

MECHANICAL TECHNOLOGY INC
Form 10-K
March 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2014
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934
FOR THE TRANSITION PERIOD FROM ____ TO ____**

Mechanical Technology, Incorporated

(Exact name of registrant as specified in its charter)

New York
(State or other jurisdiction
of incorporation or organization)

000-06890
(Commission File Number)

14-1462255
(IRS Employer
Identification No.)

325 Washington Avenue Extension, Albany, New York 12205

(Address of principal executive offices)

(518) 218-2550

(Registrant's telephone number, including area code)

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

| Title of each class | Name of each exchange on which registered |
|---------------------|---|
| None | None |

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

Common Stock

(\$0.01 par value)

Title of Class

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

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

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 checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the 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.

Edgar Filing: MECHANICAL TECHNOLOGY INC - Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-------------------|---|---------------------------|
| Large Accelerated Filer | Accelerated Filer | Non-Accelerated Filer (Do not check if a smaller reporting company) | Smaller reporting company |
|-------------------------|-------------------|---|---------------------------|

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2014 (based on the last sale price of \$1.28 per share for such stock reported on the over-the-counter market for that date) was \$6,021,362.

As of February 26, 2015, the Registrant had 5,258,883 shares of common stock outstanding.

Documents incorporated by reference: Portions of the registrant's Proxy Statement for its 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

INDEX TO FORM 10-K

PART I

| | <u>Page</u> |
|---|-------------|
| Item 1. <u>Business</u> | 3 |
| Item 1A. <u>Risk Factors</u> | 7 |
| Item 1B. <u>Unresolved Staff Comments</u> | 12 |
| Item 2. <u>Properties</u> | 12 |
| Item 3. <u>Legal Proceedings</u> | 12 |
| Item 4. <u>Mine Safety Disclosure</u> | 12 |

PART II

| | |
|---|----|
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 13 |
| Item 6. <u>Selected Financial Data</u> | 13 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 14 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 19 |
| Item 8. <u>Financial Statements and Supplementary Data</u> | 19 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | 19 |
| Item 9A. <u>Controls and Procedures</u> | 19 |
| Item 9B. <u>Other Information</u> | 20 |

PART III

| | |
|--|----|
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | 21 |
| Item 11. <u>Executive Compensation</u> | 21 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 21 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | 21 |
| Item 14. <u>Principal Accounting Fees and Services</u> | 22 |

PART IV

Item 15. Exhibits, Financial Statement Schedules

23

2

PART I

Item 1: Business

Unless the context requires otherwise in this Annual Report on Form 10-K, the terms the Company, we, us, and our refer to Mechanical Technology, Incorporated, MTI Instruments refers to MTI Instruments, Inc., and MTI Micro refers to MTI MicroFuel Cells, Inc. Other trademarks, trade names, and service marks used in this Annual Report on Form 10-K are the property of their respective owners.

Mechanical Technology, Incorporated, a New York corporation, was incorporated in 1961. The Company's core business is conducted through MTI Instruments, Inc., a wholly-owned subsidiary incorporated in New York on March 8, 2000 and the sole component of the Company's Test and Measurement Instrumentation segment. The Company's operations are headquartered in Albany, New York where it designs, manufactures, and markets its products globally. The Company also operated in a New Energy segment with business conducted through MTI MicroFuel Cells, Inc. until December 31, 2013 (date of MTI Micro deconsolidation). In August 2014, its management changed MTI Micro's name to MeOH Power, Inc. MTI continues to retain our equity ownership in that entity as discussed below. However, to keep prior and future filings consistent, MTI will continue to refer to this entity as MTI Micro in its reports.

MTI Instruments is a supplier of precision linear displacement solutions, vibration measurement and system balancing solutions, and wafer inspection tools. These tools and solutions are developed for markets that require the precise measurements and control of products processes for the development and implementation of automated manufacturing, assembly, and consistent operation of complex machinery.

As part of its strategy, MTI Instruments provides its customers with enabling sensors and sensing technologies that help advance manufacturing processes and new product development efforts. The demand for higher quality and lower cost products ranging from semiconductor chips to electronics and large items such as automobiles continues to drive Original Equipment Manufacturers (OEMs) and their suppliers to invest in technology and the capability to rapidly produce high quality products. Industry has moved towards flexible manufacturing doctrines around mass customization and production incorporating lean principles to reduce labor and waste, while increasing quality. Modern manufacturing advances at a very rapid pace with the help of automation controls and precision sensing technologies for operating equipment, processes in factories, and other applications with minimal or reduced human intervention. OEMs find that using automation helps them not only improve on quality, but also can save labor, energy and materials while significantly improving accuracy and precision. In some industries like semiconductors, fabrication facilities are fully automated and are aided by humans on a low frequency basis.

Using a combination of integrated smart robotics, manufacturing lines, and a myriad of sensors that measure ongoing equipment performance, monitoring and drive controls have resulted in significant advancements in productivity and quality in manufacturing. There is no question that the world is moving from classic manufacturing and assembly towards automation and measurement.

MTI Instruments has decades of experience in working with OEMs and their subcontractors in the supply of sensor technology to complement OEMs' manufacturing processes, and now in their development of new automation controls and processes by providing sensors and sensing technologies. The Company has taken steps to move towards a market-based approach by examining and targeting specific segments including the industrial and consumer electronics, automotive and other precision automated manufacturing industries, turbo machinery and research for both product and process development segments that lead to the key markets served.

This same approach is driving the demand for engine vibration measurement and balancing. Ongoing efforts to improve engine performance and lower fuel consumption drive both military and commercial axial turbo-machinery operators to maintain their equipment at peak performance.

These market drivers are also providing opportunity and demand for MTI to enhance current and develop new products and technologies. This has become a central theme in our supporting a larger, more complex customer base. Our efforts to become more capable and competitive in operations and quality are being met by our well defined approach to lean manufacturing principles and the achievement of International Organization for Standardization (ISO) ISO 9001:2008 certification in 2014.

Precision Automated Manufacturing

As demand increases for higher quality, lower cost, and more efficient products, there is a world-wide need for OEMs to drive continuous improvement efforts through use of the most innovative manufacturing and assembly techniques in products and processes. Due to the level of precision required, these products or processes are managed through automated systems (Piezo positioners, robots, quality in measurement, etc.) and require precise measurement, data transmission, analysis and management.

MTI Instruments provides advanced, ultra precision linear displacement solutions that help customers achieve higher levels of efficiency through precision measurement systems that enable valuable data collection and allow process and quality control. We customize linear displacement solutions for OEMs that can be incorporated into a tool or equipment manufactured by a company to monitor performance and/or achieve control (in product application) or into a process to control the manufacture of parts or measure critical parameters of parts as they enter or leave a process (in process applications).

MTI Instruments is a preferred supplier for applications that require complex and extremely precise measurement of small, intricate targets and assemblies. MTI Instruments uses its significant track record and experience using capacitance, laser and fiber optic technologies to make accurate linear displacement measurements to the sub-nanometer level of accuracy. These advanced sensing and physical measurement technologies are used to produce products that range from basic sensors to complete, fully integrated measurement systems. Applications include precision positioning, material surface measurements, off-center vibration measurements, and pattern recognition analysis.

Listed below are selected MTI Instruments Automated Manufacturing product offerings and technologies:

| | Product Model | Description |
|-----|-----------------------------------|---|
| | Accumeasure Series Microtrak 3 | Ultra-high precision capacitive systems offering nanometer accuracy. Single spot laser sensor equipped with the latest complementary metal oxide semiconductor (CMOS) sensor technology with higher sensitivity than previous generation. |
| | Microtrak PRO-2D | 2D laser triangulation scanners that provide profile, displacement, and 3D images. |
| | MTI-2100 Fotonic Sensor Series | Fiber-optic based displacement sensor systems with high frequency response. |
| NEW | Accumeasure D Series | Ultra-high precision digital capacitive systems offering sub-nanometer accuracy. |
| NEW | Microtrak TGS | Intuitive laser thickness systems using two single spot laser heads with digital linearization providing superb linearity. |

Axial Turbo Machinery

Turbo machines are categorized according to the type of flow. When the fuel and air flow is parallel to the axis of rotation, they are referred to as axial flow machines. MTI Instruments is a leader in the development and commercialization of vibration measurement and system balancing for axial type engines typically medium and large turbo fan aircraft engines for both military and commercial applications. In addition, we are exploring possibilities for expansion of its product offerings for a variety of applications within this market segment.

MTI Instruments designs and manufactures computer-based portable balancing systems (PBS) products which automatically collect and record engine vibration data, identifying vibration or balance trouble, and calculating a solution to the problem. These products are designed to quickly pinpoint engine vibration issues for improved fuel efficiency, lower maintenance cost and safety.

PBS products are used by major aircraft engine manufacturers, the U.S. and foreign militaries, and commercial airlines, as well as gas turbine manufacturers.

Listed below are selected MTI Instruments Turbo Machinery product offerings and technologies:

Product Model

PBS-4100+ Portable Balancing System
PBS-4100R+ Test Cell Vibration Analysis & Trim Balancing System
TSC-4800A Tachometer Signal Conditioner
1510A Calibrator

Description

Provides easy to follow solutions for engine vibration and trim balancing problems.
Advanced trim balancing and diagnostics for engine test cells.
Tachometer signal conditioner detects and conditions signals for monitoring, measuring, and indicating engine speeds.
National Institute of Standards and Technology (NIST) traceable signal generator that outputs voltage signals useful to test and calibrate electronic equipment.

Industrial and Academic Research and Development (R&D)

Present-day research and process development is a core part of the modern business world; critical decisions are made from data and discoveries made through these efforts. As companies understand and profit from the benefits of organized R&D efforts, they also make further commitments and investments into new R&D cycles making internal R&D budgets reach higher and higher levels. R&D is also a tool for modern companies to proactively leapfrog competition and keep pace with trends, enhance manufacturing processes, and develop products to meet new customer demands.

MTI Instruments has a long track record of working with private sector companies as well as academic institutions on their R&D efforts. We have a dedicated line of tabletop linear displacement instruments, material testers, and wafer metrology tools that help provide valuable information to enhance products and processes. Our family of R&D related products are used

widely in applications including wafer surface metrology, nano-material testing, and precision linear displacement and positioning. Our customers include testing and R&D departments in large industry and academia as well as process development laboratories focused in automotive, electronics, semiconductor, solar, and material development.

Listed below are MTI Instruments Industrial and Academic Research and Development product offerings and technologies:

| Product Model | Description |
|--------------------------------|---|
| Accumeasure Digital Series | Ultra-high precision digital capacitive systems offering sub-nanometer accuracy. |
| Accumeasure Analog Series | Ultra-high precision capacitive displacement systems offering nanometer accuracy. |
| Semtester Tensile Stages | Tensile testers specifically designed for use inside SEM (scanning electron microscopes) and light microscopes. |
| Proforma 300i | Manual, non-contact measurement of semiconductor wafer thickness, TTV and bow. |
| PV 1000 | Manual tool for measuring thickness and bow of solar wafers. |
| MTI-2100 Fotonic Sensor Series | Fiber-optic based displacement sensor systems with high frequency response. |

Marketing and Sales

MTI Instruments markets its products and services using selected and specific channels of distribution. In the Americas, for precision automated manufacturing and the R&D sectors, MTI Instruments uses a combination of direct sales and representatives. Overseas, particularly in Europe and Asia, MTI Instruments uses distributors and agents specific to our targeted end markets. For axial turbo machinery, MTI Instruments primarily sells directly to end users.

To supplement these efforts, we use both commercial and industrial search engines, targeted newsletters, purchased customer lists and participation in trade shows to identify and expand its customer base.

Product Development

MTI Instruments continuously conducts research to develop new and advance existing technologies in support of its business strategy. Along with innovation as a key hallmark to its efforts, we carefully consider a number of factors including customer needs, product or technology uniqueness, market trends, costs, the competitive landscape, and creative marketing and communications plans in developing our products. We take a customer-centered approach in order to find new ways to solve customer needs, engage with customers directly, and create a loyal customer base while offering a more compelling value proposition.

In 2014, MTI Instruments continued the commercialization efforts of its new, state-of-the-art, family of products – the Accumeasure D series. Using more than 30 years of linear displacement experience, our engineers and scientists worked hand in hand to combine capacitance principles with modern enabling digital technology – the result, an ultra precise linear displacement capacitance system with a true digital output, and a range of sensing probes to accommodate a large range of customer applications. This series of products also offers a range of unique features that allow customers the ability to quickly and easily set them up in production, thereby minimizing downtime.

Following the 2013 launch of our Microtrak 3 family of single spot laser sensors equipped with the latest CMOS technology, we strengthened our development efforts and, as a result, plan to launch the next generation Microtrak 3 plus system in early 2015 which, like the Accumeasure D series of products, emphasizes its digital capabilities and features. The new Microtrak 3 plus system has a sampling rate to 40 kilo-samples per second, providing 16bit output at full sample rate bandwidth via a USB connection – covering the majority of application in selected target markets. The last few years of product development for our optical based laser systems has proven successful – today, this series of new products have been adopted and used by some of the largest consumer electronic assembly operations in Asia.

In 2014, we also launched our brand new Microtrak LTS product, which uses all of the advancements of the Microtrak series and packages it in a convenient and easy to use system providing accurate and reliable non-contact thickness linear displacement measurements for in process applications. Additionally, we continue to invest in the development of a thread checking system as a product extension of our Accumeasure D series of products.

With investments in research and product development, we seek to achieve a competitive position by continuously advancing our technology, producing new state-of-the-art precision measurement equipment, expanding our worldwide distribution, and providing intimate customer support. Management believes that MTI Instruments' success depends to a large extent on identifying market requirements, innovation, and utilizing our technological expertise to develop and implement new products.

Product Manufacturing & Operations

We conduct research, product development and innovation, and manufacture our products, in the United States (U.S.). We manufacture our products in the U.S. While many of our competitors have reached out and moved manufacturing operations overseas, MTI has remained a U.S. based manufacturing company. Products are conceived, developed, tested, and shipped out from our headquarters in Albany, New York.

Management believes that there are inherent advantages in keeping manufacturing in the U.S. including attenuating the risk of inadvertent technology transfer, the ability to control manufacturing quality, and a much more effective customer management and satisfaction process. We have long-term vendor relationships and believe that most raw materials used in our products are readily available from a variety of vendors.

To prepare for future growth, we have also made strides in bringing a more flexible approach to manufacturing. While cross-training in different functional areas, management has also implemented lean principles on the manufacturing floor to increase capacity, productivity and throughput, eliminate waste, and quickly adapt to larger customers demands while continuing to keep inventory levels under control. As production volumes increase, MTI now has additional capabilities in its existing, flexible manufacturing space. In 2014, MTI was able to increase its production of single point lasers more than tenfold to meet the demands of a large Asian customer with existing resources, proving its ability to effectively increase product throughput.

On April 7, 2014, the Company received ISO certification 9001:2008. The certification was authorized by TÜVRheinland®, an independent agency. To obtain certification, we underwent a rigorous five step process including preparation, documentation, implementation, internal audit, and final certification. The ISO 9001:2008 certification confirms our commitment to an effective management system and continuous improvement, a practice management believes is important for continuous growth.

Intellectual Property and Proprietary Rights

We rely on trade secret and copyright laws to establish and protect the proprietary rights of our products. In addition, we enter into standard confidentiality agreements with our employees and consultants and seek to control access to and distribution of our proprietary information. Even with these precautions, it may be possible for a third party to copy or otherwise obtain and use our products or technology without authorization or to develop similar technology independently. In addition, effective copyright and trade secret protection may be unavailable or limited in certain foreign countries.

Significant Customers

MTI Instruments' largest customer is the U.S. Air Force. We also have strong relationships with companies in the electronics, aircraft, aerospace, automotive, semiconductor and research industries. The U.S. Air Force accounted for 27.9% and 27.2%, respectively, of total product revenues during 2014 and 2013. The largest commercial customer in 2014 was an Asian customer, who accounted for 8.3% of total product revenue in 2014. The largest commercial customer in 2013 was an Asian customer, who accounted for 6.8% of total product revenue in 2013.

Competition

We compete with several companies, substantially all of which are larger than MTI Instruments.

