

SL INDUSTRIES INC  
Form 10-Q  
August 01, 2014  
Table of Contents

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2014**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**Commission file number 1-4987**

**SL INDUSTRIES, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**21-0682685**  
**(I.R.S. Employer**  
**Identification No.)**

**520 Fellowship Road, Suite A114, Mt. Laurel, NJ**  
**(Address of principal executive offices)**

**08054**  
**(Zip Code)**

**Registrant's telephone number, including area code: 856-727-1500**

**N/A**

**(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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

Edgar Filing: SL INDUSTRIES INC - Form 10-Q

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. (Check One):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting Company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes  No

The number of shares of common stock outstanding as of July 25, 2014 was 4,144,000.

---

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets</u> <u>June 30, 2014 (Unaudited) and December 31, 2013</u>	2
<u>Consolidated Statements of Income and Comprehensive Income</u> <u>Three Months Ended June 30, 2014 and 2013 (Unaudited) and Six Months Ended June 30, 2014</u> <u>and 2013 (Unaudited)</u>	3
<u>Consolidated Statements of Cash Flows (Unaudited)</u>	4
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	51
Item 4. <u>Controls and Procedures</u>	51
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	51
Item 1A. <u>Risk Factors</u>	51
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	52
Item 3. <u>Defaults Upon Senior Securities</u>	52
Item 4. <u>Mine Safety Disclosures</u>	52
Item 5. <u>Other Information</u>	52
Item 6. <u>Exhibits</u>	53
<b><u>Signatures</u></b>	54

**Table of Contents****Item 1. Financial Statements**

## SL INDUSTRIES, INC.

## CONSOLIDATED BALANCE SHEETS

	June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 15,790,000	\$ 7,163,000
Receivables, net	34,876,000	30,765,000
Inventories, net	23,076,000	22,963,000
Other current assets	1,988,000	7,168,000
Deferred income taxes, net	3,033,000	2,804,000
<b>Total current assets</b>	<b>78,763,000</b>	<b>70,863,000</b>
Property, plant and equipment, net	10,772,000	10,790,000
Deferred income taxes, net	9,367,000	10,239,000
Goodwill	17,670,000	17,666,000
Other intangible assets, net	2,298,000	2,346,000
Other assets and deferred charges, net	1,390,000	1,430,000
<b>Total assets</b>	<b>\$ 120,260,000</b>	<b>\$ 113,334,000</b>
<b>LIABILITIES</b>		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	\$ 48,000	\$ 1,048,000
Accounts payable	19,996,000	17,112,000
Accrued income taxes	1,100,000	20,000
Accrued liabilities:		
Payroll and related costs	4,457,000	5,373,000
Other	14,034,000	10,259,000
<b>Total current liabilities</b>	<b>39,635,000</b>	<b>33,812,000</b>
Long-term debt, less current maturities	164,000	187,000
Deferred compensation and supplemental retirement benefits	1,591,000	1,695,000
Other long-term liabilities	12,339,000	18,465,000
<b>Total liabilities</b>	<b>53,729,000</b>	<b>54,159,000</b>

## Commitments and contingencies

## SHAREHOLDERS EQUITY

Preferred stock, no par value; authorized, 6,000,000 shares; none issued		
Common stock, \$.20 par value; authorized, 25,000,000 shares; issued, 6,656,000 and 6,656,000 shares, respectively	1,331,000	1,331,000
Capital in excess of par value	22,313,000	22,153,000
Retained earnings	68,575,000	60,520,000
Accumulated other comprehensive (loss) income, net of tax	(154,000)	822,000
Treasury stock at cost, 2,512,000 and 2,530,000 shares, respectively	(25,534,000)	(25,651,000)
Total shareholders equity	66,531,000	59,175,000
Total liabilities and shareholders equity	\$ 120,260,000	\$ 113,334,000

**Table of Contents**

## SL INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net sales	\$ 56,749,000	\$ 49,786,000	\$ 109,334,000	\$ 98,881,000
Cost and expenses:				
Cost of products sold	36,686,000	32,764,000	71,863,000	64,963,000
Engineering and product development	3,097,000	3,672,000	6,395,000	7,175,000
Selling, general and administrative	9,555,000	9,104,000	18,179,000	17,911,000
Depreciation and amortization	636,000	615,000	1,250,000	1,215,000
Restructuring charges			463,000	
Total cost and expenses	49,974,000	46,155,000	98,150,000	91,264,000
Income from operations	6,775,000	3,631,000	11,184,000	7,617,000
Other income (expense):				
Amortization of deferred financing costs	(22,000)	(20,000)	(43,000)	(39,000)
Interest income	1,000	2,000	3,000	3,000
Interest expense	(8,000)	(15,000)	(43,000)	(50,000)
Other gain (loss), net	1,729,000	(301,000)	1,479,000	(327,000)
Income from continuing operations before income taxes	8,475,000	3,297,000	12,580,000	7,204,000
Income tax provision	2,820,000	1,045,000	4,260,000	1,968,000
Income from continuing operations	5,655,000	2,252,000	8,320,000	5,236,000
(Loss) from discontinued operations, net of tax	(127,000)	(237,000)	(265,000)	(455,000)
Net income	\$ 5,528,000	\$ 2,015,000	\$ 8,055,000	\$ 4,781,000
<b>Basic net income (loss) per common share</b>				
Income from continuing operations	\$ 1.37	\$ 0.54	\$ 2.01	\$ 1.26
(Loss) from discontinued operations, net of tax	(0.03)	(0.06)	(0.06)	(0.11)
Net income	\$ 1.34	\$ 0.48	\$ 1.95	\$ 1.15
<b>Diluted net income (loss) per common share</b>				
Income from continuing operations	\$ 1.36	\$ 0.54	\$ 2.00	\$ 1.25
(Loss) from discontinued operations, net of tax	(0.03)	(0.06)	(0.07)	(0.11)

