14,294,000 this year. In fiscal 2001, the Company began production and shipments of the BA-5368 battery used by the military in survival radios for pilots, and this new small cylindrical battery resulted in approximately \$2,500,000 in sales in the first half of fiscal 2002. Shipments of High Rate and assembled batteries also increased over \$800,000, or 59%, as a result of an increase in demand from the UK military. Partially offsetting these increases was a decline in Technology Contract revenues. As expected, Technology Contract revenues declined \$575,000, from \$1,068,000 to \$493,000 due to the scheduled reduction of certain non-renewable government contracts.

Cost of products sold amounted to \$15,735,000 for the six-month period ended December 31, 2001, an increase of \$1,443,000, or 10% over the same six month period a year ago. The gross margin on total revenues for the first half of the year was a loss of 4%, compared to a loss of 18% in the prior year. The improvement in gross margins was affected by two offsetting factors. Primary gross margins increased \$1,901,000 over the prior year from a 0% gross margin in fiscal 2001 to a 13% gross margin in fiscal 2002. This improvement in margins is principally the result of increased sales and enhancements in the manufacturing process due to the implementation of lean manufacturing practices. To date, lean manufacturing practices in the Primary battery segment have resulted in quicker manufacturing throughput times, greater operating efficiencies and a reduction of inventory. The improvements in gross margins in the Primary segment were partially offset by declines in the Rechargeable segment. In the Rechargeable segment cost of products sold increased \$495,000 over the prior year period due to less overhead absorption due to lower production volumes. In the second quarter of fiscal 2001, due to the heavy competition, the Company shifted its focus to design and manufacture lightweight custom sized batteries for OEMs rather than focus on the broad retail cell phone market. The manufacture of cell phone batteries was an important milestone for the Company as it demonstrated the Company's ability to mass produce polymer rechargeable batteries. The Company continues to actively design and develop rechargeable batteries and is vigorously supplying samples to OEMs in order to achieve the desired sales growth in this segment. Additionally, in the second quarter of fiscal 2002, the Company reallocated resources to better align itself with the demand in the marketplace. The Company has experienced significant demand from the military and as a result shifted significant resources to be able to produce levels necessary to meet the demand. This resulted in less costs charged to the Rechargeable business unit.

Operating and other expenses were \$6,367,000 for the six months ended December 31, 2001 from \$5,364,000 in the prior year, an increase of \$1,003,000, or 19%. Of the Company's operating and other expenses, research and development expenses increased \$646,000, or 43%, to \$2,154,000 for the first half of fiscal 2002. The increase in research and development expenses was due to greater development of samples and new product designs of polymer rechargeable batteries in fiscal 2002, as well as increases in research and development costs in the Primary battery business unit as prototypes were built for qualification with the US Army. Selling, general and administrative costs increased \$357,000 or 9% over the prior year period. This increase was mainly due to higher selling, marketing, and advertising costs, both in the U.S. and abroad as the Company enhanced its market coverage at the end of fiscal 2001, as well as severance costs incurred in conjunction with the realignment previously mentioned.

Interest income decreased \$417,000, or 83%, from \$502,000 in the first half of fiscal 2001 to \$85,000 in the first half of fiscal 2002. The reduction in interest income is principally the result of lower average

cash balances and the reduction of rates of return on investments. Interest expense declined \$78,000 due to lower average balances outstanding on the credit facility and lower borrowing rates. Equity loss in affiliate was \$1,590,000 for its equity interest in Ultralife Taiwan, Inc. (UTI) for the first half of fiscal 2001. No losses have been recorded in fiscal 2002 as the investment on the balance sheet has been written down to zero under the equity method of accounting. Additionally, in August 2001, the Company's ownership in UTI was reduced to 33% as a result of additional capital raised by UTI for its ongoing expansion. Miscellaneous income (expense) relates primarily to foreign currency transaction gains and losses for the period reported.

Net losses were \$7,062,000, or \$0.58 per share, for the first six months of fiscal 2002 compared to \$8,841,000, or \$0.80 per share, for the same quarter last year primarily as a result of the reasons described above.