In the precision automated manufacturing market, MTI Instruments faces competition from companies including Keyence, Micro Epsilon, Schmitt Industries, Capacitec, and Lion Precision Instruments.

In axial turbo machinery, MTI Instruments competes with companies including ACES Systems and Meggitt Sensing Systems.

In R&D, competition includes companies in precision linear displacement, including Gatan, Deben, and E+H (Eichhorn+Hausmann) GmbH.

The primary competitive considerations in MTI Instruments' markets are product quality, performance, price, timely delivery, and the ability to identify, pursue and obtain new customers. MTI Instruments believes that its employees, product development skills, sales and marketing systems and reputation are competitive advantages.

Research and Development

MTI Instruments conducts research and develops technology to support its existing products and develop new products. MTI incurred research and development costs of approximately \$1.3 million in each of the years ended December 31, 2014 and 2013, which is exclusively related to MTI Instruments. We expect to continue to invest in research and development in the future at MTI Instruments as part of our growth strategy.

Employees

As of December 31, 2014, we had 35 employees including 30 full-time employees.

Item 1A: Risk Factors

Factors Affecting Future Results

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Any statements contained, or incorporated by reference, in this Annual Report on Form 10-K that are not statements of historical fact may be forward-looking statements. When we use the words anticipate, estimate, plans, projects, continuing, ongoing, expects, management believe, we intend, should, could, may, will and similar words or phrases, we are identifying forward-looking statements. Forward-looking statements include, but are not limited to, statements regarding:

- anticipated growth in revenues and cashflows;
- management's belief that it will have adequate resources to fund the Company's operations and capital expenditures over at least the next twelve months;
- projected taxable income and the ability to use deferred tax assets;
- the expected impact of new accounting pronouncements;
- anticipated levels of future earnings and continued positive cash flow;
- the expectation that cost-cutting measures will be avoided;
- future capital expenditures and spending on research and development;
- needing to purchase equipment; and
- expected funding of future cash expenditures.

Forward-looking statements involve risks, uncertainties, estimates and assumptions that may cause our actual results, performance or achievements to be materially different from those expressed or implied by forward-looking statements. Important factors that could cause these differences include the following:

- statements with respect to management's strategy and planned initiatives;
- sales revenue growth may not be achieved or maintained;
- the dependence of our business on a small number of customers and potential loss of government contracts - particularly in light of potential cuts that may be imposed as a result of U.S. government budget appropriations;
- our lack of long-term purchase commitments from our customers and the ability of our customers to cancel, reduce, or delay orders for our products;
- our inability to build and maintain relationships with our customers;
- our inability to develop and utilize new technologies that address the needs of our customers;
- the cyclical nature of the electronics and military industries;
- the uncertainty of the U.S. and global economy;
- the impact of future exchange rate fluctuations;
- failure of our strategic alliances to achieve their objectives or perform as contemplated and the risk of cancellation or early termination of such alliance by either party;
- the loss of services of one or more of our key employees or the inability to hire, train, and retain key personnel;
- risks related to protection and infringement of intellectual property;
- our occasional dependence on sole suppliers or a limited group of suppliers;
- our ability to generate income to realize the tax benefit of our historical net operating losses;

- risks related to the limitation of the use, for tax purposes, of our net historical operating losses in the event of certain ownership changes; and
- other risks discussed below.

Except as may be required by applicable law, we do not undertake or intend to update or revise our forward-looking statements, and we assume no obligation to update any forward-looking statements contained in, or incorporated by reference into, this Annual Report on Form 10-K as a result of new information or future events or developments. Thus, assumptions should not be made that our silence over time means that actual events are bearing out as expressed or implied in such forward-looking statements.

Risk Factors

*You should consider carefully the following risks, along with other information contained in this Annual Report on Form 10-K. The risks and uncertainties described below are not the only ones that may affect us. Additional risks and uncertainties also may adversely affect our business and operations including those discussed in the heading **Factors Affecting Future Results** above. Any of the following events, should they actually occur, could materially and adversely affect our business and financial results.*

If we are unsuccessful at addressing our business challenges, our business and results of operations and financial condition may be adversely affected and our ability to invest in and grow our business could be limited.

In order to sustain profitability and improve liquidity, we must successfully achieve all or some combination of the following initiatives: increasing sales, developing new products, controlling operating expenses, managing our cash flows, improving operational efficiency and estimating and projecting accurately our liquidity and capital resources. In Management's Discussion and Analysis of Financial Condition and Results of Operations Management's Plan, Liquidity and Capital Resources in this Annual Report on Form 10-K, we made estimates regarding our cash flow, results of operations and ability to access our existing line of credit for the year ending December 31, 2015. If our cash flow, results of operations or ability to borrow under our line of credit are less favorable than we have estimated, we may not be able to make all of our planned operating or capital expenditures or fully execute all of our other plans. Our financial success depends in part on management's ability to execute our growth strategy. We expect that we will depend primarily on cash generated by our operations for funds to pay our expenses and any amounts due under our credit facility and any other indebtedness we may incur. Our ability to make these payments depends on our future performance, which will be affected by financial, business, economic and other factors, many of which we cannot control. Our business may not generate sufficient cash flows from operations in the future and our currently anticipated growth in revenues and cash flows may not be realized, either or both of which could result in our being unable to repay indebtedness or to fund other liquidity needs. If we do not have enough money, we may be required to sell assets or borrow money, in each case on terms that may not be acceptable to us. In addition, the terms of existing or future debt agreements, including our existing line of credit, may restrict us from adopting any of these alternatives. Further, any significant levels of indebtedness in the future could place us at a competitive disadvantage compared to our competitors that may have access to additional resources or proportionately less debt and could make us more

vulnerable to economic downturns and adverse developments in our business. Any future loss incurred by the Company could have a material adverse effect on our business and our ability to generate the cash needed to operate our business. Even though we achieved profitability during 2013 and 2014, we may be unable to sustain or increase our profitability in the future. Failure to continue to implement these initiatives successfully, or the failure of such initiatives to result in improved profitability, could have a material adverse effect on our business plans, liquidity, results of operations and financial condition and may result in a downsize to the business.

We currently derive all of our product revenue from our MTI Instruments business.

All of our revenue is currently derived from our MTI Instruments business. We do not have a broad portfolio of other products we could rely on to support operations if we were to experience a substantial slowdown in our MTI Instruments business, which is subject to a number of risks, including:

- dependence on a limited number of customers;
- a continued slow down or cancellation of sales to the military as a result of a potential redeployment, or sequestration, of governmental funding;
- our ability to maintain, improve, or expand its channels of distribution;
- the potential failure to expand or maintain the business as a result of competition, a lack of brand awareness, or market saturation; and
- an inability to launch new products as a result of intense competition, uncertainty of new technology development, or limited or unavailable resources to fund development.

In addition, revenues from the sale of MTI Instruments products can vary significantly from one period to the next. We may sell a significant amount of our products to one or a few customers for various short term projects in one period, and then have markedly decreased sales in following periods as these projects end or customers have the products they require for the foreseeable future. The fact that we sell a significant amount of our products to a limited number of customers also results in a customer concentration risk. The loss of any significant portion of such customers or a material adverse change in the financial condition of any one of these customers could have a material adverse effect on our revenues, our business and our ability to generate the cash needed to operate our business.

Variability of customer requirements resulting in cancellations, reductions, or delays may adversely affect our operating results.

We are required to provide rapid product turnaround and respond to short lead times. A variety of conditions, both specific to individual customers and generally affecting the demand for OEMs products, may cause customers to cancel, reduce, or delay orders. Cancellations, reductions, or delays by a significant customer or by a group of customers could adversely affect our operating results. Conversely, if our customers unexpectedly and significantly increase product orders, we may be required to rapidly increase production, which could strain our resources and

reduce our margins.

If we do not keep pace with technological innovations, our products may not be competitive and our revenue and operating results may suffer.

The electronic, semiconductor, solar, automotive and general industrial segments are subject to constant technological change. Our future success will depend on our ability to respond appropriately to changing technologies and changes in product function and quality. If we rely on products and technologies that are not attractive to end users, we may not be successful in capturing or retaining market share. Technological advances, the introduction of new products, and new design techniques could adversely affect our business prospects unless we are able to adapt to the changing conditions. Technological advances could render our products obsolete, and we may not be able to respond effectively to the technological requirements of evolving markets. As a result, we will be required to expend substantial funds for and commit significant resources to:

- continue research and development activities on all product lines;
- hire additional engineering and other technical personnel; and
- purchase advanced design tools and test equipment.

Our business could be harmed if we are unable to develop and utilize new technologies that address the needs of our customers, or our competitors do so more effectively than we do.

We may not be able to enhance our product solutions and develop new product solutions in a timely manner.

Our future operating results will depend to a significant extent on our ability to provide new products that compare favorably with alternative solutions on the basis of time to introduction, cost, performance, and end-user preferences. Our success in attracting and retaining customers and developing business will depend on various factors, including the following:

- innovative development of new products for customers;
- utilization of advances in technology;
- maintenance of quality standards;
- efficient and cost-effective solutions; and
- timely completion of the design and introduction of new products.

Our inability to develop new product solutions on a timely basis could harm our operating results and impede our growth.

Our efforts to develop new technologies may not result in commercial success and/or may result in delays in development, which could cause a decline in our revenue and could harm our business.

Our research and development efforts with respect to our technologies may not result in customer or market acceptance. Some or all of those technologies may not successfully make the transition from the research and development lab to cost-effective production as a result of technology problems, competitive cost issues, yield problems, and other factors. Even when we successfully complete a research and development effort with respect to a particular technology, our customers may decide not to introduce or may discontinue products utilizing the technology for a variety of reasons, including the following:

- difficulties with other suppliers of components for the products;
- superior technologies developed by our competitors and unfavorable comparisons of our solutions with these technologies;
- price considerations; and
- lack of anticipated or actual market demand for the products.

The nature of our business will require us to make continuing investments for new technologies. Significant expenses relating to one or more new technologies that ultimately prove to be unsuccessful for any reason could have a material adverse effect on us. In addition, any investments or acquisitions made to enhance our technologies may prove to be unsuccessful. If our efforts are unsuccessful, our business could be harmed.

The electronics and military industries are cyclical and may result in fluctuations in our operating results.

The electronics and military industries have experienced significant economic downturns at various times. These downturns are characterized by diminished product demand, accelerated erosion of average selling prices, and production overcapacity. We may seek to reduce our exposure to industry downturns by providing design and production services for leading companies in rapidly expanding industry segments. We may, however, experience substantial period-to-period fluctuations in future operating results because of general industry conditions or events occurring in the general economy.

Our operating results may experience significant fluctuations.

In addition to the variability resulting from the short-term nature of our customers' commitments, other factors contribute to significant periodic fluctuations in our results of operations. These factors include:

- the cyclical nature of the markets we serve;
- the timing and size of orders;
- the volume of orders relative to our capacity;
- product introductions and market acceptance of new products or new generations of products;
- evolution in the life cycles of our customers' products;
- timing of expenses in anticipation of future orders;
- changes in product mix;
- availability of manufacturing and assembly services;
- changes in cost and availability of labor and components;
- timely delivery of product solutions to customers;
- pricing and availability of competitive products;
- introduction of new technologies into the markets we serve;
- pressures on reducing selling prices;
- our success in serving new markets; and
- changes in economic conditions.

International sales risks could adversely affect our operating results. Furthermore, our operating results could be adversely affected by fluctuations in the value of the U.S. dollar against foreign currencies.

Having a worldwide distribution network for our products exposes us to various economic, political, and other risks that could adversely affect our operations and operating results, including the following:

- unexpected changes in regulatory requirements;
- timing to meet regulatory requirements;
- tariffs, duties and other trade barrier restrictions;
- greater difficulty in collecting accounts receivable;
- the burdens and costs of compliance with a variety of foreign laws;
- potentially reduced protection for intellectual property rights; and
- political or economic instability in certain parts of the world.

The risks associated with international sales could negatively affect our operating results.

We transact our business in U.S. dollars and bill and collect our sales in U.S. dollars. In 2014, approximately 35.6% of our revenue was from customers outside of the United States. A weakening of the dollar could cause our overseas vendors to require renegotiation of either the prices or currency we pay for their goods and services. Similarly, a strengthening of the dollar could cause our products to be more expensive for our international customers, which could impact price and margins and/or cause the demand for our products, and thus our revenue, to decline.

In the future, customers may negotiate pricing and make payments in non-U.S. currencies. If our overseas vendors or customers require us to transact business in non-U.S. currencies, fluctuations in foreign currency exchange rates could affect our cost of goods, operating expenses, and operating margins and could result in exchange losses. In addition, currency devaluation can result in a loss to us if we hold deposits of that currency. Hedging foreign currencies can be difficult, especially if the currency is not freely traded. We cannot predict the impact that future exchange rate fluctuations may have on our operating results.

Continuing uncertainty of the U.S. and global economy may have serious implications for the growth and stability of our business.

Revenue growth and continued profitability of our business will depend significantly on the overall demand for test and measurement instrumentations in key markets including research and development, automotive, semiconductor and electronics. Softening demand in these markets caused by ongoing economic uncertainty, technological developments, competitive changes or other factors may result in decreased revenue or earnings levels. The U.S. and global economy has been historically cyclical and market conditions continue to be challenging, which has resulted in individuals and companies delaying or reducing expenditures. Further delays or reductions in spending could have a

material adverse effect on demand for our products, and consequently on our business, financial condition, results of operations, prospects, stock price, and ability to continue to operate.

We depend on key personnel who would be difficult to replace, and our business will likely be harmed if we lose their services or cannot hire additional qualified personnel.

Our success depends substantially on the efforts and abilities of our senior management and key personnel. The competition for qualified management and key personnel, especially engineers, is intense. Although we maintain non-competition and non-disclosure covenants with most of our key personnel, we do not have employment agreements with most of them. The loss of services of one or more of our key employees or the inability to hire, train, and retain key personnel, especially engineers, technical support personnel, and capable sales and customer-support employees outside the United States, could delay the development and sale of our products, disrupt our business, and interfere with our ability to execute our business plan.

We may become subject to claims of infringement or misappropriation of the intellectual property rights of others, which could prohibit us from selling our products, require us to obtain licenses from third parties or to develop non-infringing alternatives, and subject us to substantial monetary damages and injunctive relief.

We may receive notices from third parties that the manufacture, use, or sale of any products we develop infringes upon one or more claims of their patents. Moreover, because patent applications can take many years to issue, there may be currently pending applications, unknown to us, that may later result in issued patents that materially and adversely affect our business. Third parties could also assert infringement or misappropriation claims against us with respect to our future product offerings, if any. We cannot be certain that we have not infringed the intellectual property rights of any third parties. Any infringement or misappropriation claim could result in significant costs, substantial damages, and our inability to manufacture, market, or sell any of our product offerings that are found to infringe. Even if we were to prevail in any such action, the litigation could result in substantial cost and diversion of resources that could materially and adversely affect our business. If a court determined, or if we independently discovered, that our product offerings violated third-party proprietary rights, there can be no assurance that we would be able to re-engineer our product offerings to avoid those rights or obtain a license under those rights on commercially reasonable terms, if at all. As a result, we could be prohibited from selling products that are found to infringe upon the rights of others. Even if obtaining a license were feasible, it may be costly and time-consuming. A court could also enter orders that temporarily, preliminarily, or permanently enjoin us from making, using, selling, offering to sell, or importing our products that are found to infringe on third parties' intellectual property rights, or could enter orders mandating that we undertake certain remedial actions. Further, a court could order us to pay compensatory damages for any such infringement, plus prejudgment interest, and could in addition treble the compensatory damages and award attorneys' fees. Any such payments could materially and adversely affect our business and financial condition.

Our confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and other proprietary information, which could limit our ability to compete.

We rely on trade secrets to protect our proprietary technology and processes. Trade secrets are difficult to protect. We enter into confidentiality and intellectual property assignment agreements with our employees, consultants, and other advisors. These agreements generally require that the other party keep confidential and not disclose to third parties confidential information developed by the party under such agreements or made known to the party by us during the course of the party's relationship with us. However, these agreements may not be honored and enforcing a claim that a party illegally obtained and is using our trade secrets is difficult, expensive and time-consuming, and the outcome is unpredictable. Our failure to obtain and maintain trade secret protection could adversely affect our competitive position.