Net income	\$	1.33	\$	0.48	\$	1.93	\$	1.14
------------	----	------	----	------	----	------	----	------

Shares used in computing basic net income (loss) per common share	4,138,000	4,157,000	4,133,000	4,148,000
-------------------------------------------------------------------	-----------	-----------	-----------	-----------

Shares used in computing diluted net income (loss) per common share	4,168,000	4,204,000	4,163,000	4,189,000
---------------------------------------------------------------------	-----------	-----------	-----------	-----------

SL INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net income	\$ 5,528,000	\$ 2,015,000	\$ 8,055,000	\$ 4,781,000
Other comprehensive income, net of tax:				
Foreign currency translation	152,000	17,000	118,000	93,000
Net unrealized gain on available-for-sale securities	130,000			
Net unrealized gain reclassified into income on sale of available-for-sale securities	(1,028,000)		(1,094,000)	
Comprehensive income	\$ 4,782,000	\$ 2,032,000	\$ 7,079,000	\$ 4,874,000

See accompanying notes to consolidated financial statements.



**Table of Contents**

## SL INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30,

(Unaudited)

	2014	2013
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 8,055,000	\$ 4,781,000
Adjustment for losses from discontinued operations	265,000	455,000
Income from continuing operations	8,320,000	5,236,000
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:		
Depreciation	930,000	918,000
Amortization	320,000	297,000
Amortization of deferred financing costs	43,000	39,000
Stock-based compensation	334,000	332,000
Excess tax benefit on stock compensation		(35,000)
Loss on foreign exchange contracts	221,000	327,000
(Recoveries of) provisions for losses on accounts receivable	(141,000)	34,000
Deferred compensation and supplemental retirement benefits	151,000	132,000
Deferred compensation and supplemental retirement benefit payments	(249,000)	(260,000)
Deferred income taxes	643,000	70,000
(Gain) on sale of available-for-sale securities	(1,691,000)	
Changes in operating assets and liabilities:		
Accounts receivable	(3,949,000)	(1,820,000)
Inventories	(136,000)	(2,507,000)
Other assets	1,716,000	(1,049,000)
Accounts payable	2,912,000	(1,045,000)
Other accrued liabilities	(967,000)	335,000
Accrued income taxes	1,305,000	(383,000)
Net cash provided by operating activities from continuing operations	9,762,000	621,000
Net cash (used in) operating activities from discontinued operations	(2,833,000)	(2,934,000)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>6,929,000</b>	<b>(2,313,000)</b>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(940,000)	(1,801,000)
Proceeds from sale of available-for-sale securities	4,054,000	
Purchases of other assets	(264,000)	(62,000)

NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	2,850,000	(1,863,000)
FINANCING ACTIVITIES:		
Proceeds from Senior Revolving Credit Facility		13,550,000
Payments of Senior Revolving Credit Facility	(1,000,000)	(11,060,000)
Payments of Capital Leases	(24,000)	
Payments of deferred financing costs		(30,000)
Treasury stock purchases	(106,000)	(792,000)
Proceeds from stock options exercised		227,000
Excess tax benefit on stock compensation		35,000
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(1,130,000)	1,930,000
Effect of exchange rate changes on cash	(22,000)	24,000
NET CHANGE IN CASH AND CASH EQUIVALENTS	8,627,000	(2,222,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	7,163,000	3,196,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 15,790,000	\$ 974,000
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	\$ 44,000	\$ 49,000
Income taxes	\$ 1,754,000	\$ 2,445,000
See accompanying notes to consolidated financial statements.		

**Table of Contents****SL INDUSTRIES, INC.****Notes to Consolidated Financial Statements (Unaudited)****1. Basis Of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereon included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Unless the context requires otherwise, the terms the Company, SL Industries, we, us and our mean SL Industries, Inc., a Delaware corporation and its consolidated subsidiaries.