#### Liquidity and Capital Resources

At December 31, 2001, cash and cash equivalents and available for sale securities totaled \$2,974,000. Of this amount, \$1,300,000 is restricted at December 31, 2001 to cover a portion of the outstanding letters of credit. The Company used \$5,534,000 of cash in operating activities during the first six months of fiscal 2002. This usage of cash related primarily to the net loss reported for the period and an increase in accounts receivable, offset in part by depreciation and decreases in other current assets. More specifically, receivables increased \$1,047,000 from June 30, 2001 to December 31, 2001. This increase resulted from a significant increase in revenues in the second quarter of fiscal 2002 as compared with the fourth quarter of fiscal 2001. The Company does not anticipate any significant recoverability issues with these outstanding receivables. The Company spent \$1,538,000 for capital expenditures for production equipment and facilities improvements during the first half 2002, and of this amount approximately \$544,000 was received as proceeds in a sale leaseback transaction. Additionally, in February 2002, the Company received approximately \$450,000 in proceeds from a sale leaseback of assets previously purchased by the Company. As of February 11, 2002 nearly \$600,000 remains available under the lease line of credit.

At December 31, 2001, the Company had long-term debt outstanding including capital lease obligations of \$2,202,000 primarily relating to the financing arrangement entered into by the Company at the end of fiscal 2000, described below.

In June 2000, the Company entered into a \$20,000,000 secured credit facility with a lending institution. The financing agreement consists of an initial \$12,000,000 term loan component based on the valuation of the Company's fixed assets (of which \$2,867,000 was outstanding on the term loan at December 31, 2001) 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). While the amount available under the term loan component amortizes over time, the amount of the revolving credit facility component increases by an equal and offsetting amount. Principal and interest are paid monthly on outstanding amounts borrowed. The loans bear interest at the prime rate or other LIBOR-based rate options at the discretion of the Company. 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 \$3,800,000 outstanding on a letter of credit as of December 31, 2001. In October 2001, the Company was informed by its primary lending institution that its borrowing availability under the \$20,000,000 credit facility had been effectively reduced to zero as the result of a recent appraisal of its fixed assets. The appraisal resulted in a significant decrease in the valuation of the Company's machinery and equipment which was based on an "orderly liquidation valuation" methodology used by the appraiser. The Company is in the process of restructuring the terms of the credit facility with the lending institution to enhance the Company's borrowing flexibility.

On July 20, 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 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.

In October 2001, the Company increased the lease line of credit with a financing institution to \$4,000,000 to acquire equipment in the Primary business. In conjunction with this lease, the Company has obtained and is required to maintain an additional letter of credit for \$1,900,000. The total outstanding letters of credit for this lease arrangement equal \$3,800,000.

The Company's capital resource commitments as of December 31, 2001 consisted principally of capital equipment commitments of approximately \$732,000.

As previously noted, the Company's primary lending institution significantly reduced the total amount of the credit facility available. Accordingly, the Company's liquidity depends on the Company's ability to successfully generate positive cash flow from operations and achieve adequate operational savings. In addition, the Company is working with its primary lending bank to obtain increased credit flexibility. The Company is also exploring opportunities for new or additional equity or debt financing. Notwithstanding the foregoing, there can be no assurance that the Company will have sufficient cash flows to meet its working capital and capital expenditure requirements. See additional comments on the Company's recent cost reduction actions in "Outlook".

#### Outlook

The Company expects to achieve an increase of approximately 15% in consolidated revenues in the third quarter of fiscal 2002 as compared to the second quarter of fiscal 2002. During the third fiscal quarter, the Company is projecting the growth to come largely from standard cylindrical and high rate batteries for growth in military markets. Sales of 9-volt batteries are expected to increase slightly from the second quarter as smoke detector and medical customers replenish their inventories. The Company expects to take advantage of its flexibility to tailor and develop its existing and new products that will continue to enhance revenue growth throughout the year. The Company believes that it is well positioned with its current portfolio of products, and its new products in development, to meet the current demands communicated to the Company by the commercial and military customers, both in the US and UK. Management believes that revenues will increase fiscal year 2002 over fiscal year 2001 in the range of 40%.