We experienced an ownership change in MTI Micro that resulted in a limitation of tax attributes relating to the use of their net operating losses, and we may experience further ownership changes in MTI which would result in a further limitation of the use of our net operating losses.

A corporation generally undergoes an ownership change when the ownership of its stock, by value, changes by more than 50 percentage points over any three-year testing period. In the event of an ownership change, Section 382 of the Internal Revenue Code of 1986 imposes an annual limitation on the amount of post-ownership change taxable income a corporation may offset with pre-ownership change net operating loss (NOL) carryforwards and certain recognized built-in losses.

We estimate that as of December 31, 2014, the Company and MTI Instruments have NOL carryforwards of approximately \$51.2 million. Our ability to utilize the MTI NOL carryforwards, including any future NOL carryforwards that may arise, may be limited by Section 382 if we undergo any further ownership changes as a result of subsequent changes in the ownership of our outstanding common stock pursuant to the exercise of MTI options outstanding, additional financings obtained, or otherwise.

Item 1B: Unresolved Staff Comments

Not applicable.

Item 2: Properties

We lease approximately 17,400 square feet of office, manufacturing and research and development space at 325 Washington Avenue Extension, Albany, NY 12205. The current lease agreement expires on November 30, 2019. We believe our facilities are generally well maintained and adequate for our current needs and for expansion, if required.

Item 3: Legal Proceedings

At any point in time, we may be involved in various lawsuits or other legal proceedings. Such lawsuits could arise from the sale of products or services or from other matters relating to our regular business activities, compliance with various governmental regulations and requirements, or other transactions or circumstances. We do not believe there are any such proceedings presently pending that could have a material effect on our business, financial condition or results of operations.

Item 4: Mine Safety Disclosure

Not applicable.

PART II**Item 5: Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

(a)

Market Information

Our common stock is quoted on the OTC Markets Group quotation system (OTCQB: MKTY) on the OTCQB venture stage marketplace for early stage and developing U.S. and international companies. We are current in our reporting and undergo an annual verification and management certification process. Investors can find Real-Time quotes and market information for the Company on www.otcmarkets.com. The following table sets forth the high and low bid information for our common stock as reported on the OTC Market Group quotation system for the periods indicated:

| | High | Low |
|--|-------------|------------|
| Fiscal Year Ended December 31, 2014 | | |
| First Quarter | \$ 1.83 | \$.88 |
| Second Quarter | 1.66 | 1.01 |
| Third Quarter | 1.38 | .90 |
| Fourth Quarter | 1.18 | .64 |
| Fiscal Year Ended December 31, 2013 | | |
| First Quarter | \$.39 | \$.11 |
| Second Quarter | .70 | .22 |
| Third Quarter | 1.65 | .49 |
| Fourth Quarter | 1.08 | .75 |

Holdings

We have one class of common stock, par value \$.01, and are authorized to issue 75,000,000 shares of common stock. Each share of the Company's common stock is entitled to one vote on all matters submitted to stockholders. As of December 31, 2014, there were 5,258,883 shares of common stock issued and outstanding. As of February 18, 2015,

there were approximately 216 shareholders of record of the Company's common stock. The number of shareholders of record does not reflect the number of persons whose shares are held in nominee or street name accounts through brokers.

Dividends

We have never declared or paid dividends on our common stock and do not anticipate or contemplate paying cash dividends on our common stock in the foreseeable future. We currently intend to use all available funds to develop our business. We can give no assurances that we will ever have excess funds available to pay dividends. Any future determination as to the payment of dividends will depend upon critical requirements and limitations imposed by our credit agreements, if any, and such other factors as our board of directors may consider.

Item 6: Selected Financial Data

Not applicable.

Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the related notes included elsewhere in this Annual Report. This discussion contains forward-looking statements, which involve risk and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors, including those discussed in Item 1A: Risk Factors and elsewhere in this Annual Report.

Overview

MTI's core business is conducted through MTI Instruments, Inc., a wholly-owned subsidiary and the sole component of the Company's Test and Measurement Instrumentation segment. The Company also operated in a New Energy segment with business conducted through MTI MicroFuel Cells, Inc. until December 31, 2013 (date of MTI Micro deconsolidation). In August 2014, its management changed MTI Micro's name to MeOH Power, Inc. MTI continues to retain our equity ownership in that entity as discussed below. However, to keep prior and future filings consistent, MTI will continue to refer to this entity as MTI Micro in its reports.

Test and Measurement Instrumentation Segment MTI Instruments is a supplier of precision linear displacement solutions, vibration measurement and system balancing solutions, precision tensile measurement systems and wafer inspection tools, serving markets that require 1) the precise measurements and control of products and processes in automated manufacturing, assembly, and consistent operation of complex machinery, 2) metrology tools for semiconductor and solar wafer characterization, tensile stage systems for materials testing and precision linear displacement gauges all for use in academic and industrial research and development settings, and 3) engine balancing and vibration analysis systems for both military and commercial aircraft.

We are continuously working on ways to increase our sales reach, including expanded worldwide sales coverage and enhanced internet marketing.

New Energy Segment MTI Micro had been developing an off-the-grid power solution for various portable electronic devices. Its patented proprietary direct methanol fuel cell technology platform converts methanol fuel to usable electricity capable of providing continuous power, as long as necessary fuel flows are maintained. We are no longer active in this segment as of December 31, 2013.

Recent Developments

On April 7, 2014, MTI Instruments received International Organization for Standardization (ISO) ISO 9001:2008 certification, an internationally recognized standard issued to organizations with a quality management system. The certification was authorized by TÜVRheinland®, a premier global provider of independent testing and certification services with 15 locations throughout North America. ISO certification, in many cases, is a pre-requisite for vendors to establish relationships with large OEMs – an important set of customers for MTI Instruments.

The Mechanical Technology, Incorporated 2014 Equity Incentive Plan (the 2014 Plan) was adopted by the Company's Board of Directors on March 12, 2014 and approved by its stockholders on June 11, 2014. The 2014 Plan provides an initial aggregate number of 500,000 shares of common stock that may be awarded or issued. The number of shares that may be awarded under the 2014 Plan and awards outstanding may be subject to adjustment on account of any stock dividend, spin-off, stock split, reverse stock split, split-up, recapitalization, reclassification, reorganization, combination or exchange of shares, merger, consolidation, liquidation, business combination, exchange of shares or the like. Under the 2014 Plan, the Board-appointed administrator of the 2014 Plan is authorized to issue stock options (incentive and nonqualified), stock appreciation rights, restricted stock, restricted stock units, phantom stock, performance awards and other stock-based awards to employees, officers and directors of, and other individuals providing bona fide services to or for, the Company or any affiliate of the Company. Incentive stock options may only be granted to employees of the Company and its subsidiaries. As of December 31, 2014, 102,000 option awards have been issued under the 2014 Plan.

Results of Operations

Results of Operations for the Year Ended December 31, 2014 Compared to the Year Ended December 31, 2013.

Test and Measurement Instrumentation Segment

Product Revenue: Product revenue consists of revenue recognized from the Test and Measurement Instrumentation product lines.

Product revenue in our Test and Measurement Instrumentation segment for the year ended December 31, 2014 increased by \$429 thousand, or 5.1%, to \$8.8 million in 2014 from \$8.4 million in 2013. This increase in product revenue was attributable to an increase in both instruments for automated manufacturing and engine vibration and balancing system activity under government contracts as noted below. For the year ended December 31, 2014, the largest commercial customer for the segment was an Asian customer, which accounted for 8.3% of annual product revenue. In 2013, the largest commercial customer for the segment was an Asian customer, which accounted for 6.8% of annual product revenue. The U.S. Air Force was the largest government customer for the years ended December 31,

2014 and 2013, and accounted for 27.9% and 27.2%, respectively of annual product revenue.

Information regarding government contracts included in product revenue is as follows:

(Dollars in thousands)

| Contract ⁽¹⁾ | Expiration | Revenues for the | | Contract Revenues | Total Contract |
|--|---------------------------|------------------------------|------------------------------|------------------------|---------------------------|
| | | Year Ended December 31, 2014 | Year Ended December 31, 2013 | to Date | Orders Received |
| | | | | Date December 31, 2014 | To Date December 31, 2014 |
| \$6.5 million U.S. Air Force Maintenance | 09/27/2014 ⁽²⁾ | \$ 731 | \$ 863 | \$ 5,001 | \$ 5,001 |
| \$4.1 million U.S. Air Force Systems | 08/29/2015 ⁽²⁾ | \$ 1,539 | \$ 399 | \$ 2,793 | \$2,793 |
| \$917 thousand U.S. Air Force Kit | 09/30/2014 ⁽²⁾ | \$ — | \$585 | \$769 | \$769 |

(1) Contract values represent maximum potential values at time of contract placement and may not be representative of actual results.

(2) Date represents expiration of contract, including the exercise of option extensions.

Cost of Product Revenue: Cost of product revenue includes the direct material and labor cost as well as an allocation of overhead costs that relate to the manufacturing of products we sell. In addition, cost of product revenue also includes the labor and material costs incurred for product maintenance, replacement parts and service under our contractual obligations.

Cost of product revenue in our Test and Measurement Instrumentation segment for the year ended December 31, 2014 increased by \$30 thousand, or 0.9%, remaining at \$3.3 million in both 2014 and 2013. This increase was primarily as a result of the increased sales as discussed above under *Product Revenue*, partially offset by lower product material costs and improved inventory management. Gross profit, as a percentage of product revenue, increased to 62.6% in 2014 compared to 61.0% in 2013 due to the composition of the product sales mix and lower product material costs.

Unfunded Research and Product Development Expenses: Unfunded research and product development expenses (meaning research and development that we conduct that is not reimbursed by customers) includes the costs of materials to build development and prototype units, cash and non-cash compensation and benefits for the engineering and related staff, expenses for contract engineers, fees paid to outside suppliers for subcontracted components and services, fees paid to consultants for services provided, materials and supplies consumed, facility related costs such as computer and network services, and other general overhead costs associated with our research and development activities.

Unfunded research and product development expenses in our Test and Measurement Instrumentation segment for the year ended December 31, 2014 increased by \$26 thousand, or 2.0%, remaining at \$1.3 million in both 2014 and 2013. This increase was due to higher labor costs.

Selling, General and Administrative Expenses: Selling, general and administrative expenses includes cash and non-cash compensation, benefits and related costs in support of our general corporate functions, including general management, finance and accounting, human resources, selling and marketing, information technology and legal services.

Selling, general and administrative expenses in our Test and Measurement Instrumentation segment for the year ended December 31, 2014 increased by \$213 thousand, or 10.4%, to \$2.3 million in 2014 from \$2.1 million in 2013. This increase is the result of additional staffing in the sales department, increased international travel and higher promotional spending.

New Energy Segment

Selling, General and Administrative Expenses: Selling, general and administrative expenses in our New Energy segment for the year ended December 31, 2013 were \$89 thousand. As of December 31, 2013, the Company no longer reported the New Energy segment as a VIE and therefore there were no expenses related to this segment in 2014. Refer to the Consolidated Financial Statements Note 2 regarding the deconsolidation of the VIE.

MTI Parent Corporate Entity

Selling, General and Administrative Expenses: Selling, general and administrative expenses incurred by the Corporate Entity for the year ended December 31, 2014 increased by \$45 thousand, or 3.6%, remaining at \$1.3 million in both 2014 and 2013. This increase is primarily the result of increased compensation benefits partially offset by consulting costs incurred during 2013 in connection with the termination of the Company's former Chief Executive Officer, in 2012, for which there was no corresponding expense in 2014.

Results of Consolidated Operations

Operating Income: Operating income for the year ended December 31, 2014 was \$565 thousand compared to \$361 thousand in 2013. The change in operating income was a result of the factors noted above, primarily the increase in product revenue and the composition of the product sales mix.

Gain on Variable Interest Entity Deconsolidation: Gain on variable interest entity deconsolidation was \$3.6 million for the year ended December 31, 2013. As of December 31, 2013, the Company no longer reported MTI Micro as a VIE and the removal of the associated non-controlling interest from MTI's consolidated equity triggered this one-time gain. Refer to the Consolidated Financial Statements Note 2 regarding the deconsolidation of the VIE.

Other Income (Expense): Other income for the year ended December 31, 2014 was \$135 thousand compared to other expense of \$366 thousand in 2013. The increase in other income of \$501 thousand primarily relates to the \$380 thousand allowance recorded on a related party note receivable with MTI Micro in 2013 and a \$122 thousand reduction of the allowance during 2014 for funds received in 2014 and early 2015 related to New York State tax refunds.

Income Tax Benefit (Expense): Income tax benefit for the year ended December 31, 2014 was \$40 thousand and income tax expense for the year ended December 31, 2013 was \$35 thousand. Our income tax rate for the years ended December 31, 2014 and 2013 was (6)% and 1%, respectively. The year ended December 31, 2014 income tax benefit consists primarily of a \$210 thousand New York State tax refund and \$165 thousand in tax expense related to the utilization of our deferred tax assets. The year ended December 31, 2013 income tax expense consists of minimal state tax expense of under \$1 thousand and \$35 thousand in deferred tax expense related to the utilization of our deferred tax assets and an increase in the valuation allowance.

Net Loss Attributed to Non-Controlling Interests (of MTI Micro): The net loss attributed to non-controlling interests for the year ended December 31, 2013 was \$75 thousand. As of December 31, 2013, the Company no longer reported the New Energy segment as a VIE. Refer to the Condensed Consolidated Financial Statements Note 2 regarding the deconsolidation of the VIE.

Net Income: Net income for the year ended December 31, 2014 was \$740 thousand compared to net income of \$3.7 million for the same period in 2013. The decrease in net income of \$3.0 million for the year ended December 31, 2014 as compared to the same period in 2013 is primarily attributable to the \$3.6 million gain on variable interest entity deconsolidation in 2013.

Management's Plan, Liquidity and Capital Resources

Several key indicators of our liquidity are summarized in the following table:

| (Dollars in thousands) | Years Ended | |
|---|---------------------|-------------|
| | December 31, | |
| | 2014 | 2013 |
| Cash | \$ 1,923 | \$ 1,211 |
| Working capital | 2,763 | 1,771 |
| Net income attributed to MTI | 740 | 3,654 |
| Net cash provided by operating activities | 686 | 1,017 |
| Purchase of property, plant and equipment | (77) | (108) |

The Company has historically incurred significant losses, until 2012 the majority stemming from the direct methanol fuel cell product development and commercialization programs of MTI Micro, and had a consolidated accumulated deficit of \$117.8 million as of December 31, 2014. During the year ended December 31, 2014, the Company generated net income attributed to MTI of \$740 thousand, had cash provided by operating activities totaling \$686 thousand and had working capital of \$2.8 million at December 31, 2014. Management believes that the Company currently has adequate resources to avoid cost cutting measures that could adversely affect the business. As of December 31, 2014, we had no debt, \$5 thousand in outstanding commitments for capital expenditures and approximately \$1.9 million of cash available to fund our operations.

If production levels rise at MTI Instruments, additional capital equipment may be required in the foreseeable future. We expect to spend approximately \$400 thousand on capital equipment and \$1.5 million in research and development on MTI Instruments' products during 2015. We expect to finance any future expenditures and continue funding our operations from our current cash position and our projected 2015 cash flow pursuant to management's current plan. We may also seek to supplement our resources through sales of stock or assets. Besides the Company's line of credit, the Company has no other commitments for funding future needs of the organization at this time and such additional financing during 2015, if required, may not be available to us on acceptable terms or at all.

While it cannot be assured, management believes that, due in part to our current working capital level, recent replacements in sales staff, improved inventory management and stabilized spending, the Company should continue the positive cash flows that it experienced during 2014 and 2013 to fund the Company's active operations for the foreseeable future. However, if revenue estimates are delayed or missed, the Company may need to implement additional steps to ensure liquidity including, but not limited to, the deferral of planned capital spending and/or delaying existing or pending product development initiatives. Such steps, if required, could potentially have a material and adverse effect on our business, results of operations and financial condition.