**2. Receivables**

Receivables consist of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
Trade receivables	\$ 34,482	\$ 30,766
Less: allowance for doubtful accounts	(379)	(581)
Trade receivables, net	34,103	30,185
Recoverable income taxes	273	344
Other	500	236
Receivables, net	\$ 34,876	\$ 30,765

**3. Inventories**

Inventories consist of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
Raw materials	\$ 16,988	\$ 16,198
Work in process	4,669	4,842
Finished goods	4,013	4,124

Edgar Filing: SL INDUSTRIES INC - Form 10-Q

Gross inventory	25,670	25,164
Less: allowances	(2,594)	(2,201)
Inventories, net	\$ 23,076	\$ 22,963

**Table of Contents****4. Income Per Share**

The Company has presented net income (loss) per common share pursuant to Accounting Standards Codification ( ASC ) 260 Earnings Per Share. Basic net income (loss) per common share is computed by dividing reported net income (loss) available to common shareholders by the weighted-average number of shares outstanding for the period.

Diluted net income (loss) per common share is computed by dividing reported net income (loss) available to common shareholders by the weighted-average shares outstanding for the period, adjusted for the dilutive effect of common stock equivalents, which consist of stock options, using the treasury stock method. For the three and six months ended June 30, 2014, 13,000 and 11,000 stock options were excluded from the dilutive computation, respectively, as the impact of their inclusion would have been anti-dilutive. There were no anti-dilutive options for the three and six months ended June 30, 2013.

The table below sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(in thousands, except per share amounts)			
<b>Basic net income available to common shareholders:</b>				
Net income available to common shareholders from continuing operations	\$ 5,655	\$ 2,252	\$ 8,320	\$ 5,236
Diluted net income available to common shareholders from continuing operations	\$ 5,655	\$ 2,252	\$ 8,320	\$ 5,236
<b>Shares:</b>				
Basic weighted average number of common shares outstanding	4,138	4,157	4,133	4,148
Common shares assumed upon exercise of stock options	30	47	30	41
Diluted weighted average number of common shares outstanding	4,168	4,204	4,163	4,189
<b>Basic net income (loss) per common share:</b>				
Income from continuing operations	\$ 1.37	\$ 0.54	\$ 2.01	\$ 1.26
(Loss) from discontinued operations (net of tax)	(0.03)	(0.06)	(0.06)	(0.11)
Net income	\$ 1.34	\$ 0.48	\$ 1.95	\$ 1.15
<b>Diluted net income (loss) per common share:</b>				
Income from continuing operations	\$ 1.36	\$ 0.54	\$ 2.00	\$ 1.25

Edgar Filing: SL INDUSTRIES INC - Form 10-Q

(Loss) from discontinued operations (net of tax)	(0.03)	(0.06)	(0.07)	(0.11)
Net income	\$ 1.33	\$ 0.48	\$ 1.93	\$ 1.14

---

**Table of Contents****5. Stock-Based Compensation**

At June 30, 2014, the Company had stock-based employee compensation plans as described below. For the three and six months ended June 30, 2014, the total compensation expense (included in selling, general and administrative expense) related to these plans was \$225,000 and \$334,000 (\$150,000 and \$221,000 net of tax), respectively. For the three and six months ended June 30, 2013, the total compensation expense was \$210,000 and \$332,000 (\$148,000 and \$241,000, net of tax), respectively.

During the first quarter of 2014, the Company implemented a Long-Term Incentive Plan (the 2014 LTIP ) pursuant to the 2008 Incentive Stock Plan (the 2008 Plan ) which awarded restricted stock units ( RSUs ) to eligible executives. Under the terms of the 2014 LTIP, the number of RSUs that may vest, if any, will be based on, among other things, the Company achieving certain sales and return on invested capital ( ROIC ), as defined, targets during the January 2014 to December 2016 performance period. Earned RSUs, if any, cliff vest at the end of fiscal 2016 (100% of earned RSUs vest at December 31, 2016). The final value of these RSUs will be determined by the number of shares earned. The value of these RSUs is charged to compensation expense on a straight-line basis over the three year vesting period with periodic adjustments to account for changes in anticipated award amounts. The weighted-average price for these RSUs was \$26.24 per share based on the grant date of March 3, 2014. During the three and six months ended June 30, 2014, \$31,000 and \$48,000 was charged to compensation expense. As of June 30, 2014, total unamortized compensation expense for this grant was \$369,000. As of June 30, 2014, the maximum number of achievable RSUs under the 2014 LTIP was 22,000 RSUs.

During the first quarter of 2014, the Company granted 91,000 stock options to two officers of the Company under the 2008 Incentive Stock Plan (the 2008 Plan ). The options issued vest in two equal installments each on the second and third anniversary of the grant date. The options granted are exercisable no later than 5 years after the grant date. Compensation expense is recognized straight-line over the vesting period of the options.

During the first quarter of 2014, the Company granted 10,000 stock options to a key executive under the 2008 Plan. The options issued vest in three equal installments each on the first, second and third anniversary of the grant date. The options granted are exercisable no later than 10 years after the grant date. Compensation expense is recognized straight-line over the vesting period of the options.

On May 9, 2013, the Company granted each Director 3,000 restricted shares pursuant to the 2008 Plan. The shares vest upon the first anniversary of the grant date. All shares vested and were granted under this award on May 9, 2014.