Management has maintained focus on two key financial goals - to reach operating cash breakeven by March 2002 and to attain positive net income by June 2002. While these goals are dependent on continuing increases in sales volumes and improving operating efficiencies, management is striving to meet these objectives, and they believe that the strategies being put into action will drive the Company toward these goals.

In October and November 2001, the Company realigned its resources to address the changing market conditions and to better meet customer demand in areas of the business that are growing. The realignment did not significantly change any of the Company's existing operations nor were any product lines discontinued. 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. Less than 7% of the Company's total employees were terminated. The realignment did not result in any significant severance costs. The Company expects to realize cost savings from the measures being taken of approximately \$1.5 million per quarter. These quarterly savings are comprised of approximately \$1.1 million of reduced labor costs, approximately \$0.2 million of reduced material usage, and approximately \$0.2 million of



lower administrative expenses. The Company anticipates the full amount of this realignment to be realized in the third fiscal quarter.

On February 11, 2002, in its ongoing effort to improve liquidity to bring costs more in line with revenues, the Company took further action to reduce costs. The cost reductions included employee terminations and salary reductions, discontinuance of certain employee benefits and other cost saving initiatives in general and administrative areas. As part of these actions, the Company temporarily suspended the Company's match on the 401k plan. The Company anticipates an approximately \$800,000 reduction in expenses per quarter because of this action. Nearly two-thirds of the savings will reduce cost of products sold and one-third will reduce general and administrative costs. The Company expects to realize approximately half of the savings in the third fiscal quarter and 100% in the fourth fiscal quarter. Severance costs associated with this action will be incurred in the third fiscal quarter and are not material. This action plus the prior actions taken by the Company as outlined above will aggregate to an anticipated cost savings of approximately \$2.3 million per quarter.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company is exposed to various market risks in the normal course of business, primarily interest rate risk and changes in market value of its investments and believes its exposure to these risks is minimal. The Company's investments are made in accordance with the Company's investment policy and primarily consist of commercial paper and U.S. corporate bonds. The Company does not currently participate in the investment of derivative financial instruments.

### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

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 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 has 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. Because of these developments with the insurance carrier, the Company may cancel the settlement agreement and allow the stockholders to proceed with their appeal.

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. Test sampling occurred in the fourth quarter of fiscal 2001 and the engineering report was submitted to the New York State Department of Environmental Conservation (NYSDEC) for review. NYSDEC has reviewed the report and in January 2002 recommended additional testing. The Company has responded by submitting a proposed work plan to NYSDEC and is waiting further review. 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.

Item 4. Submission of Matters to a Vote of Security Holders

- (a) On December 5, 2001, an Annual Meeting of Shareholders of the Company was held.
- (b) At the Annual Meeting, the Shareholders of the Company elected to the Board of Directors all eight nominees for Director with the following votes:

DIRECTOR -----	FOR ---	WITHHELD -----
Joseph C. Abeles	11,085,384	33,117
Joseph N. Barrella	11,085,384	33,117
Patricia C. Barron	11,069,384	49,117
Daniel W. Christman	11,085,384	33,117
John D. Kavazanjian	11,085,384	33,117
Arthur M. Lieberman	10,246,684	871,817
Carl H. Rosner	11,085,384	33,117
Ranjit Singh	11,085,384	33,117

- (c) At the Annual Meeting, the Shareholders of the Company voted for the ratification of Arthur Andersen LLP as independent auditors with the following votes:

FOR ---	AGAINST -----	ABSTAIN -----
11,057,101	48,450	12,950

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits
  - 10.1 Amended Lease Agreement between Winthrop Resources and the Registrant
- (b) Reports on Form 8-K
  - None

SIGNATURES

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

ULTRALIFE BATTERIES, INC.

-----  
(Registrant)

Date: February 12, 2002

By: /s/John D. Kavazanjian

-----  
John D. Kavazanjian  
President and Chief  
Executive Officer

Date: February 12, 2002

By: /s/Robert W. Fishback

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

AMENDED LEASE SCHEDULE

LEASE SCHEDULE NO. 001R

(This Lease Schedule No. 001R replaces Lease Schedule No. 001)

This Lease Schedule is issued pursuant to the Lease Agreement Number UL022101 dated February 21, 2001. The terms of the Lease Agreement and serial numbers contained on Certificates of Acceptance are a part hereof and are incorporated by reference herein.