Line of Credit

On May 5, 2014, the Company entered into a new revolving line of credit with Bank of America, N.A. (the Bank) to replace MTI Instruments' line of credit as discussed below. The Company may borrow under the line of credit from time to time up to \$1 million to support its working capital needs. The line of credit is available until July 31, 2015 and may be renewed subject to all the terms and conditions as set forth in the Loan Agreement (the Loan). The Loan is payable no later than the expiration date of the Loan, currently July 31, 2015, and interest is payable on the last day of each month beginning on May 30, 2014 and until payment has been made in full. The interest rate on funds borrowed under the line of credit is equal to the LIBOR Daily Floating Rate plus 2.75%. The Loan is secured by equipment and fixtures, inventory and receivables owned by the Company and guaranteed by MTI Instruments. The Company is required to hold a balance of \$0 for 30 consecutive days during the period from May 5, 2014 through July 31, 2015, and each subsequent one-year period of the Loan, if any. Upon the occurrence of an event of default, the Bank may set off against our repayment obligations any amounts we maintain at the Bank. The Company is also subject to other restrictions as set forth in the Loan. As of December 31, 2014, there were no amounts outstanding under the line of credit.

On September 20, 2011, MTI Instruments entered into a working capital line of credit with First Niagara Bank, N.A. Under this agreement, MTI Instruments could borrow from time to time up to \$400 thousand to support its working capital needs. The note was payable upon demand, and the interest rate on the note was equal to the prime rate with a floor of 4.0% per annum. The note was secured by a lien on all of the assets of MTI Instruments and was guaranteed by the Company. The line of credit was renewed on September 23, 2013 and expired on June 30, 2014. Under this line of credit, MTI Instruments was required to maintain a line balance of \$0 for 30 consecutive days during each calendar year. As of December 31, 2013, there were no amounts outstanding under the line of credit.

Backlog, Inventory and Accounts Receivable

At December 31, 2014, the Company's order backlog was \$665 thousand, compared to \$198 thousand at December 31, 2013. The increase in backlog was due to additional capacitance and fiber-optic products, along with a wafer metrology tool, in process at the end of the year.

Our inventory turnover ratios and average accounts receivable days outstanding for the years ended December 31, 2014 and 2013 and their changes are as follows:

| | Years Ended | | Change |
|--|---------------------|-------------|---------------|
| | December 31, | | |
| | 2014 | 2013 | |
| Inventory turnover | 3.9 | 3.8 | 0.1 |
| Average accounts receivable days outstanding | 39 | 42 | (3) |

The improvement in inventory turns is due to a 7% decrease in average inventory balances on 5% higher sales during the comparable periods.

The average accounts receivable days outstanding decreased three days in 2014 compared with 2013 due to the increase in sales to the U.S. Government, which pays within 30 days.

Off-Balance Sheet Arrangements

We have no off balance sheet arrangements.

Critical Accounting Policies and Significant Judgments and Estimates

The prior discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Note 2 of the Consolidated Financial Statements included in this Annual Report on Form 10-K includes a summary of our most significant accounting policies. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, inventories, income taxes and share-based

compensation. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Periodically, our management reviews our critical accounting estimates with the Audit Committee of our Board of Directors.

The significant accounting policies that we believe are most critical to aid in fully understanding and evaluating our consolidated financial statements include the following:

Revenue Recognition. We recognize product revenue when there is persuasive evidence of an arrangement, delivery of the product to the customer or distributor has occurred, at which time title generally is passed to the customer or distributor, and we have determined that collection of a fixed fee is probable, all of which occur upon shipment of the product. If the product requires that we provide installation, all revenue related to the product is deferred and recognized upon the completion of the installation.

Inventory. Inventory is valued at the lower of cost or the current estimated market value of the inventory. We periodically review inventory quantities on hand and record a provision for excess or obsolete inventory based primarily on our estimated forecast of product demand, as well as based on historical usage. Demand and usage for products and materials can fluctuate significantly. A significant decrease in demand for our products could result in a short-term increase in the cost of inventory purchases and an increase of excess inventory quantities on hand. Therefore, although we make every effort to assure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand could have a significant impact on the value of our inventory and our reported operating results. If changes in market conditions result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would increase our reserve in the period in which we made such a determination and record a charge to cost of product revenue.

Share-Based Payments. We grant options to purchase our common stock and award restricted stock to our employees and directors under our equity incentive plans. The benefits provided under these plans are share-based payments subject to the appropriate accounting provisions regarding Share-Based Payments. Effective January 1, 2006, we use the fair value method of accounting with the modified prospective application, which provides for certain changes to the method for valuing share-based compensation. The valuation provisions apply to new awards and to awards that are outstanding on the effective date and subsequently modified. Under the modified prospective application, prior periods are not revised for comparative purposes.

We estimate the fair value of share-based awards on the date of grant using a Black-Scholes option-pricing model. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate, and expected dividends.

If factors change and we employ different assumptions for the accounting methodology during future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period. Therefore, we believe it is important for investors to be aware of the high degree of subjectivity involved when using option-pricing models to estimate share-based compensation. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions, are fully transferable and do not cause dilution. Because our share-based payments have characteristics significantly different from those of freely traded options, and because changes in the subjective input assumptions can materially affect our estimates of fair values, in our opinion, existing valuation models, including the Black-Scholes Option Pricing model, may not provide reliable measures of the fair values of our share-based compensation. Consequently, there is a risk that our estimates of the fair values of our share-based compensation awards on the grant dates may bear little resemblance to the intrinsic values realized upon the exercise, expiration, cancellation, or forfeiture of those share-based payments in the future. Certain share-based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and expensed in our financial statements. Alternatively, value may be realized from these instruments that are significantly in excess of the fair values originally estimated on the grant date and expensed in our financial statements. There currently is neither a market-based mechanism nor other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor a way to compare and adjust the estimates to actual values. Although the fair value of employee share-based awards is determined using a qualified option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction. Estimates of share-based compensation expenses are significant to our financial statements, but these expenses are based on the aforementioned option valuation model and will never result in our payment of cash.

Theoretical valuation models and market-based methods are evolving and may result in lower or higher fair value estimates for share-based compensation. The timing, readiness, adoption, general acceptance, reliability, and testing of these methods is uncertain. Sophisticated mathematical models may require voluminous historical information, modeling expertise, financial analyses, correlation analyses, integrated software and databases, consulting fees, customization, and testing for adequacy of internal controls.

For purposes of estimating the fair value of stock options granted during the twelve months ended December 31, 2014 using the Black-Scholes model, we used the historical volatility of our stock for the expected volatility assumption input to the Black-Scholes model, consistent with the accounting guidance. The risk-free interest rate is based on the risk-free zero-coupon rate for a period consistent with the expected option term at the time of grant. We do not currently pay nor do we anticipate paying dividends, but we are required to assume a dividend yield as an input to the Black-Scholes model. As such, we use a zero dividend rate. The expected option term is calculated as an average time to forfeiture for all grants.

Income Taxes. As part of the process of preparing our consolidated financial statements, we calculate income taxes for each of the jurisdictions in which we operate. This involves estimating actual current taxes due together with assessing temporary differences resulting from differing treatment for tax and accounting purposes that are recorded as deferred tax assets and liabilities. We periodically evaluate deferred tax assets, net operating loss carryforwards and tax credit carryforwards to determine their recoverability based primarily on our ability to generate future taxable income.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our net deferred tax assets. We considered all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income amongst other items in determining our valuation allowance. In addition, our assessment requires us to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance, which further requires the exercise of significant management judgment.

We account for taxes in accordance with the asset and liability method of accounting for income taxes. Under this method, we must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The impact of our reassessment of our tax positions for these standards did not have a material impact on our results of operations, financial condition, or liquidity.

Recent Accounting Pronouncements

A discussion of recently adopted and new accounting pronouncements is included in Note 2 of the Consolidated Financial Statements in Part II, Item 8 of this Annual Report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8: Financial Statements and Supplementary Data

The Company's Consolidated Financial Statements begin on page F-1 and are incorporated in this Item 8 by reference.

Item 9: Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A: Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of MTI's disclosure controls and procedures as of December 31, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. We recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and we necessarily apply our judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the valuation of our disclosure controls and

procedures as of December 31, 2014, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Management's Report on Internal Control Over Financial Reporting

Management of our Company is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including the principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth in *Internal Control Integrated Framework* (1992 version) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation using the criteria set forth in *Internal Control Integrated Framework*, Management has concluded that our internal control over financial reporting was effective as of December 31, 2014.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Our report was not subject to attestation by our independent registered public accounting firm pursuant to rules of the SEC that permit us to provide only Management's Report in this annual report.

/s/ Kevin G. Lynch
Chief Executive Officer
(Principal Executive Officer)

/s/ Frederick W. Jones
Chief Financial Officer
(Principal Financial Officer)

(c) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during our fiscal quarter ended December 31, 2014 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Item 9B: Other Information

No information was required to be disclosed in a current Report on Form 8-K during the fourth quarter of the fiscal year covered by this Annual Report on Form 10-K that has not been reported.

PART III

Item 10: Directors, Executive Officers and Corporate Governance

Code of Ethics: We have adopted a Code of Ethics for employees, officers and directors. A copy of the Code of Ethics is available on our website at <http://www.mechtech.com> under Investor Relations, Corporate Governance.

The remaining information required by this Item 10 is incorporated herein by reference to the information appearing under the captions Information about our Directors, Executive Officers, Board of Director Meetings and Committees Audit Committee and Section 16(a) Beneficial Ownership Reporting Compliance in our definitive Proxy Statement for our 2015 Annual Meeting of Stockholders to be filed with the SEC on or before April 30, 2015.

Item 11: Executive Compensation

The information required by this Item 11 is incorporated herein by reference to the information appearing under the caption Executive Compensation in the Company's definitive Proxy Statement for our 2015 Annual Meeting of Stockholders to be filed with the SEC on or before April 30, 2015.

Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Equity Compensation Plans

As of December 31, 2014, we have five equity compensation plans, each of which was originally approved by our stockholders; the Mechanical Technology, Incorporated 1996 Stock Incentive Plan (the 1996 Plan), 1999 Employee Stock Incentive Plan (the 1999 Plan), 2006 Equity Incentive Plan (the 2006 Plan), the Mechanical Technology Incorporated 2012 Equity Incentive Plan (the 2012 Plan) and the Mechanical Technology Incorporated 2014 Equity Incentive Plan (the 2014 Plan). The 2006 Plan was amended and restated and approved by our Board of Directors in 2011 and 2009. We refer collectively to these as the Plans. See Note 12 of our Consolidated Financial Statements in

this Annual Report on Form 10-K for a description of these Plans.

The following table presents information regarding these plans as of December 31, 2014:

| Plan Category | Number of Securities To | Weighted Average | Number of Securities |
|---|--|--|---|
| | Be Issued Upon Exercise of | | Remaining Available for Future Issuance |
| | Outstanding Options, Warrants, Rights ⁽¹⁾ | Exercise | Under |
| | (a) | Price of Outstanding Options, Warrants, Rights | Equity Compensation Plans (excluding securities reflected in column (a)) ⁽²⁾ |
| | | (b) | (c) |
| Equity compensation plans approved by security holders | 693,439 | \$ 0.72 | 406,500 |
| Equity compensation plans not approved by security holders ⁽³⁾ | 109,469 | 0.74 | -0- |

(1) Under the 1996, 1999, 2006, 2012 and 2014 Plans, the securities available under the Plans for issuance and issuable pursuant to exercises of outstanding options may be adjusted in the event of a change in outstanding stock by reason of stock dividend, stock splits, reverse stock splits, etc.

(2) The 2012 and 2014 Plans are the only plans under which future awards can currently be made.

(3) Includes options outstanding under the 2006 Plan, which was amended by our Board of Directors without stockholder approval in 2009 and 2011 to increase the number of shares available for issuance thereunder. Under the 2006 Plan, the Board of Directors is authorized to issue stock options, stock appreciation rights, restricted stock, and other stock-based incentives to officers, employees and others. See Note 12 of our Consolidated Financial Statements in this Annual Report on Form 10-K for a further description of this Plan.

The remaining information required by this Item 12 is incorporated herein by reference to information appearing under the caption Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters in our definitive Proxy Statement for our 2015 Annual Meeting of Stockholders to be filed with the SEC on or before April 30, 2015.

Item 13: Certain Relationships and Related Transactions, and Director Independence

The information required by this Item 13 is incorporated herein by reference to the information appearing under the captions Certain Relationships and Related Transactions and Information about our Directors in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders to be filed with the SEC on or before April 30, 2015.

Item 14: Principal Accounting Fees and Services

The information required by this Item 14 is incorporated herein by reference to the information appearing under the caption "Independent Registered Public Accounting Firm" in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders to be filed with the SEC on or before April 30, 2015.

PART IV

Item 15: Exhibits, Financial Statement Schedules

15(a) (1) Financial Statements: The financial statements filed herewith are set forth on the Index to Consolidated Financial Statements on page F-1 of the separate financial section which accompanies this Report, which is incorporated herein by reference.

15(a) (2) Financial Statement Schedules: Financial statement schedules not listed have been omitted because they are either not required, not applicable, or the information has been included elsewhere in the consolidated financial statements or notes thereto.

15(a) (3) Exhibits: The exhibits listed in the Exhibit Index below are filed as part of this Annual Report on Form 10-K.

| Exhibit Number | Description |
|----------------|--|
| 3.1 | Certificate of Incorporation of the registrant, as amended and restated (Incorporated by reference from Exhibit 3.1 of the Company's Form 10-K Report for the year ended December 31, 2007). |
| 3.2 | Certificate of Amendment of the Certificate of Incorporation of the registrant (Incorporated by reference from Exhibit 3.2 of the Company's Form 8-K Report filed May 15, 2008). |
| 3.3 | Amended and Restated By-Laws of the registrant (Incorporated by reference from Exhibit 3.3 of the Company's Form 8-K Report filed December 14, 2007). |
| 10.1 | Mechanical Technology, Incorporated 1996 Stock Incentive Plan (Incorporated by reference from Appendix A of the Company's Definitive Proxy Statement Schedule 14A filed November 19, 1996).* |
| 10.2 | Mechanical Technology, Incorporated 1999 Employee Stock Incentive Plan (Incorporated by reference from Exhibit A of the Company's Proxy Statement Schedule 14A filed February 13, 1999).* |
| 10.3 | Form of Restricted Stock Agreement for the 1996 and 1999 Mechanical Technology, Inc. Stock Incentive Plans (Incorporated by reference from Exhibit 10.140 of the Company's Form 8-K Report filed May 18, 2006).* |
| 10.4 | Mechanical Technology, Incorporated Amended and Restated 2006 Equity Incentive Plan (Incorporated by reference from Exhibit 10.1 of the Company's Form S-8 Registration Statement filed September 18, |

Edgar Filing: MECHANICAL TECHNOLOGY INC - Form 10-K

2009).*

- 10.5 Mechanical Technology, Incorporated Amended and Restated 2006 Equity Incentive Plan (Incorporated by reference from Exhibit 10.1 of the Company's Form S-8 Registration Statement (File No. 333-175406) filed July 8, 2011).*
- 10.6 Form of Restricted Stock Agreement for Mechanical Technology, Incorporated Amended and Restated 2006 Equity Incentive Plan (Incorporated by reference from Exhibit 10.2 of the Company's Form 8-K Report filed July 11, 2011).*
- 10.7 Mechanical Technology, Incorporated 2012 Equity Incentive Plan (Incorporated by reference from Exhibit 10.1 of the Company's Form S-8 Registration Statement (File No. 333-182730) filed July 18, 2012).*
- 10.8 Form of Restricted Stock Agreement Notice for Board of Directors and Employees for Mechanical Technology, Incorporated 2012 Equity Incentive Plan (Incorporated by reference from Exhibit 10.2 of the Company's Form 10-Q Report for the quarter ended June 30, 2012).*
- 10.9 Form of Incentive Stock Option Notice for Employees for Mechanical Technology, Incorporated 2012 Equity Incentive Plan (Incorporated by reference from Exhibit 10.3 of the Company's Form 10-Q Report for the quarter ended June 30, 2012).*
- 10.10 Form of Non-Qualified Stock Option Notice for Employees for Mechanical Technology, Incorporated 2012 Equity Incentive Plan (Incorporated by reference from Exhibit 10.3 of the Company's Form 10-Q Report for the quarter ended June 30, 2012).*
- 10.11 Form of Non-Qualified Stock Option Notice for Board of Directors for Mechanical Technology, Incorporated 2012 Equity Incentive Plan (Incorporated by reference from Exhibit 10.3 of the Company's Form 10-Q Report for the quarter ended June 30, 2012).*
- 10.12 Mechanical Technology, Incorporated 2014 Equity Incentive Plan (incorporated by reference to Exhibit A to the Registrant's Proxy Statement on Schedule 14A filed with the Commission on April 25, 2014). *
- 10.13 Form of Restricted Stock Grant Agreement under the Mechanical Technology, Incorporated 2014 Equity Incentive Plan (incorporated by reference from Exhibit 4.2 of the Company's Registration Statement on Form S-8 (File No. 333-196989) filed with the Commission on June 24, 2014). *
- 10.14 Form of Nonstatutory Stock Option Grant Agreement under the Mechanical Technology, Incorporated 2014 Equity Incentive Plan (incorporated by reference from Exhibit 4.3 of the Company's Registration Statement on Form S-8 (File No. 333-196989) filed with the Commission on June 24, 2014). *
- 10.15 Form of Incentive Stock Option Grant Agreement under the Mechanical Technology, Incorporated 2014 Equity Incentive Plan (incorporated by reference from Exhibit 4.4 of the Company's Registration Statement on Form S-8 (File No. 333-196989) filed with the Commission on June 24, 2014). *