On May 12, 2014, the Company granted each Director 3,000 restricted shares pursuant to the 2008 Plan. The shares vest upon the first anniversary of the grant date. Based on the terms of the awards the value of these restricted shares is charged to compensation expense on a straight-line basis over the one year vesting period. As a result, the Company recognized \$54,000 of stock compensation expense during the second quarter of 2014. As of June 30, 2014, total unamortized compensation expense for this grant was \$348,000. The weighted-average price of these restricted stock grants was \$26.79 per share based on the grant date of May 12, 2014. As of June 30, 2014, no shares were granted under this award.

**Table of Contents**

On May 12, 2014, the shareholders of the Company approved an amendment to the 2008 Plan to increase number of shares of Common Stock subject to the 2008 Plan from 450,000 shares to 500,000 shares. As of June 30, 2014, there were 184,000 options outstanding under the 2008 Plan. As of June 30, 2014, there were 79,000 shares available for grant under the 2008 Plan.

The Company uses the Black-Scholes option pricing model to value all stock options. Volatility is determined using changes in historical stock prices. The weighted average expected life computation is based on historical exercise patterns and post-vesting termination behavior. The interest rate for periods within the expected life of the award is based on the U.S. Treasury yield curve in effect at the time of grant.

The fair value of all option grants was estimated using the Black-Scholes option pricing model with the following assumptions and weighted average fair values as follows:

	Six Months Ended June 30, 2014
Weighted average fair value of grants	\$ 9.00
Valuation assumptions:	
Expected dividend yield	0.0%
Expected volatility	47.62%
Expected life (in years)	3.35
Risk-free interest rate	0.83%

No stock options were granted during the six months ended June 30, 2013.

**Stock Options**

Option activity under the principal option plans as of June 30, 2014 and changes during the six months ended June 30, 2014 were as follows:

	Outstanding Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2013	83	\$ 11.99	3.28	\$ 1,247
Granted	101	26.02		
Exercised				
Forfeited				
Expired				
Outstanding as of June 30, 2014	184	\$ 19.71	4.10	\$ 1,616
Exercisable as of June 30, 2014	83	\$ 11.99	2.79	\$ 1,364





## **Table of Contents**

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of fiscal 2014 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2014. This amount changes based on the fair market value of the Company's stock. No options were exercised during the six months ended June 30, 2014. The total intrinsic value of options exercised for the six months ended June 30, 2013 was \$185,000.

As of June 30, 2014, \$809,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 2.7 years.

Tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows. No options were exercised during the six months ended June 30, 2014. Cash received from option exercises for the six months ended June 30, 2013 was \$227,000. The actual tax benefit realized for the tax deduction from option exercises of share-based payment arrangements totaled \$70,000 for the six months ended June 30, 2013. The Company has applied the Short-cut method in calculating the historical windfall tax benefits. All tax shortfalls will be applied against this windfall before being charged to earnings.

## **6. Income Tax**

The Company calculates its interim tax provision in accordance with the provisions of ASC 740-270 Income Taxes Interim Reporting. For each interim period the Company estimates its annual effective income tax rate and applies the estimated rate to its year-to-date income or loss before income taxes. The Company also computes the tax provision or benefit related to items separately reported, such as discontinued operations, and recognizes the items net of their related tax effect in the interim periods in which they occur. The Company also recognizes the effect of changes in enacted tax laws or rates in the interim periods in which the changes occur.

For the six months ended June 30, 2014 and June 30, 2013, the estimated income tax rate from continuing operations was 34% and 27%, respectively. The increase in the effective tax rate was primarily due to the expiration of the federal research and development tax credits in 2014 as compared to 2013. In the first quarter of 2013, the Company recorded a research and development tax benefit for the quarter, plus the retroactive reinstatement of the federal research and development tax credits from the enactment of the American Tax Relief Act of 2012.

During the three and six months ended June 30, 2014, the Company recorded additional benefits from state research and development tax credits of \$61,000 and \$122,000, respectively. During the three months ended June 30, 2013, the Company recorded additional benefits from federal and state research and development tax credits of \$196,000 and \$65,000, respectively. During the six months ended June 30, 2013, the Company recorded additional benefits from federal and state research and development tax credits of \$496,000 and \$98,000, respectively.

As of June 30, 2014, the Company's gross research and development tax credit carryforwards totaled approximately \$1,165,000. Of these credits, approximately \$493,000 can be carried forward for 15 years and will expire between 2015 and 2029, and approximately \$672,000 of state credits can be carried forward indefinitely.

## **Table of Contents**

The Company has recorded gross unrecognized tax benefits, excluding interest and penalties, as of June 30, 2014 and December 31, 2013 of \$859,000 and \$834,000, respectively. Tax benefits are recorded pursuant to the provisions of ASC 740 Income Taxes. If such unrecognized tax benefits are ultimately recorded in any period, the Company's effective tax rate would be reduced accordingly for such period.

The Company has adopted FASB Accounting Standard Update (ASU) 2013-11 effective during the first quarter of 2014. The pronouncement requires the Company to offset its uncertain tax positions against certain deferred tax assets in the same jurisdiction. During the six months ended June 30, 2014, the Company has reclassified \$347,000 of its uncertain tax positions against its related deferred tax assets.