LESSOR  
 Winthrop Resources Corporation  
 11100 Wayzata Boulevard  
 Suite 800  
 Minnetonka, MN 55305

LESSEE  
 Ultralife Batteries, Inc.  
 2000 Technology Parkway  
 Newark, NY 14513

SUPPLIER OF EQUIPMENT  
 Various

LOCATION OF INSTALLATION  
 Same As Above

Term of Lease from Commencement Date: 60 Months (20 quarters) Quarterly Lease Charge: \$75,213.00, due quarterly as \$225,639.00 Anticipated Delivery and Installation: February 2001 - March 2002 Security Deposit: Upon Lessee's execution of this Lease Schedule, Lessee shall deliver a security deposit in the amount of \$225,639.00. If there is no event of default, this security deposit will be applied toward the total Lease Charges associated with the last quarter of this Lease Schedule.

EQUIPMENT

MANUFACTURER	QTY	MACHINE/MODEL	EQUIPMENT DESCRIPTION (including features)
SEE ATTACHMENT A			

Upon execution of this Lease Schedule, Lessee shall deliver a non-refundable sum of money equal to the Security Deposit, which shall become the Security Deposit after Lessor's receipt of a letter of credit satisfactory in all respects to Winthrop Resources Corporation. If a letter of credit is not delivered by Lessee, Lessor shall be entitled to retain any and all monies paid it by Lessee. Lease Agreement Number UL022101 and this Lease Schedule 001R are subject to Winthrop Resources Corporation receiving a letter of credit that is satisfactory in all respects to Winthrop Resources Corporation, including, but not limited to, the terms and conditions contained therein and the bank drawn thereon. Obtaining this letter of credit is a condition precedent to Winthrop Resources Corporation's obligations under Lease Agreement UL022101 and Lease Schedule Number 001R.

The Monthly Lease Charge will be prorated and charged as interim rent between the date an item of equipment is accepted and the Commencement Date.

Agreed to and Accepted:

Agreed to and Accepted:

WINTHROP RESOURCES CORPORATION

ULTRALIFE BATTERIES, INC.

"LESSOR"

"LESSEE"

By: s/o Richard J. Pieper

By: s/o Molly Henderson

Print

Print

Name: Richard J. Pieper  
 Title: Sr. Vice President  
 Date: September 26, 2001

Name: Molly Henderson  
 Title: Corporate Controller  
 Date: August 15, 2001

Lease Agreement Number: UL022101

Lease Schedule Number: 001R

ATTACHMENT A

MANUFACTURER	QTY	MACHINE/MODEL	EQUIPMENT DESCRIPTION (including features)
--------------	-----	---------------	--

Innovative Machine Corp.			Coating Line Equipment
Various			Cathode Manufacturing Cell
Various			Anode Manufacturing Cell
Various			Other Related Equipment
LET	1	Laminator	Bi-cell Asselmy Lamination Machine and Packaging Machine
LET	1	Tab Welder	LET Tab Welder
LET	1	Benchtop	Benchtop Form Station Which Includes ATP, 303480, 103 Products
X103			PCB Welding System
LET	1		Accumulator System for Custom Automation Equipment
DDS	1		Automation Trim and Fold Machine
Intelligent Automation	1		
Intelligent Automation	1		Automation Trim and Fold Machine Final Payment
Intelligent Automation	1		Automation Trim and Fold Machine ECN
Intelligent Automation	1		Automation Trim and Fold Machine 10% due with Ultralife Acceptance

Agreed to and Accepted:

WINTHROP RESOURCES CORPORATION

"LESSOR"

By: s/o Richard J. Pieper

Print

Name: Richard J. Pieper  
Title: Sr. Vice President  
Date: September 26, 2001

Agreed to and Accepted:

ULTRALIFE BATTERIES, INC.

"LESSEE"

By: s/o Molly Henderson

Print

Name: Molly Henderson  
Title: Corporate Controller  
Date: August 15, 2001