- 10.16 Lease dated August 10, 1999 between Carl E. Touhey and Mechanical Technology, Inc. (Incorporated by reference from Exhibit 10.38 of the Company's Form 10-K Report for the fiscal year ended September 30, 1999).
- 10.17 Amendment No. 1 to Lease Agreement Between Mechanical Technology Inc. and Carl E. Touhey dated September 29, 2009 (Incorporated by reference from Exhibit 10.166 of the Company's Form 10-K Report for the year ended December 31, 2009).
- 10.18 Amendment No. 2 to Lease Agreement Between MTI Instruments Inc. and Carl E. Touhey dated May 2, 2014 (Incorporated by reference from Exhibit 10.1 of the Company's Form 10-Q Report for the quarter ended March 31, 2014).
- 10.19 Loan Agreement dated May 5, 2014 between Mechanical Technology, Incorporated and Bank of America, N.A. (Incorporated by reference from Exhibit 10.2 of the Company's Form 10-Q Report for the quarter ended March 31, 2014).
- 10.20 Security Agreement dated May 5, 2014 between Mechanical Technology, Incorporated and Bank of America, N.A. (Incorporated by reference from Exhibit 10.3 of the Company's Form 10-Q Report for the quarter ended March 31, 2014).
- 10.21 Continuing and Unconditional Guaranty Agreement dated May 5, 2014 between MTI Instruments, Inc. and Bank of America, N.A. (Incorporated by reference from Exhibit 10.4 of the Company's Form 10-Q Report for the quarter ended March 31, 2014).
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Independent Registered Public Accounting Firm UHY LLP.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

All other exhibits for which no other filing information is given are filed herewith.

* Represents management contract or compensation plan or arrangement.

Signatures

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

**MECHANICAL TECHNOLOGY,
INCORPORATED**

Date: March 5, 2015

By: /s/ Kevin G. Lynch
Kevin G. Lynch
Chief 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.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--|---------------|
| <u>/s/ Kevin G. Lynch</u> Kevin G. Lynch | Chairman, Chief Executive Officer and Director (Principal Executive Officer) | March 5, 2015 |
| <u>/s/ Frederick W. Jones</u> | Chief Financial Officer and Secretary | |
| Frederick W. Jones | (Principal Financial and Accounting Officer) | March 5, 2015 |
| <u>/s/ Thomas J. Marusak</u> Thomas J. Marusak | Director | March 5, 2015 |
| <u>/s/ David C. Michaels</u> | Director | |

Edgar Filing: MECHANICAL TECHNOLOGY INC - Form 10-K

| | | |
|---|----------|---------------|
| David C. Michaels | | March 5, 2015 |
| <u>/s/ E. Dennis O Connor</u> E. Dennis O Connor | Director | March 5, 2015 |
| <u>/s/ William P. Phelan</u> William P. Phelan | Director | March 5, 2015 |
| <u>/s/ Walter L. Robb</u> Dr. Walter L. Robb | Director | March 5, 2015 |

**MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

| | Page |
|---|-------------|
| <u>Report of Independent Registered Public Accounting Firm</u> | F-2 |
| Consolidated Financial Statements: | |
| <u>Balance Sheets as of December 31, 2014 and 2013</u> | F-3 |
| <u>Statements of Operations for the Years Ended December 31, 2014 and 2013</u> | F-4 |
| <u>Statements of Changes in Equity for the Years Ended December 31, 2014 and 2013</u> | F-5 |
| <u>Statements of Cash Flows for the Years Ended December 31, 2014 and 2013</u> | F-6 |
| <u>Notes to Consolidated Financial Statements</u> | F-7 to F-23 |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Mechanical Technology, Incorporated

We have audited the accompanying consolidated balance sheets of Mechanical Technology, Incorporated as of December 31, 2014 and 2013, and the related consolidated statements of operations, changes in equity, and cash flows for each of the years in the two-year period ended December 31, 2014. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mechanical Technology, Incorporated as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America.

/s/UHY LLP
Albany, New York
March 5, 2015

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2014 and 2013

(Dollars in thousands, except per share)

| | December 31, | |
|--|---------------------|--------------|
| | 2014 | 2013 |
| Assets | | |
| Current Assets: | | |
| Cash | \$ 1,923 | \$ 1,211 |
| Accounts receivable | 1,196 | 824 |
| Notes receivable – related party, net | 20 | — |
| Inventories | 773 | 742 |
| Deferred income taxes, net | 20 | 25 |
| Prepaid expenses and other current assets | 92 | 111 |
| Total Current Assets | 4,024 | 2,913 |
| Deferred income taxes, net | 1,315 | 1,475 |
| Property, plant and equipment, net | 140 | 146 |
| Total Assets | \$5,479 | \$4,534 |
| Liabilities and Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 216 | \$ 149 |
| Accrued liabilities | 1,045 | 993 |
| Total Current Liabilities | 1,261 | 1,142 |
| Commitments and Contingencies (Note 14) | | |
| Equity: | | |
| Common stock, par value \$0.01 per share, authorized 75,000,000; 6,263,975 and 6,261,975 issued in 2014 and 2013, respectively | 63 | 63 |
| Additional paid-in-capital | 135,698 | 135,612 |
| Accumulated deficit | (117,789) | (118,529) |
| Common stock in treasury, at cost, 1,005,092 shares in both 2014 and 2013 | (13,754) | (13,754) |
| Total Stockholders' Equity | 4,218 | 3,392 |
| Total Liabilities and Equity | \$5,479 | \$4,534 |

The accompanying notes are an integral part of the consolidated financial statements.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended December 31, 2014 and 2013

| (Dollars in thousands, except per share) | Year Ended December 31, 2014 | Year Ended December 31, 2013 |
|---|---|---|
| Product revenue | \$8,781 | \$8,352 |
| Operating costs and expenses: | | |
| Cost of product revenue | 3,284 | 3,254 |
| Unfunded research and product development expenses | 1,346 | 1,320 |
| Selling, general and administrative expenses | 3,586 | 3,417 |
| Operating income | 565 | 361 |
| Gain on variable interest entity deconsolidation | — | 3,619 |
| Other income (expense), net | 135 | (366) |
| Income before income taxes and non-controlling interest | 700 | 3,614 |
| Income tax benefit (expense) | 40 | (35) |
| Net income | 740 | 3,579 |
| Plus: Net loss attributed to non-controlling interest | — | 75 |
| Net income attributed to MTI | \$740 | \$3,654 |
| Income per share attributable to MTI (Basic) | \$0.14 | \$0.70 |
| Income per share attributable to MTI (Diluted) | \$0.14 | \$0.69 |
| Weighted average shares outstanding (Basic) | 5,257,360 | 5,256,883 |
| Weighted average shares outstanding (Diluted) | 5,464,003 | 5,308,498 |

The accompanying notes are an integral part of the consolidated financial statements.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the Years Ended December 31, 2014 and 2013

| | Common Stock | | | Treasury Stock | | Total MTI Stockholders Equity (Deficit) | Non- Controlling Interest (NCI) | Total Equity | |
|--|--------------|--------|--------------------------------------|------------------------|-----------|---|--|-----------------|----------|
| | Shares | Amount | Additional Paid- in Capital | Accumulated Deficit | Shares | | | | Amount |
| January 1, 2013 | 6,261,975 | \$ 63 | \$ 135,561 | \$(122,183) | 1,005,092 | \$(13,754) | \$ (313) | \$ 3,311 | \$ 2,998 |
| Net income attributed to MTI | - | - | - | 3,654 | - | - | 3,654 | - | 3,654 |
| Stock based compensation | - | - | 51 | - | - | - | 51 | - | 51 |
| Net loss attributed to NCI | - | - | - | - | - | - | - | (75) | (75) |
| Equity contribution to NCI | - | - | - | - | - | - | - | 25 | 25 |
| Variable interest entity deconsolidation | - | - | - | - | - | - | - | (3,261) | (3,261) |
| December 31, 2013 | 6,261,975 | \$ 63 | \$ 135,612 | \$(118,529) | 1,005,092 | \$(13,754) | \$ 3,392 | \$ - | \$ 3,392 |
| Net income attributed to MTI | - | - | - | 740 | - | - | 740 | - | 740 |
| Stock based compensation | - | - | 85 | - | - | - | 85 | - | 85 |
| Issuance of shares – option exercises | 2,000 | - | 1 | - | - | - | 1 | - | 1 |
| December 31, 2014 | 6,263,975 | \$ 63 | \$ 135,698 | \$(117,789) | 1,005,092 | \$(13,754) | \$ 4,218 | \$ - | \$ 4,218 |

The accompanying notes are an integral part of the consolidated financial statements.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Years Ended December 31, 2014 and 2013**

| (Dollars in thousands) | Year Ended December 31, 2014 | Year Ended December 31, 2013 |
|---|---|---|
| Operating Activities | | |
| Net income | \$ 740 | \$ 3,579 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on variable interest entity deconsolidation | — | (3,619) |
| Depreciation | 83 | 91 |
| Gain on disposal of equipment | — | (13) |
| Deferred income taxes | 165 | 35 |
| Stock based compensation | 85 | 51 |
| Provision for excess and obsolete inventories | 16 | (159) |
| Provision for notes receivable – related party | (122) | 380 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (372) | 850 |
| Inventories | (47) | 535 |
| Prepaid expenses and other current assets | 19 | (11) |
| Accounts payable | 67 | (56) |
| Deferred revenue | — | (591) |
| Accrued liabilities | 52 | (55) |
| Net cash provided by operating activities | 686 | 1,017 |
| Investing Activities | | |
| Cash transfer from variable interest entity deconsolidation | — | (25) |
| Purchases of equipment | (77) | (108) |
| Principle payments from notes receivable – related party | 102 | — |
| Proceeds from sale of equipment | — | 13 |
| Net cash provided by (used in) investing activities | 25 | (120) |
| Financing Activities | | |
| Proceeds from stock option exercises | 1 | — |
| Proceeds from the issuance of stock due to the exercise of warrants | — | 25 |
| Net cash provided by financing activities | 1 | 25 |
| Increase in cash | 712 | 922 |
| Cash - beginning of period | 1,211 | 289 |
| Cash - end of period | \$ 1,923 | \$ 1,211 |

The accompanying notes are an integral part of the consolidated financial statements.

F - 6

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations

Description of Business

Mechanical Technology, Incorporated, (MTI or the Company), a New York corporation, was incorporated in 1961. The Company's core business is conducted through MTI Instruments, Inc. (MTI Instruments), a wholly-owned subsidiary and the sole component of the Company's Test and Measurement Instrumentation segment. Through the year ended December 31, 2013, the Company also operated in a New Energy segment with business conducted through MTI MicroFuel Cells, Inc. (MTI Micro). On December 31, 2013, as a result of a stock warrant exercise, the Company transferred management of MTI Micro to Dr. Walter L. Robb (a member of the Company's and MTI Micro's board of directors) and his new management team. The Company is consequently no longer reporting MTI Micro as a variable interest entity (VIE) as of the close of business on December 31, 2013 (date of MTI Micro deconsolidation). In August 2014, its management changed MTI Micro's name to MeOH Power, Inc. MTI continues to retain our equity ownership in that entity as discussed below. However, to keep prior and future filings consistent, MTI will continue to refer to this entity as MTI Micro in its reports.

MTI Instruments was incorporated in New York on March 8, 2000 and is a supplier of precision linear displacement solutions, vibration measurement and system balancing systems, and wafer inspection tools, consisting of electronic gauging instruments for position, displacement and vibration application within the industrial manufacturing/production markets, as well as the research, design and process development market; tensile stage systems for materials testing at academic and industrial research settings; and engine vibration analysis systems for both military and commercial aircraft. These tools, systems and solutions are developed for markets and applications that require the precise measurements and control of products, processes, and the development and implementation of automated manufacturing, assembly, and consistent operation of complex machinery.

MTI Micro was incorporated in Delaware on March 26, 2001, and, until its operations were suspended in late 2011, had been developing a handheld energy-generating device to replace current lithium-ion and similar rechargeable battery systems in many handheld electronic devices for the military and consumer markets.

Liquidity

The Company has incurred significant losses primarily due to its past efforts to fund MTI Micro's direct methanol fuel cell product development and commercialization programs, and has an accumulated deficit of approximately \$117.8 million and working capital of approximately \$2.8 million at December 31, 2014.

Based on the Company's projected cash requirements for operations and capital expenditures for 2015, its current available cash of approximately \$1.9 million, the \$1.0 million available from its existing line of credit, current cash flow requirements and revenue and expense projections, management believes it will have adequate resources to fund operations and capital expenditures for at least the next twelve months.

2. Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, MTI Instruments. The consolidated financial statements also include the accounts of a former VIE, MTI Micro, through December 31, 2013. The Company was considered the primary beneficiary of the VIE until December 31, 2013, when the Company transferred management of MTI Micro to Dr. Robb and his new management team. For purposes of these consolidated financial statements, the deconsolidation of MTI Micro was effective as of the close of business on December 31, 2013. All intercompany balances and transactions are eliminated in consolidation. The Company reflected the impact of the equity securities issuances in its investment in a VIE and additional paid-in-capital accounts for the dilution or anti-dilution of its ownership interest in the VIE.

The Company determined that the effect of the deconsolidation of the VIE would be to remove MTI Micro in the consolidated balance sheet as of December 31, 2013 but include MTI Micro's activity in the consolidated statement of operations for the year ended December 31, 2013. The following assets and liabilities of MTI Micro were not included in the consolidated balance sheet as of December 31, 2013 as a result of the VIE deconsolidation:

| (dollars in thousands) | 2013 |
|--|-------------|
| Cash | \$25 |
| Prepaid expenses and other current assets | 1 |
| Accounts payable | 3 |
| Related party note payable (see Note 15 for more detail) | 380 |

The fair value of the Company's current non-controlling interest (NCI) in MTI Micro was determined to be \$0 as of December 31, 2013 (date of MTI Micro deconsolidation) and \$0 as of December 31, 2014 based on MTI Micro's net position and expected cash flows. The Company records its investment in MTI Micro using the equity method of accounting. As of December 31, 2014, the Company retained its equity ownership of approximately 47.5% of MTI Micro's outstanding common stock, or 75,049,937 shares, and 54.0% of the common stock and warrants issued, which includes 31,904,136 warrants outstanding.

As of December 31, 2013, NCI is classified as equity in the consolidated financial statements. The consolidated statement of operations presents net income (loss) for both the Company and the non-controlling interests. The calculation of earnings per share is based on net income (loss) attributable to the Company.

Use of Estimates

The consolidated financial statements of the Company have been prepared in accordance with United States of America Generally Accepted Accounting Principles (U.S. GAAP), which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable and accounts payable. The estimated fair values of these financial instruments approximate their carrying values at December 31, 2014 and 2013. The estimated fair values have been determined through information obtained from market sources, where available.

Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are stated at the invoiced amount billed to customers and do not bear interest. An allowance for doubtful accounts, if necessary, represents the Company's best estimate of the amount of probable credit losses in its existing accounts receivable. The Company determines the allowance based on historical write-off experience and current exposures identified. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis by type of receivable. Account balances are charged off against the allowance when the Company believes it is probable the receivable will not be recovered. The Company does not have any off-balance-sheet credit

exposure related to its customers.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market. The Company provides estimated inventory allowances for excess, slow moving and obsolete inventory as well as inventory whose carrying value is in excess of net realizable value.

Property, Plant, and Equipment

Property, plant and equipment are stated at cost and depreciated using the straight-line method over their estimated useful lives as follows:

| | |
|--|---|
| Leasehold improvements | Lesser of the life of the lease or the useful life of the improvement |
| Computers and related software | 3 to 5 years |
| Machinery and equipment | 3 to 10 years |
| Office furniture, equipment and fixtures | 2 to 10 years |

Significant additions or improvements extending assets' useful lives are capitalized; normal maintenance and repair costs are expensed as incurred. The costs of fully depreciated assets remaining in use are included in the respective asset and accumulated depreciation accounts. When items are sold or retired, related gains or losses are included in net (loss) income.

Income Taxes

Deferred tax assets and liabilities are recognized for temporary differences between financial statement and income tax bases of assets and liabilities, loss carryforwards, and tax credit carryforwards, for which income tax benefits are expected to be realized in future years. A valuation allowance has been established to reduce deferred tax assets, if it is more likely than not that all, or some portion, of such deferred tax assets will not be realized. The effect on deferred taxes of a change in tax rates is recognized in the period which includes the enactment date.

The Company accounts for uncertain tax positions in accordance with accounting standards that address income taxes. The Company must recognize in its financial statements the impact of a tax position, if that position is more likely than not to be sustained on an audit, based on the technical merits of the position.

Equity Method Investments

Effective December 31, 2013, in connection with the deconsolidation of MTI Micro, the Company's consolidated net income (loss) will include our proportionate share, if any, of the net income or loss of our equity method investee. When the Company records its proportionate share of net income, it increases equity income (loss), net in our consolidated statements of operations and our carrying value in that investment. Conversely, when the Company records its proportionate share of a net loss, it decreases equity income (loss), net in our consolidated statements of operations and our carrying value in that investment. The Company's proportionate share of the net income or loss of our equity method investee includes significant operating and non-operating items recorded by our equity method investee. These items can have a significant impact on the amount of equity income (loss), net in our consolidated statements of operations and our carrying value in that investment. The carrying value of our equity method investment is also impacted by our proportionate share of items impacting the equity investee's accumulated other comprehensive income, if any.

Fair Value Measurement

The estimated fair value of certain financial instruments, including cash and short-term debt approximates their carrying value due to their short maturities and varying interest rates. "Fair value" is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation methods, the Company is required to provide the following information according to the fair value accounting standards. These standards established a fair value hierarchy as specified that ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities are classified and disclosed in one of the following three categories:

Level
1: Quoted market prices in active markets for identical assets or liabilities, which includes listed equities.

Level
2: Observable market based inputs or unobservable inputs that are corroborated by market data. These items are typically priced using models or other valuation techniques. These models are primarily financial industry-standard models that consider various assumptions, including the time value of money, yield curves, volatility factors, as well as other relevant economic measures.

Level
3: These use unobservable inputs that are not corroborated by market data. These values are generally estimated based upon methodologies utilizing significant inputs that are generally less observable from objective sources.

Revenue Recognition

The Company applies the accounting guidance for revenue recognition in the evaluation of its contracts to determine when to properly recognize revenue. The following outlines the various types of revenue and the determination of the recognition of income for each category:

Product Revenue

Product revenue is recognized when there is persuasive evidence of an arrangement, the collection of a fixed fee is probable or determinable, and delivery of the product to the customer or distributor has occurred, at which time title generally is passed to the customer or distributor. All of these generally occur upon shipment of the product. If the product requires installation to be performed by the Company, all revenue related to the product is deferred and recognized upon the completion of the installation. If the product requires specific customer acceptance, revenue is deferred until customer acceptance occurs or the acceptance provisions lapse, unless the Company can objectively and reliably demonstrate that the criteria specified in the acceptance provisions is satisfied.

MTI Instruments currently has distributor agreements in place for the international sale of general instrument and semiconductor products in certain global regions. Such agreements grant a distributor the right of first refusal to act as distributor for such products in the distributor's territory. In return, the distributor agrees to not market other products which are considered by MTI Instruments to be in direct competition with MTI Instruments' products. The distributor is allowed to purchase MTI Instruments' equipment at a price which is discounted off the published domestic/international list prices. Such list prices can be adjusted by MTI Instruments during the term of the distributor agreement. Generally, payment terms with the distributor are standard net 30 days; however, on occasion, extended payment terms have been granted. Title and risk of loss of the product passes to the distributor upon delivery to the independent carrier (standard "free-on-board" factory), and the distributor is responsible for any required training and/or service with the end-user. The sale (and subsequent payment) between MTI Instruments and the distributor is not contingent upon the successful resale of the product by the distributor. Distributor sales are covered by MTI Instruments' standard one-year warranty and there are no special return policies for distributors.

Some of MTI Instruments' direct sales, particularly sales of semi-automatic semiconductor metrology equipment, or rack-mounted vibration systems, involve on-site customer acceptance and/or installation. In those instances, revenue recognition does not take place at time of shipment. Instead, MTI Instruments recognizes the sale after the unit is installed and/or an on-site acceptance is given by the customer. Agreed-upon acceptance terms and conditions, if any, are negotiated at the time of purchase.

Cost of Product Revenue

Cost of product revenue includes material, labor, overhead and shipping and handling costs.

Deferred Revenue

Deferred revenue consists of billings to and/or payments received from customers in advance of services performed, completed installation or customer acceptance. As of December 31, 2014 and 2013, the Company had no deferred revenue.

Warranty

The Company accrues a warranty liability at the time product revenue is recorded based on historical experience. The liability is reviewed during the year and is adjusted, if appropriate, to reflect new product offerings or changes in experience. Actual warranty claims are tracked by product line. Warranty liability was \$18 thousand and \$17 thousand at December 31, 2014 and 2013, respectively.

Long-Lived Assets

The Company accounts for impairment or disposal of long-lived assets in accordance with accounting standards that address the financial accounting and reporting for the impairment or disposal of long-lived assets, specify how impairment will be measured, and how impaired assets will be classified in the consolidated financial statements. On a quarterly basis, the Company analyzes the status of its long-lived assets at each subsidiary for potential impairment. As of December 31, 2014, the Company does not believe that any of its long-lived assets have suffered any type of impairment that would require an adjustment to that asset's recorded value.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments with original maturities of less than three months.

Net Income (Loss) per Share

The Company computes basic income (loss) per common share by dividing net income (loss) by the weighted average number of common shares outstanding during the reporting period. Diluted income (loss) per share reflects the potential dilution, if any, computed by dividing income (loss) by the combination of dilutive common share equivalents, comprised of shares issuable under outstanding investment rights, warrants and the Company's share-based compensation plans, and the weighted average number of common shares outstanding during the reporting period. Dilutive common share equivalents include the dilutive effect of in-the-money stock options, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of a stock option, the amount of compensation cost, if any, for future service that the Company has not yet recognized, and the amount of windfall tax benefits that would be recorded in additional paid-in capital, if any, when the stock option is exercised are assumed to be used to repurchase shares in the current period.

Share-Based Payments

The Company accounts for stock based awards exchanged for employee service in accordance with the stock-based payment accounting guidance. The Company has five share-based employee compensation plans, all of which are described more fully in Note 12, Stock Based Compensation.

Stock-based compensation represents the cost related to stock-based awards granted to employees and directors. The Company measures stock-based compensation cost at grant date based on the estimated fair value of the award, and recognizes the cost as expense on a straight-line basis in accordance with the vesting of the options (net of estimated forfeitures) over the option's requisite service period. The Company estimates the fair value of stock-based awards using a Black Scholes valuation model. Stock-based compensation expense is recorded in the lines titled "Cost of product revenue," "Selling, general and administrative expenses" and "Unfunded research and product development expenses" in the Consolidated Statements of Operations based on the employees' respective functions.

The Company records deferred tax assets for awards that potentially can result in deductions on the Company's income tax returns based on the amount of compensation cost that would be recognized upon issuance of the award and the Company's statutory tax rate. Differences between the deferred tax assets recognized for financial reporting purposes

and the actual tax deduction reported on the Company's income tax return are recorded in Additional Paid-In Capital (if the tax deduction exceeds the deferred tax asset) or in the Consolidated Statement of Operations (if the deferred tax asset exceeds the tax deduction and no historical pool of windfall tax benefits exists). Since the adoption of the revised accounting standard on share-based payments, no tax benefits have been recognized related to share-based compensation since the Company has established a full valuation allowance to offset all potential tax benefits associated with these deferred tax assets.

Concentration of Credit Risk

Financial instruments that subject the Company to concentrations of credit risk principally consist of cash equivalents and trade accounts receivable. The Company's trade accounts receivable are primarily from sales to commercial customers, the U.S. government and state agencies. The Company does not require collateral and has not historically experienced significant credit losses related to receivables from individual customers or groups of customers in any particular industry or geographic area.

The Company has cash deposits in excess of federally insured limits, but does not believe them to be at risk.

Research and Development Costs

The Company expenses research and development costs as incurred. The Company incurred research and development costs of approximately \$1.3 million, which was entirely related to MTI Instruments, in each of the years ended December 31, 2014 and 2013.

Advertising Costs

The Company expenses advertising costs as incurred. The Company incurred advertising costs of approximately \$121 and \$73 thousand, which was entirely related to MTI Instruments, for the years ended December 31, 2014 and 2013, respectively.

Other Comprehensive Income

The Company had no other comprehensive income (loss) items for the years ended December 31, 2014 and 2013.

Effect of Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09 (Revenue from Contracts with Customers) to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The standard is principles-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This standard is effective for fiscal years and interim periods within those years beginning after December 15, 2016; early adoption is not permitted. This standard is effective for the Company beginning in fiscal 2017 and may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. This standard could impact the timing and amounts of revenue recognized. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In August 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-15 (Presentation of Financial Statements – Going Concern) which requires management to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and provide related footnote disclosures. This standard is effective for annual and interim reporting periods beginning on or after December 15, 2016. Early adoption is permitted for financial statements that have not been previously issued. This standard allows for either a full retrospective or modified retrospective transition method. The Company does not expect this standard to have a material impact on its consolidated financial statements upon adoption.

3. Accounts Receivable

Accounts receivables consist of the following at December 31:

| (dollars in thousands) | 2014 | 2013 |
|-------------------------------|-------------|-------------|
| U.S. and State Government | \$3 | \$37 |
| Commercial | 1,193 | 787 |
| Total | \$1,196 | \$824 |

As of December 31, 2014 and 2013, the Company had no allowance for doubtful trade accounts receivable.

4. Inventories

Inventories consist of the following at December 31:

| (dollars in thousands) | 2014 | 2013 |
|-------------------------------|-------------|-------------|
| Finished goods | \$314 | \$287 |
| Work in process | 161 | 188 |
| Raw materials | 298 | 267 |
| Total | \$773 | \$742 |

5. Property, Plant and Equipment

Property, plant and equipment consist of the following at December 31:

| (dollars in thousands) | 2014 | 2013 |
|--------------------------------|-------------|-------------|
| Leasehold improvements | \$39 | \$32 |
| Computers and related software | 1,035 | 1,281 |
| Machinery and equipment | 817 | 810 |
| Office furniture and fixtures | 61 | 125 |
| | 1,952 | 2,248 |
| Less: Accumulated depreciation | 1,812 | 2,102 |
| | \$140 | \$146 |

Depreciation expense was \$83 thousand and \$91 thousand for 2014 and 2013, respectively. Repairs and maintenance expense was \$22 thousand and \$19 thousand for 2014 and 2013, respectively. In conjunction with the suspension of MTI Micro operations in late 2011, sales of certain surplus equipment on hand were made during 2013. This resulted in a net gain on sale of \$13 thousand for 2013. As of December 31, 2013 all \$13 thousand in sales proceeds were received.

6. Income Taxes

Income tax benefit (expense) for each of the years ended December 31 consists of the following:

| (dollars in thousands) | 2014 | 2013 |
|-------------------------------|-------------|-------------|
| Federal | \$(2) | \$— |

| | | |
|----------|-------|--------|
| State | 207 | — |
| Deferred | (165) | (35) |
| Total | \$40 | \$(35) |

The significant components of deferred income tax (expense) benefit from operations before non-controlling interest for each of the years ended December 31 consists of the following:

| (dollars in thousands) | 2014 | 2013 |
|----------------------------------|-------------|-------------|
| Deferred tax (expense) benefit | \$(46) | \$64 |
| Net operating loss carry forward | (234) | (165) |
| Valuation allowance | 115 | 66 |
| | \$(165) | \$(35) |

F - 12

The Company's effective income tax rate from operations before non-controlling interest differed from the Federal statutory rate for each of the years ended December 31 as follows:

| | 2014 | 2013 |
|--|-------------|-------------|
| Federal statutory tax rate | 34 % | 34 % |
| Gain on VIE deconsolidation | — | (33) |
| Change in valuation allowance | (16) | (2) |
| State research and development credits | (30) | — |
| Expiration of stock option | 5 | 1 |
| Other, net | 1 | 1 |
| Tax Rate | (6)% | 1 % |

Pre-tax income (loss) before non-controlling interests was \$700 thousand and \$3.6 million for 2014 and 2013, respectively.

The Company was entitled to a research tax credit for qualifying amounts paid or incurred on or before December 31, 2011, for which the Company made the appropriate filings in 2013. Given the uncertain nature of the tax benefit, the Company did not take a tax position with regards to these credits. During 2014, the Company determined that realization of this asset was more likely than not and recognized a tax benefit of \$210 thousand for qualifying amounts incurred in 2009.

Deferred Tax Assets:

Deferred tax assets are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates. Temporary differences, net operating loss carryforwards and tax credit carryforwards that give rise to deferred tax assets and liabilities are summarized as follows as of December 31:

| (dollars in thousands) | 2014 | 2013 |
|---|-------------|-------------|
| Current deferred tax assets: | | |
| Inventory valuation | \$69 | \$65 |
| Inventory capitalization | 4 | 4 |
| Vacation pay | 32 | 34 |
| Warranty and other sale obligations | 6 | 6 |
| Allowance for related party note receivable | 88 | 131 |
| Other reserves and accruals | 66 | 63 |
| | 265 | 303 |
| Valuation allowance – current | (245) | (278) |

| | | |
|-------------------------------------|----------|----------|
| Net current deferred tax assets | \$20 | \$25 |
| Noncurrent deferred tax assets: | | |
| Net operating loss | \$17,216 | \$17,450 |
| Property, plant and equipment | (2 |) — |
| Stock options | 77 | 83 |
| Research and development tax credit | 450 | 450 |
| Alternative minimum tax credit | 54 | 54 |
| | 17,795 | 18,037 |
| Valuation allowance – noncurrent | (16,480) | (16,562) |
| Non-current net deferred tax assets | \$1,315 | \$1,475 |

As of December 31, 2014, the Company has approximately \$450 thousand of research and development tax credit carry forwards, which begin to expire in 2018, and approximately \$54 thousand of alternative minimum tax credit carry forwards, which have no expiration date.

Valuation Allowance:

The Company provides for recognition of deferred tax assets if the realization of such assets is more likely than not to occur in accordance with accounting standards that address income taxes. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. The Company has considered all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income amongst other items, in determining its valuation allowance. In addition, the Company's assessment requires us to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance which further requires the exercise of significant management judgment.

The Company has determined that it expects to generate sufficient levels of pre-tax earnings in the future to realize the net deferred tax assets recorded on the balance sheet at December 31, 2014. The Company has projected such pre-tax earnings utilizing a combination of historical and projected results, taking into consideration existing levels of permanent differences, non-deductible expense and the reversal of significant temporary differences. We project that our taxable income for the next three years is adequate to ensure the realizability of the \$1.3 million of deferred tax assets recorded on our balance sheet at December 31, 2014. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust the recorded valuation allowance, which could materially impact our financial position and results of operations. We will continue to evaluate the ability to realize our deferred tax assets and related valuation allowance on a quarterly basis.