The Company has been examined by the Internal Revenue Service (the IRS) through the calendar year 2010. State income tax statutes are generally open for periods back to and including the calendar year 2009.

It is reasonably possible that the Company's gross unrecognized tax benefits, including interest, may change within the next twelve months due to the expiration of the statutes of limitation of the federal government and various state governments by a range of zero to \$327,000. The Company records such unrecognized tax benefits upon the expiration of the applicable statute of limitations or the settlement with tax authorities. As of June 30, 2014, the Company has a liability for unrecognized benefits of \$512,000 and \$347,000 for federal and state taxes, respectively. Such benefits relate primarily to expenses incurred in those jurisdictions.

The Company classifies interest and penalties related to unrecognized tax benefits as income tax expense. At June 30, 2014, and December 31, 2013, the Company has accrued approximately \$126,000 and \$100,000 for the payment of interest and penalties, respectively.

## **7. Recently Adopted and Issued Accounting Pronouncements**

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force), which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 is effective for fiscal periods beginning after December 15, 2013. The implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

In March 2014, the FASB issued ASU No. 2014-06, Technical Corrections and Improvements Related to Glossary Terms, which amends the FASB Accounting Standards Codification Master Glossary to clarify the Master Glossary of the Codification, consolidate multiple instances of the same term into a single definition, and makes minor improvements to the Master Glossary. The amendments are not expected to result in substantive changes to the application of existing guidance. ASU 2014-06 is effective upon issuance. The implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

## **Table of Contents**

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of an Entity, which amends the guidance for reporting discontinued operations and disposals of components of an entity. The amended guidance requires that a disposal representing a strategic shift that has (or will have) a major effect on an entity's financial results or a business activity classified as held for sale should be reported as discontinued operations. The amendments also expand the disclosure requirements for discontinued operations and add new disclosures for individually significant dispositions that do not qualify as discontinued operations. ASU 2014-08 is effective prospectively for fiscal periods beginning after December 15, 2014 (early adoption is permitted only for disposals that have not been previously reported). The implementation of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal periods beginning after December 15, 2016. Early application is not permitted. The Company is currently evaluating the impact of the implementation of this guidance on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force), which requires a reporting entity to treat a performance target that affects vesting and that could be achieved after the requisite service period as a performance condition. ASU 2014-12 is effective for fiscal periods beginning after December 15, 2015. Earlier application is permitted. The implementation of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

## **8. Goodwill And Intangible Assets**

### *Acquisition in Fiscal 2012*

On February 27, 2012, the Company purchased certain assets of Pro-Dex Astromec, Inc. (Astromec), a subsidiary of Pro-Dex Inc. (Pro-Dex), for approximately \$1,050,000, which includes the assumption of liabilities for an estimated earn-out of \$294,000. The total liability for the earn-out as of June 30, 2014 and December 31, 2013 was \$56,000 and \$116,000, respectively. During the six month periods ended June 30, 2014, and June 30, 2013, \$74,000 and \$88,000 were paid related to the earn-out, respectively. The results from the acquisition date through June 30, 2014 are included in the SL Montevideo Technology, Inc. (SL-MTI) segment.

**Table of Contents***Goodwill And Intangible Assets*

Intangible assets consist of the following:

	Amortizable Life (years)	June 30, 2014			December 31, 2013		
		Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
(in thousands)							
<b>Finite-lived intangible assets:</b>							
Customer relationships	5 to 8	\$ 3,868	\$ 3,616	\$ 252	\$ 3,868	\$ 3,436	\$ 432
Patents <sup>(1)</sup>	5 to 20	1,475	1,216	259	1,302	1,212	90
Developed technology	5 to 6	1,700	1,700		1,700	1,700	
Licensing fees	5 to 10	550	435	115	550	398	152
Total amortized finite-lived intangible assets		7,593	6,967	626	7,420	6,746	674
<b>Indefinite-lived intangible assets:</b>							
Trademarks		1,672		1,672	1,672		1,672
Other intangible assets, net		\$ 9,265	\$ 6,967	\$ 2,298	\$ 9,092	\$ 6,746	\$ 2,346

(1) During 2014, the Company's MTE division purchased a patent from a third party. The value of the asset is \$160,000 and the estimated useful life of the asset is 14 years. During 2014, the Company's MTE division also capitalized legal fees related to a new patent application. The estimated useful life of the asset is 20 years. In accordance with ASC 350 Intangibles—Goodwill and Other, goodwill and other indefinite-lived intangible assets are not amortized, but are tested for impairment. Such impairment testing is undertaken annually, or more frequently upon the occurrence of some indication that an impairment has taken place. The Company conducted an annual impairment test as of December 31, 2013.

A two-step process is utilized to determine if goodwill has been impaired. In the first step, the fair value of each reporting unit is compared to the net asset value recorded for such unit. If the fair value exceeds the net asset value, the goodwill of the reporting unit is not adjusted. However, if the recorded net asset value exceeds the fair value, the Company performs a second step to measure the amount of impairment loss, if any. In the second step, the implied fair value of the reporting unit's goodwill is compared with the goodwill recorded for such unit. If the recorded amount of goodwill exceeds the implied fair value, an impairment loss is recognized in the amount of the excess.