The valuation allowance at December 31, 2014 and 2013 was \$16.7 million and \$16.8 million, respectively. Activity in the valuation allowance for deferred tax assets is as follows as of December 31:

| (dollars in thousands) | 2014 | 2013 |
|---|-------------|-------------|
| Valuation allowance, beginning of year | \$16,840 | \$17,817 |
| VIE deconsolidation | — | (911) |
| Allowance for related party note receivable | (42) | 131 |
| Inventory | 5 | (58) |
| Net operating loss | (72) | (130) |
| Property, plant and equipment | (2) | (19) |
| Stock options | (6) | (22) |
| Other reserves and accruals | 2 | 32 |
| Valuation allowance, end of year | \$16,725 | \$16,840 |

Net operating losses:

At December 31, 2014, the Company has unused Federal net operating loss carryforwards of approximately \$51.2 million. Of these, \$2.0 million will expire in 2020, with the remainder expiring through 2034. Of the Company's carryforwards, \$1.3 million represents windfall tax benefits from stock option transactions, the tax effect of which are not included in the Company's net deferred tax assets.

The Company's and/or its subsidiaries' ability to utilize their net operating loss carryforwards may be significantly limited by Section 382 of the IRC of 1986, as amended, if the Company or any of its subsidiaries undergoes an "ownership change" as a result of changes in the ownership of the Company's or its subsidiaries' outstanding stock pursuant to the exercise of the warrants or otherwise.

Unrecognized tax benefits:

The unrecognized tax benefits in accordance with accounting standards that address income taxes at December 31, 2014 and 2013 was \$1.2 million. These unrecognized tax benefits relate to former subsidiaries of the Company and a prior investment in a partnership.

In future periods, if \$1.2 million of these unrecognized benefits become supportable, the Company may not recognize a change in its effective tax rate as long as it remains in a partial valuation allowance position. Additionally the Company does not have uncertain tax positions that it expects will increase or decrease within twelve months of this reporting date. The Company recognizes interest and penalties related to uncertain tax positions as a component of tax expense. The Company did not recognize any interest or penalties in 2014 and 2013.

The Company files income tax returns, including returns for its subsidiaries, with federal and state jurisdictions. The Company is no longer subject to IRS or NYS examinations for its federal and state returns for any periods prior to 2009, although carryforward attributes that were generated prior to 2009 may still be adjusted upon examination by the IRS if they either have been or will be used in a future period.

7. Accrued Liabilities

Accrued liabilities consist of the following at December 31:

| (dollars in thousands) | 2014 | 2013 |
|--|-------------|-------------|
| Salaries, wages and related expenses | \$349 | \$399 |
| Liability to shareholders for previous acquisition | 363 | 363 |
| Legal and professional fees | 96 | 103 |
| Warranty and other sale obligations | 18 | 17 |
| Commissions | 37 | 39 |
| Other | 182 | 72 |
| | \$1,045 | \$993 |

8. Stockholders' Equity**Common Stock**

The Company has one class of common stock, par value \$.01. Each share of the Company's common stock is entitled to one vote on all matters submitted to stockholders. As of December 31, 2014 and 2013 there were 5,258,883 and 5,256,883 shares of common stock issued and outstanding, respectively.

Reservation of Shares

The Company has reserved common shares for future issuance as follows as of December 31, 2014:

| | |
|--|-----------|
| Stock options outstanding | 802,908 |
| Common stock available for future equity awards or issuance of options | 406,500 |
| Number of common shares reserved | 1,209,408 |

9. Issuance of Common Stock, Warrants and Stock Options by MTI Micro

MTI Micro was formed on March 26, 2001, and, as of December 31, 2014, the Company owned an aggregate of approximately 47.5% of MTI Micro's outstanding common stock, or 75,049,937 shares, and 54.0% of the common stock and warrants issued, which includes 31,904,136 warrants outstanding. The number of shares of MTI Micro common stock authorized for issuance is 240,000,000 as of December 31, 2014.

As a result of the deconsolidation of MTI Micro operations on December 31, 2013 (see Note 2), MTI Micro will no longer remain in our consolidated operations.

Common Stock Issued – MTI Micro

On December 31, 2013, Dr. Robb exercised a portion of his outstanding MTI Micro warrants to purchase 357,143 shares of MTI Micro Common Stock at an exercise price of \$0.07 per share.

The following table represents changes in ownership between the Company and non-controlling interests (NCI) in common shares of MTI Micro:

| | MTI | | Non Controlling Interests | | Total Shares |
|--|------------|-------------|---------------------------|-------------|--------------|
| | Shares | Ownership % | Shares | Ownership % | |
| Balance at 12/31/12 | 75,049,937 | 47.61 | 82,573,107 | 52.39 | 157,623,044 |
| Stock issued from the exercise of warrants | | | 357,143 | | 357,143 |
| Balance at 12/31/13 | 75,049,937 | 47.51 | 82,930,250 | 52.49 | 157,980,187 |

10. Retirement Plan

The Company maintains a voluntary savings and retirement plan under IRC Section 401(k) covering substantially all employees. Employees must complete six months of service and have attained the age of twenty-one prior to becoming eligible for participation in the plan. The Company plan allows eligible employees to contribute a percentage of their compensation on a pre-tax basis and the Company matches employee contributions dollar for dollar up to a discretionary amount, currently 4%, of the employee's salary, subject to annual tax deduction limitations. Company matching contributions vest at a rate of 25% annually for each year of service completed. Company matching contributions were \$83 thousand and \$60 thousand for 2014 and 2013, respectively. The Company may also make additional discretionary contributions in amounts as determined by management and the Board of Directors. There were no additional discretionary contributions by the Company for the years 2014 or 2013.

11. Income (Loss) per Share

The following table sets forth the reconciliation of the numerators and denominators of the basic and diluted per share computations for continuing operations for the years ended December 31:

| (dollars in thousands, except shares) | 2014 | 2013 |
|---|-----------|-----------|
| <u>Numerator:</u> | | |
| Net income (loss) | \$740 | \$3,654 |
| <u>Denominator:</u> | | |
| Basic EPS: | | |
| Common shares outstanding, beginning of period | 5,256,883 | 5,256,883 |
| Weighted average common shares issued during the period | 477 | — |
| Denominator for basic earnings per common shares — Weighted average common shares | 5,257,360 | 5,256,883 |
| Diluted EPS: | | |
| Common shares outstanding, beginning of period | 5,256,883 | 5,256,883 |
| Common stock equivalents - options | 206,643 | 51,615 |
| Weighted average common shares issued during the period | 477 | — |
| Denominator for diluted earnings per common shares - Weighted average common shares | 5,464,003 | 5,308,498 |

Not included in the computation of earnings per share-assuming dilution for the year ended December 31, 2014 were options to purchase 383,158 shares of the Company's common stock. These potentially dilutive items were excluded even though the average market price of the common stock exceeded the exercise prices for a portion of the options because the calculation of incremental shares resulted in an anti-dilutive effect.

Not included in the computation of earnings per share-assuming dilution for the year ended December 31, 2013 were options to purchase 332,506 shares of the Company's common stock. These potentially dilutive items were excluded even though the average market price of the common stock exceeded the exercise prices for a portion of the options because the calculation of incremental shares resulted in an anti-dilutive effect.

12. Stock Based Compensation

MTI Option Plans

Stock-based incentive awards are provided to employees and directors under the terms of the Company's 1996 Stock Incentive Plan (1996 Plan), 1999 Employee Stock Incentive Plan (1999 Plan), 2006 Equity Incentive Plan (2006 Plan), which was amended and restated effective June 30, 2011 and September 16, 2009, 2012 Equity Incentive Plan (the 2012 Plan) and 2014 Equity Incentive Plan (the 2014 Plan), (collectively, the Plans). Awards under the Plans have generally included at-the-money options and restricted stock grants.

Stock options are awards which allow holders to purchase shares of the Company's common stock at a fixed price. Stock options issued to employees generally vest 50% immediately, and then quarterly over the next three years. Options issued to non-employee members of the MTI Board of Directors generally vest upon grant. Certain options granted may be fully or partially exercisable immediately, may vest on other than a four year schedule or vest upon attainment of specific performance criteria. Restricted stock awards generally vest one year after the date of grant; however, certain awards may vest immediately or vest upon attainment of specific performance criteria. Option exercise prices are generally equivalent to the closing market value price of the Company's common stock on the date of grant. Unexercised options generally terminate either seven or ten years after date of grant.

The 1996 Plan was approved by stockholders during December 1996 and expired during October 2006. The 1996 Plan provided an initial aggregate number of 500,000 shares of common stock to be awarded or issued. The number of shares available to be awarded under the 1996 Plan and awards outstanding were adjusted for stock splits and rights offerings. The total number of shares which may be awarded under the 1996 Plan was 468,352 during 2005. Under the 1996 Plan, the Board of Directors was authorized to issue stock options, stock appreciation rights, restricted stock, and other stock-based incentives to officers, employees and others.

The 1999 Plan was adopted by the Company's Board of Directors, approved by stockholders on March 18, 1999 and expired during 2009. The 1999 Plan provided an initial aggregate number of 1,000,000 shares of common stock to be awarded or issued. The number of shares to be awarded under the 1999 Plan and awards outstanding were adjusted for stock splits, and during 2005, 2006, and 2007, the total number of shares which could be awarded under the 1999 Plan was 562,500 shares. Under the 1999 Plan, the Board of Directors was authorized to issue stock-based awards to officers, employees and others.

The 2006 Plan was adopted by the Company's Board of Directors on March 16, 2006 and approved by stockholders on May 18, 2006. The plan was amended and restated by the Board of Directors effective September 16, 2009 and June 30, 2011. The September 16, 2009 Amended and Restated 2006 Equity Incentive Plan increased the initial aggregate number of 250,000 shares of common stock which may be awarded or issued to 600,000, and the June 30, 2011 Amended and Restated 2006 Equity Incentive Plan increased the aggregate number of shares of common stock which may be awarded or issued to 1,200,000. The number of shares which may be awarded under the 2006 Plan and awards outstanding has been adjusted for stock splits and other similar events. Under the 2006 Plan, the Board of Directors is authorized to issue stock options, stock appreciation rights, restricted stock, and other stock-based incentives to officers, employees and others. In connection with seeking stockholder approval of the 2012 Plan, the Company agreed not to make further awards under the 2006 Plan.

The 2012 Plan was adopted by the Company's Board of Directors on April 14, 2012 and approved by its stockholders on June 14, 2012. The 2012 Plan provides an initial aggregate number of 600,000 shares of common stock which may be awarded or issued. The number of shares which may be awarded under the 2012 Plan and awards outstanding can be subject to adjustment on account of any recapitalization, reclassification, stock split, reverse stock split and other dilutive changes in Common Stock. Under the 2012 Plan, the Board of Directors is authorized to issue stock options (incentive and nonqualified), stock appreciation rights, restricted stock, restricted stock units and other stock-based

awards to employees, officers, directors, consultants and advisors of the Company and its subsidiaries. Incentive stock options may only be granted to employees of the Company and its subsidiaries.

The 2014 Plan was adopted by the Company's Board of Directors on March 12, 2014 and approved by its stockholders on June 11, 2014. The 2014 Plan provides an initial aggregate number of 500,000 shares of common stock that may be awarded or issued. The number of shares that may be awarded under the 2014 Plan and awards outstanding may be subject to adjustment on account of any stock dividend, spin-off, stock split, reverse stock split, split-up, recapitalization, reclassification, reorganization, combination or exchange of shares, merger, consolidation, liquidation, business combination, exchange of shares or the like. Under the 2014 Plan, the Board appointed administrator of the 2014 Plan is authorized to issue stock options (incentive and nonqualified), stock appreciation rights, restricted stock, restricted stock units, phantom stock, performance awards and other stock-based awards to employees, officers and directors of, and other individuals providing bona fide services to or for, the Company or any affiliate of the Company. Incentive stock options may only be granted to employees of the Company and its subsidiaries.

During 2014, the Company granted 140,000 options to purchase the Company's common stock from the 2012 Plan, which generally vest 25% on each of the first four anniversaries of the date of the award. The exercise price of these grants was \$1.08 per share and was based on the closing market price of the Company's common stock on the dates of grant. Using a Black-Scholes Option Pricing Model, the weighted average fair value of these options was \$1.07 per share and was estimated at the date of grant.

During 2014, the Company granted 102,000 options to purchase the Company's common stock from the 2014 Plan, which generally vest 25% on each of the first four anniversaries of the date of the award. The exercise price of these grants was \$0.85 per share and was based on the closing market price of the Company's common stock on the dates of grant. Using a Black-Scholes Option Pricing Model, the weighted average fair value of these options was \$0.84 per share and was estimated at the date of grant.

During 2013, the Company granted 298,000 options to purchase the Company's common stock from the 2012 Plan, which generally vest 25% on each of the first four anniversaries of the date of the award. The exercise price of these grants ranged from \$0.46 per share to \$0.90 per share and was based on the closing market price of the Company's common stock on the dates of grant. Using a Black-Scholes Option Pricing Model, the weighted average fair value of these options was \$0.58 per share and was estimated at the date of grant.

Stock-based compensation expense for the years ended December 31, 2014 and 2013 was generated from stock option awards. Stock options are awards which allow holders to purchase shares of the Company's common stock at a fixed price. Under the 2014 and 2012 Plans, stock options issued to employees generally vest 25% over four years. Options issued to non-employee members of the MTI Board of Directors generally vest 25% over four years. Certain options granted may be fully or partially exercisable immediately, may vest on other than a four year schedule or vest upon attainment of specific performance criteria. Restricted stock awards generally vest one year after the date of grant; however, certain awards may vest immediately or vest upon attainment of specific performance criteria. Option exercise prices are generally equivalent to the closing market value price of the Company's common stock on the date of grant. Unexercised options generally terminate ten years after date of grant.

The Company estimates the fair value of stock options using a Black-Scholes valuation model. Key inputs and assumptions used to estimate the fair value of stock options include the grant price of the award, the expected option term, volatility of the Company's stock, an appropriate risk-free rate, and the Company's dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the Company. The Company's estimate of an expected option term was calculated in accordance with the simplified method for calculating the expected term assumption.

The following table presents the weighted-average assumptions used for options granted under the 2012 Plan:

| | 2014 | 2013 |
|--|-------------|-------------|
| Option term (years) | 6.29 | 4.13 |
| Volatility | 202.37% | 204.95% |
| Risk-free interest rate | 1.59 % | 1.05 % |
| Dividend yield | 0 % | 0 % |
| Weighted-average fair value per option granted | \$1.07 | \$0.58 |

The following table presents the weighted-average assumptions used for options granted under the 2014 Plan:

| | 2014 |
|--|-------------|
| Option term (years) | 6.25 |
| Volatility | 193.96% |
| Risk-free interest rate | 1.91 % |
| Dividend yield | 0 % |
| Weighted-average fair value per option granted | \$0.84 |

Share-based compensation expense recognized in the Consolidated Statements of Operations is based on awards ultimately expected to vest, therefore, awards are reduced for estimated forfeitures. The revised accounting standard requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Total share-based compensation expense, related to all of the Company's share-based awards, recognized for the years ended December 31, was comprised as follows:

| | 2014 | 2013 |
|---|-------------|-------------|
| (dollars in thousands, except eps) | | |
| Cost of product revenue | \$2 | \$— |
| Unfunded research and product development | 6 | 3 |
| Selling, general and administrative | 77 | 46 |
| Share-based compensation expense | \$85 | \$49 |
| Impact on basic and diluted EPS | \$0.016 | \$0.009 |

Total unrecognized compensation costs related to non-vested awards as of December 31, 2014 and December 31, 2013 is \$295 thousand and \$160 thousand, respectively and is expected to be recognized over a weighted-average remaining vesting period of approximately 2.71 years and 2.98 years, respectively.