Going forward there can be no assurance that economic conditions or other events may not have a negative material impact on the long-term business prospects of any of the Company's reporting units. In such case, the Company may need to record an impairment loss, as stated above. The next annual impairment test will be conducted as of December 31, 2014, unless management identifies a triggering event in the interim.

Management has not identified any triggering events, as defined by ASC 350, during the six months ended June 30, 2014. Accordingly, no interim impairment test has been performed.

**Table of Contents**

Estimated future amortization expense for intangible assets subject to amortization in each of the next five fiscal years is as follows:

	Amortization Expense (in thousands)
2014	\$ 425
2015	\$ 91
2016	\$ 72
2017	\$ 43
2018	\$ 38

Total amortization expense, excluding the amortization of deferred financing costs, consists of amortization expense related to intangible assets and software. Amortization expense related to intangible assets for the three months ended June 30, 2014 and June 30, 2013 was \$111,000 and \$113,000 respectively. Amortization expense related to intangible assets for the six months ended June 30, 2014 and June 30, 2013 was \$220,000 and \$224,000, respectively. Amortization expense related to software for the three months ended June 30, 2014 and June 30, 2013 was \$51,000 and \$37,000, respectively. Amortization expense related to software for the six months ended June 30, 2014 and June 30, 2013 was \$100,000 and \$73,000, respectively.

The following table reflects the components of goodwill as of June 30, 2014, and December 31, 2013:

	June 30, 2014			December 31, 2013		
	Gross Amount	Accumulated Impairment Losses	Goodwill, Net (in thousands)	Gross Amount	Accumulated Impairment Losses	Goodwill, Net
SL Power Electronics Corp.	\$ 4,232		\$ 4,232	\$ 4,228		\$ 4,228
High Power Group:						
MTE Corporation	8,189		8,189	8,189		8,189
TEAL Electronics Corp.	5,055	5,055		5,055	5,055	
RFL Electronics Inc.	5,249		5,249	5,249		5,249
Goodwill	\$ 22,725	\$ 5,055	\$ 17,670	\$ 22,721	\$ 5,055	\$ 17,666

**9. Investments**

Investments in publicly traded equity securities (which include equity interests of less than 20%) are classified as available-for-sale securities. These investments are carried at fair value using quoted market prices and are included in other current assets in the Company's Consolidated Balance Sheets. Unrealized gains and losses, net of tax, are included in the determination of comprehensive income and reported in shareholders' equity.

**Table of Contents**

Available-for-sale securities consist of the following as of June 30, 2014 and December 31, 2013:

	June 30, 2014 (in thousands)			December 31, 2013 (in thousands)		
	Cost	Gains in Accumulated Other Comprehensive Income	Estimated Fair Value	Cost	Gains in Accumulated Other Comprehensive Income	Estimated Fair Value
Common stock	\$	\$	\$	\$ 2,362	\$ 1,739	\$ 4,101

During the six months ended June 30, 2014, the Company sold all of its available-for-sale securities for total proceeds of \$4,054,000. The gross realized gains on these sales totaled \$1,585,000 (\$997,000 net of tax), and \$1,691,000 (\$1,063,000 net of tax), for the three and six months ended June 30, 2014. For the purpose of determining gross realized gains, the cost of securities sold was based on the first in, first out (FIFO) method.

The Company had no available-for-sale securities during the six months ended June 30, 2013.

**10. Debt**

Debt as of June 30, 2014 and December 31, 2013 consisted of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
2012 Credit Facility:		
\$40 million variable interest rate senior revolving credit facility maturing in 2016	\$	\$ 1,000
Other capital leases with maturities through 2018	212	235
Total debt	212	1,235
Less current portion	(48)	(1,048)
Total long-term portion	\$ 164	\$ 187

On August 9, 2012, the Company entered into a Credit Agreement with PNC Bank, National Association, as administrative agent and lender ( PNC Bank ), and the lenders from time to time party thereto, as amended (the 2012 Credit Facility). The 2012 Credit Facility was amended on March 11, 2013 and June 20, 2013.

The 2012 Credit Facility provides for borrowings up to \$40,000,000 and under certain conditions maximum borrowings up to \$70,000,000. The 2012 Credit Facility includes a sublimit for letters of credit and provides for a separate \$10,700,000 letter of credit which expires one year from the date of closing, with annual extensions. The sublimit for letters of credit equals the lesser of (i) an amount equal to \$5,000,000 plus the aggregate amount of Designated Usage LC issued and outstanding under the Designated Usage LC sublimit or (ii) \$25,000,000. The 2012



Credit Facility expires on August 9, 2016.

**Table of Contents**

Borrowings under the 2012 Credit Facility bear interest, at the Company's option, at the London interbank offering rate ( LIBOR ) plus a margin rate ranging from 1.25% to 2.0%, or the higher of a Base Rate plus a margin rate ranging from 0.25% to 1.0%. The Base Rate is equal to the highest of (i) the Federal Funds Open Rate plus 0.5% and (ii) the Prime Rate and (iii) the Daily Libor Rate plus 1%. The margin rates are based on certain leverage ratios, as defined. The Company is subject to compliance with certain financial covenants set forth in the 2012 Credit Facility, including, but not limited to, indebtedness to EBITDA, as defined, minimum levels of fixed charges and limitations on capital expenditures, as defined. Availability under the 2012 Credit Facility is based upon the Company's trailing twelve month EBITDA, as defined.

The Company's obligations under the 2012 Credit Facility are secured by the grant of security interests in substantially all of its assets.

On May 28, 2013, a letter of credit in the amount of \$8,564,000 was issued in favor of the Environmental Protection Agency ( EPA ) to provide financial assurance related to the Company's environmental payments in accordance with the terms of the Consent Decree reached with the United States Department of Justice ( DOJ ) and EPA related to its liability under the terms of the Consent Decree (see Note 13 for additional information). The letter of credit requires an annual commitment fee of 0.125% and standby commission of 1%, and does not reduce amounts available under the 2012 Credit Facility.

On May 20, 2014, the Company made the second payment related to its obligation under the Consent Decree in the amount of \$2,141,000, excluding interest. As of June 30, 2014, the total liability under the letter of credit equaled \$6,423,000. The letter of credit expires on May 28, 2015, and is renewed annually.

As of June 30, 2014, the Company had no outstanding balance under the 2012 Credit Facility. As of December 31, 2013, the Company had an outstanding balance of \$1,000,000 under the 2012 Credit Facility. At June 30, 2014, and December 31, 2013, the Company had total availability under the 2012 Credit Facility of \$39,527,000 and \$38,526,000, respectively.

The aggregate maturities on all long-term debt (including current portion) are:

	Capital Leases (in thousands)
2014	\$ 24
2015	48
2016	48
2017	48
2018	44
Total	\$ 212

**Table of Contents****11. Accrued Liabilities Other**

Accrued liabilities other consist of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
Taxes (other than income) and insurance	\$ 571	\$ 769
Commissions	610	645
Litigation and legal fees	187	121
Other professional fees	403	624
Environmental	8,166	4,589
Warranty	1,281	1,145
Deferred revenue	118	54
Acquisition earn-out, current	56	107
Other	2,642	2,205
Accrued liabilities other	\$ 14,034	\$ 10,259

Included in the environmental accrual are estimates for all known costs believed to be probable and reasonably estimable for sites that the Company currently operates or operated at one time (see Note 13 for additional information).

A liability is established for estimated future warranty and service claims that relate to current and prior period sales. The Company estimates warranty costs based on historical claim experience and other factors including evaluating specific product warranty issues.

The following is a summary of activity in accrued warranty and service liabilities:

	June 30, 2014 (in thousands)
Liability, beginning of year	\$ 1,145
Expense for new warranties issued	516
Warranty claims paid	(380)
Liability, end of period	\$ 1,281

**Table of Contents****12. Other Long-Term Liabilities**

Other long-term liabilities consist of the following:

	June 30, 2014	December 31, 2013
	(in thousands)	
Environmental	\$ 11,247	\$ 17,200
Unrecognized tax benefits, interest and penalties	638	934
Long-term incentive plan	454	322
Acquisition earn-out, long-term		9
<b>Other long-term liabilities</b>	<b>\$ 12,339</b>	<b>\$ 18,465</b>

**13. Commitments and Contingencies**

The Company is involved in certain legal and regulatory actions. Management believes that the ultimate resolution of such matters is unlikely to have a material adverse effect on the Company's financial condition or results of operations, except as described below.

**Litigation:** The Company has been and is the subject of administrative actions that arise from its ownership of SL Surface Technologies, Inc. ( SurfTech ), a wholly-owned subsidiary, the assets of which were sold in November 2003. SurfTech formerly operated chrome-plating facilities in Pennsauken Township, New Jersey (the Pennsauken Site ) and Camden, New Jersey (the Camden Site ).

In 2006 the United States Environmental Protection Agency (the EPA ) named the Company as a potential responsible party (a PRP ) in connection with the remediation of the Puchack Well Field, which has been designated as a Superfund Site. The EPA is remediating the Puchack Well Field Superfund Site in two separate operable units. The first operable unit ( OU-1 ) consists of an area of chromium groundwater contamination in three aquifers that exceeds the selected cleanup standard. The second operable unit ( OU-2 ) pertains to sites that are allegedly the sources of contamination for the first operable unit.

The Company has reached an agreement with both the United States Department of Justice ( DOJ ) and EPA effective April 30, 2013 related to its liability for both OU-1 and OU-2 pursuant to the terms of a Consent Decree which governs the agreement. Specifically, the Company has agreed to perform the remediation for OU-2 and pay a fixed sum for the EPA's past cost for OU-2 and a portion of the EPA's past cost for OU-1. The payments are to be made in five equal payments of \$2,141,000, for a total \$10,705,000, plus interest. The Company has also agreed to pay the EPA's costs for oversight of the OU-2 remediation. The United States District Court judge signed the Consent Decree effective April 30, 2013, thereby triggering the Company's obligation under the Consent Decree. On May 10, 2013, the Company made the first payment related to its obligation under the Consent Decree in the amount of \$2,185,000, which included interest. On May 20, 2014, the Company made the second payment related to its obligation under the Consent Decree in the amount of \$2,211,000, which included interest. The next three payments will be made on the anniversary of the prior year's payment plus ten days in the same amount of \$2,141,000, plus interest. In 2013, the Company had obtained financial assurances for the OU-2 remediation and the fixed payments as required by the terms of the Consent Decree. The financial instruments did not affect the Company's availability under its Credit facility (see Note 10 Debt).