Presented below is a summary of the Company's stock option plans' activity for the years ended December 31:

| | 2014 | 2013 |
|--|-------------|-------------|
| Shares under option, beginning | 585,382 | 305,744 |
| Granted | 242,000 | 298,000 |
| Exercised | (2,000) | — |
| Forfeited | (5,750) | (1,874) |
| Expired/canceled | (16,724) | (16,488) |
| Shares under option, ending | 802,908 | 585,382 |
| Options exercisable | 291,455 | 197,253 |
| Remaining shares available for granting of options | 406,500 | 141,374 |

The weighted average exercise price for the Plans is as follows for each of the years ended December 31:

| | 2014 | 2013 |
|--------------------------------|-------------|-------------|
| Shares under option, beginning | \$0.99 | \$2.05 |
| Granted | 0.98 | 0.60 |
| Exercised | 0.46 | — |
| Forfeited | 0.47 | 0.29 |
| Expired/canceled | 14.05 | 13.73 |
| Shares under option, ending | 0.72 | 0.99 |
| Options exercisable, ending | 0.68 | 1.91 |

The following table summarizes information for options outstanding and exercisable for the Plans as of December 31, 2014:

| Exercise Price Range | Outstanding Options | | | Options Exercisable | |
|-----------------------------|----------------------------|--|--|----------------------------|--|
| | Number | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| \$0.00 - \$1.15 | 781,750 | 8.27 | \$ 0.66 | 270,297 | \$ 0.49 |
| \$1.16 - \$3.60 | 19,000 | 4.87 | \$ 1.40 | 19,000 | \$ 1.40 |
| \$3.61 - \$14.24 | 219 | 0.35 | \$ 3.72 | 219 | \$ 3.72 |
| \$14.25 - \$22.64 | 1,939 | 1.34 | \$ 19.24 | 1,939 | \$ 19.24 |
| | 802,908 | 8.17 | \$ 0.72 | 291,455 | \$ 0.68 |

The aggregate intrinsic value (i.e. the difference between the closing stock price and the price to be paid by the option holder to exercise the option) is \$115 thousand for the Company's outstanding options and \$61 thousand for the exercisable options as of December 31, 2014. The amounts are based on the Company's closing stock price of \$0.71 as of December 31, 2014.

There were no unvested restricted stock grants for the year ended December 31, 2014 and 2013.

Non-vested options activity is as follows for the year ended December 31:

| | 2014 | 2014 |
|---|----------------|--|
| | Options | Weighted Average Exercise Price |
| Non-vested options balance, beginning January 1 | 388,129 | \$ 0.52 |
| Non-vested options granted | 242,000 | \$ 0.98 |
| Vested options | (112,926) | \$ 0.50 |
| Non-vested options forfeited | (5,750) | \$ 0.47 |
| Non-vested options balance, ending December 31 | 511,453 | \$ 0.74 |

F - 19

MTI Micro Option Plans

As a result of the deconsolidation of MTI Micro operations on December 31, 2013 (see Note 2), MTI Micro will no longer remain in our consolidated operations.

MTI Micro had two plans for issuing MTI Micro stock-based incentive awards; the MTI MicroFuel Cells Inc. 2001 Employee, Director and Consultant Stock Option Plan (2001 MTI Micro Plan) and the MTI MicroFuel Cells Inc. 2009 Stock Plan (2009 Micro Plan), (collectively, the MTI Micro Plans).

The 2001 MTI Micro Plan was approved by MTI Micro's stockholders in 2001 and provided an initial aggregate number of 1,766,000 shares of MTI Micro common stock to be awarded. The number of shares which may be awarded under the 2001 MTI Micro Plan and awards outstanding have been adjusted for a 2004 reverse stock split, and during 2005, 2006, and 2007, the total number of shares which may be awarded under the 2001 MTI Micro Plan were 3,416,667 shares. Under the 2001 MTI Micro Plan, the MTI Micro Board of Directors was authorized to award stock options to officers, directors, employees and consultants. During 2005, MTI Micro ceased making grants under the 2001 MTI Micro Plan and determined that it would make no new awards under this plan in the future.

The MTI Micro Board of Directors approved the 2009 Micro Plan on December 8, 2009. This plan provided an initial aggregate number of 38,000,000 shares of MTI Micro's common stock to be awarded. Under the 2009 Micro Plan, the MTI Micro Board of Directors is authorized to award stock options to directors, employees, consultants and advisors of MTI Micro. Effective December 11, 2013, the MTI Micro Board of Directors voted that the 2009 Micro Plan be terminated immediately.

There were no stock options granted in 2013. Options generally vest 50% on the grant date and 50% ratably on a quarterly basis over the next three years. The fair value of stock options granted was estimated at the date of grant using a Black-Scholes Option Pricing Model. Share-based compensation expense recognized in the Consolidated Statement of Operations is based on awards ultimately expected to vest, therefore, awards are reduced for estimated forfeitures. The accounting standard requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company assumed a forfeiture rate of 5% for its outstanding grants.

Presented below is a summary of compensation expense, which is included in the summary of the Company's compensation expense under all share-based awards above, for the MTI Micro Plans:

2013

(dollars in thousands)

| | |
|--|------|
| Stock option compensation expense | \$ 2 |
| Total stock-based compensation expense | \$ 2 |

All awards were fully vested as of December 31, 2013 and, as such, there is no unrecognized compensation costs related to these awards as of December 31, 2013.

Presented below is a summary of the MTI Micro Plans activity for the year ended December 31:

| | 2013 |
|--|-------------|
| Shares under option, beginning | 1,530,040 |
| Granted | — |
| Exercised | — |
| Canceled/Forfeited | (391,800) |
| Shares under option, ending | 1,138,240 |
| Options exercisable | 1,138,240 |
| Remaining shares available for granting of options | — |

The weighted average exercise price for the MTI Micro Plans is as follows for the year ended December 31:

| | 2013 |
|--------------------------------|-------------|
| Shares under option, beginning | \$0.07 |
| Granted | — |
| Exercised | — |
| Canceled/Forfeited | 0.07 |
| Shares under option, ending | 0.07 |
| Options exercisable, ending | 0.07 |

The weighted average fair value of stock options granted is required to be based on a theoretical statistical model using the preceding Black-Scholes Option Pricing Model assumptions.

The following table summarizes information for options outstanding and exercisable for the MTI Micro Plans as of December 31, 2013:

| Outstanding Options | | | Options Exercisable | | |
|----------------------|-----------|---|---------------------------------|-----------|---------------------------------|
| Exercise Price Range | Number | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| \$0.07 | 1,138,240 | 6.23 | \$ 0.07 | 1,138,240 | \$ 0.07 |

13. Cash Flows — Supplemental Information

Cash paid for interest on the line of credit was \$1 thousand during the year ended December 31, 2013.

Non-cash activities are as follows for the year ended December 31:

| (dollars in thousands) | 2014 | 2013 |
|--|------|-------|
| Supplemental Disclosure of Non-Cash Activities: | | |
| Deconsolidation of VIE (MTI Micro) | | |
| Prepaid expenses and other current assets | \$ — | \$ 1 |
| Accounts payable | — | (3) |
| Related party note payable | — | (380) |

14. Commitments and Contingencies

Contingencies:

Legal

We are subject to legal proceedings, claims and liabilities which arise in the ordinary course of business. We accrue for losses associated with legal claims when such losses are probable and can be reasonably estimated. These accruals are adjusted as additional information becomes available or circumstances change. Legal fees are charged to expense as they are incurred.

In January 2013, an action commenced and is pending in the State of New York Supreme Court in Albany County upon a complaint of the plaintiff, Berkshire Bank, against Kingfisher, LLC; Edward L. Hoe, Jr.; Mechanical Technology, Incorporated; MTI MicroFuel Cells Inc.; Xcelaero Corporation; Regional Emergency Medical Services Council of the Hudson-Mohawk Valleys, Inc.; Inverters Unlimited Inc.; and John Doe No. 1 through John Doe No. 15 (the named defendants) for the foreclosure of the mortgaged premises located at 431 New Karner Road, Town of Colonie, County of Albany, New York. The Company was named as a party defendant to this action by virtue of its former possession of a portion of the mortgaged premises, and the fact that they have, or claim to have, a leasehold or other possessory interest in a portion of the mortgaged premises. On October 1, 2013, the State of New York Supreme Court in Albany County granted a judgment of foreclosure and closed out this action. The Company is under no obligations in relation to this judgment.

We do not believe there are any such additional proceedings presently pending which could have a material adverse effect on our financial condition.

Commitments:

Leases

The Company and its subsidiary lease certain manufacturing, laboratory and office facilities. The lease provides for the Company to pay its allocated share of insurance, taxes, maintenance and other costs of the leased property. Under the May 2, 2014 amendment, MTI Instruments has an option to terminate the lease as of December 1, 2016. If MTI Instruments terminates the lease prior to November 2019, MTI Instruments is required to reimburse the landlord for all unamortized costs that the landlord is incurring for renovations to the leased space in conjunction with the lease renewal.

Future minimum rental payments required under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 2014 are (dollars in thousands): \$221 in 2015, \$222 in 2016, \$224 in 2017, \$218 in 2018 and \$204 in 2019. Rent expense under all leases was \$280 thousand and \$284 thousand for 2014 and 2013, respectively.

Employment Agreement

The Company has an employment agreement with one employee that provides certain payments upon termination of employment under certain circumstances, as defined in the agreement. As of December 31, 2014, the Company's potential minimum obligation to this employee was approximately \$67 thousand.

15. Related Party Transactions

MTI Micro

On December 18, 2013, MTI Micro and the Company executed a Senior Demand Promissory Note (the Note) in the amount of \$380 thousand to secure the intercompany amounts due to the Company from MTI Micro upon the deconsolidation of MTI Micro. Interest accrues on the Note at the Prime Rate in effect on the first business day of the month, as published in the Wall Street Journal. At the Company's option, all or part of the principal and interest due on this Note may be converted to shares of common stock of MTI Micro at a rate of \$0.07 per share. Interest began accruing on January 1, 2014. At December 31, 2013, the Company recorded a full allowance against the Note. In 2014, \$115 thousand was received from MTI Micro in principle and interest and an additional \$20 thousand was released from the allowance in advance of a January 2015 payment from MTI Micro. As of December 31, 2014 and 2013, \$278 thousand and \$380 thousand, respectively, of principal and interest are available to convert into shares of common stock of MTI Micro. The \$380 thousand allowance was recorded as miscellaneous expense during the year ended December 31, 2013.

On December 31, 2013, Dr. Robb exercised a portion of his outstanding MTI Micro warrants to purchase 357,143 shares of MTI Micro Common Stock at an exercise price of \$0.07 per share.

As of December 31, 2014, the Company owned an aggregate of approximately 47.5% of MTI Micro's outstanding common stock, or 75,049,937 shares, and 54.0% of the common stock and warrants issued, which includes 31,904,136 warrants outstanding.

Consulting Services

During the year ended December 31, 2013, the Company paid \$80 thousand to Loudon Advisors for Kevin Lynch's services as the Acting Chief Executive Officer of the Company, through April 30, 2013.

16. Geographic and Segment Information

The Company sells its products on a worldwide basis with its principal markets listed in the table below where information on product revenue is summarized by geographic area for the Company as a whole for each of the years ended December 31:

| (dollars in thousands) | 2014 | 2013 |
|-------------------------|---------|---------|
| Product revenue: | | |
| United States | \$5,653 | \$5,467 |
| ASEAN | 2,529 | 2,110 |
| EMEA | 496 | 571 |
| North America | 76 | 191 |
| South America | 27 | 13 |
| Total product revenue | \$8,781 | \$8,352 |

Revenues are attributed to regions based on the location of customers.

Long-lived assets of \$140 thousand and \$146 thousand at December 31, 2014 and 2013, respectively consist of property, plant and equipment all located within the United States of America.

During 2013, the Company operated in two business segments, Test and Measurement Instrumentation and New Energy. As a result of the deconsolidation of MTI Micro operations on December 31, 2013 (see Note 2), the New Energy segment will no longer remain in our consolidated operations. The Test and Measurement Instrumentation segment designs, manufactures, markets and services high performance test and measurement instruments and systems, wafer characterization tools for the semiconductor and solar industries, tensile stage systems for materials testing at academic and industrial settings, and computer-based balancing systems for aircraft engines. The New Energy segment was focused on commercializing direct methanol fuel cells. The Company's principal operations are located in North America.

The accounting policies of the Test and Measurement Instrumentation and New Energy segments are similar to those described in the summary of significant accounting policies (Note 2). The Company evaluates performance based on profit or loss from operations before income taxes. Inter-segment sales and expenses are not significant.

In the Test and Measurement Instrumentation segment, the U.S. Air Force accounted for 27.9% of total product revenue in 2014 and 27.2% of total product revenue in 2013. The largest commercial customer in 2014 was an Asian customer, who accounted for 8.3% of total product revenue in 2014. The largest commercial customer in 2013 was an Asian customer, who accounted for 6.8% of total product revenue in 2013.

Summarized financial information concerning the Company's reportable segments is shown in the following tables. The "Other" column includes corporate related items and items such as income taxes or unusual items, which are not allocated to reportable segments. The "Reconciling Items" column includes non-controlling interests in a consolidated entity. In addition, segments' non-cash items include any depreciation in reported profit or loss. The New Energy segment figures include the Company's direct micro fuel cell operations. As a result of the deconsolidation of MTI Micro operations on December 31, 2013 (see Note 2), the New Energy segment will no longer remain in our consolidated operations.

As of January 1, 2014, the Company operates in one segment and therefore segment information is not presented.

| (dollars in thousands) | Test and Measurement Instrumentation | New Energy | Other | Reconciling Items | Condensed Consolidated Totals |
|--|--|---------------|---------|----------------------|-------------------------------------|
| <u>Year Ended December 31, 2013</u> | | | | | |
| Product revenue | \$ 8,352 | \$ — | \$ — | \$ — | \$ 8,352 |
| Unfunded research and product development expenses | 1,320 | — | — | — | 1,320 |
| Selling, general and administrative expenses | 2,051 | 89 | 1,277 | — | 3,417 |
| Segment income (loss) from operations before income taxes and non-controlling interest | 1,190 | (142) | (1,053) | 3,619 | 3,614 |
| Segment income (loss) | 1,190 | (143) | (1,087) | 3,694 | 3,654 |
| Total assets | 1,693 | — | 2,841 | — | 4,534 |
| Capital expenditures | 84 | — | 24 | — | 108 |
| Depreciation | 82 | 4 | 5 | — | 91 |

The following table presents the details of "Other" segment loss for the year ended December 31:

| (dollars in thousands) | 2013 |
|---|-----------|
| Corporate and other expenses: | |
| Depreciation | \$(5) |
| Salaries and benefits | (619) |
| Allowance on related party note payable | (380) |
| Income tax expense | (34) |
| Other expense, net | (49) |
| Total expense | \$(1,087) |

17. Line of Credit

On May 5, 2014, the Company entered into a new revolving line of credit with Bank of America, N.A. (the Bank) to replace MTI Instruments' line of credit as discussed below. The Company may borrow under the line of credit from time to time up to \$1 million to support its working capital needs. The line of credit is available until July 31, 2015 and may be renewed subject to all the terms and conditions as set forth in the Loan Agreement (the Loan). The Loan is payable no later than the expiration date of the Loan and interest is payable on the last day of each month beginning on May 30, 2014 and until payment has been made in full. The interest rate on funds borrowed under the line of credit is equal to the LIBOR Daily Floating Rate plus 2.75%. The Loan is secured by equipment and fixtures, inventory and receivables owned by the Company and guaranteed by MTI Instruments. The Company is required to hold a balance of \$0 for 30 consecutive days during the period from May 5, 2014 through July 31, 2015, and each subsequent one-year period of the Loan, if any. Upon the occurrence of an event of default, the Bank may set off against our repayment obligations any amounts we maintain at the Bank. The Company is also subject to other restrictions as set forth in the Loan. As of December 31, 2014, there were no amounts outstanding under the line of credit.

On September 20, 2011, MTI Instruments entered into a working capital line of credit with First Niagara Bank, N.A. Under this agreement, MTI Instruments could borrow from time to time up to \$400 thousand to support its working capital needs. The note was payable upon demand, and the interest rate on the note was equal to the prime rate with a floor of 4.0% per annum. The note was secured by a lien on all of the assets of MTI Instruments and was guaranteed by the Company. The line of credit was renewed on September 23, 2013 and expired on June 30, 2014. Under this line of credit, MTI Instruments was required to maintain a line balance of \$0 for 30 consecutive days during each calendar year. As of December 31, 2013, there were no amounts outstanding under the line of credit.