## Table of Contents

The Company is currently in the final stages of the design phase of the remediation activities for OU-2. The 90% Pre-Final Remediation Design (the Pre-Final Design) is expected to be submitted during the first week of August as required by the Scope of Work to complete the Company's obligation under the Consent Decree. The Company expects the EPA to respond to this submission by the end of August. The Pre-Final Design, once approved by the EPA, will essentially set the scope of work for the Company's remediation responsibility related to OU-2 under the terms of the Consent Decree. The Company expects to incur significant remediation costs, which have been accrued, to commence in the fall of 2014 and continue into early 2016.

On December 3, 2012, the Company received a demand letter from the State of New Jersey. The demand is for \$1,300,000 for past and future cleanup costs and \$500,000 for natural resource damages (NRD) for a total of \$1,800,000 (the New Jersey Claim). Although the Company and its counsel believe that it has meritorious defenses to any claim for reimbursement, on February 13, 2013 the Company offered to pay \$250,000 to fully resolve the claim presented by the State of New Jersey for past costs, future costs and NRD at the Puchack Well Field Superfund site. The State of New Jersey has not responded to the Company's counter-offer.

### *Other*

In the ordinary course of its business the Company is and may be subject to other loss contingencies pursuant to foreign and domestic federal, state and local governmental laws and regulations and may be party to certain legal actions, frequently involving complaints by terminated employees and disputes with customers, suppliers and others. In the opinion of management, any such other loss contingencies are not expected to have a material adverse effect on the financial condition or results of operations of the Company.

**Environmental Matters:** Loss contingencies include potential obligations to investigate and eliminate or mitigate the effects on the environment of the disposal or release of certain chemical substances at various sites, such as Superfund sites and other facilities, whether or not they are currently in operation. The Company is currently participating in environmental assessments and cleanups at a number of sites and in the future may be involved in additional environmental assessments and cleanups. Based upon investigations completed to date by the Company and its independent engineering-consulting firms, management has provided an estimated accrual for all known costs believed to be probable and costs that can be reasonably estimated in the amount of \$19,413,000, of which \$11,247,000 is included as other long-term liabilities, with the remainder recorded as other short-term accrued liabilities, as of June 30, 2014. However, it is the nature of environmental contingencies that other circumstances might arise, the costs of which are indeterminable at this time due to such factors as changing government regulations and stricter standards, the unknown magnitude of cleanup costs, and the unknown timing and extent of the remedial actions that may be required. These other circumstances could result in additional expenses or judgments, or offsets thereto. The adverse resolution of any one or more of these other circumstances could have a material adverse effect on the business, operating results, financial condition or cash flows of the Company. The Company's environmental costs primarily relate to discontinued operations and such costs have been recorded in discontinued operations, net of tax.

**Table of Contents**

There are three sites on which the Company may incur material environmental costs in the future as a result of past activities of its former subsidiary, SurfTech. There are two Company owned sites related to its former subsidiary, SurfTech. These sites are located in Pennsauken, New Jersey (the Pennsauken Site ) and in Camden, New Jersey (the Camden Site ). There is also a third site, which is not owned by the Company, referred to as the Puchack Well Field Site. The Puchack Well Field Site and the Pennsauken Site are part of the Puchack Well Field Superfund Site.

With respect to the Camden Site, the Company has reported soil contamination and a groundwater contamination plume emanating from the site. The New Jersey Department of Environmental Protection ( NJDEP ) approved, and the Company implemented in 2010, an interim remedial action pilot study to inject neutralizing chemicals into the unsaturated soil. Based on an assessment of post-injection data, our consultants believe the pilot study can be implemented as a full scale soil remedy to treat unsaturated contaminated soil. A Remedial Action Workplan for soils ( RAWP ) is being developed. The RAWP will select the injection remedy as the site wide remedy for unsaturated soils, along with demolition and proper disposal of the former concrete building slab and targeted excavation and disposal of impacted soil immediately underlying the slab. Additionally, the RAWP will address a small area of impacted soil off the property. The RAWP for soils will be submitted to the NJDEP in the third quarter of 2014, by the Licensed Site Remediation Professional ( LSRP ) for the site. The RAWP is scheduled to be implemented in the fourth quarter of 2014, so that the injections do not impact the bio-barrier pilot tests mentioned below. The Company s environmental consultants finalized an interim remedial action pilot study to treat on-site contaminated groundwater, consisting of injecting food-grade product, into the groundwater at the down gradient property boundary, to create a bio-barrier. The pilot study includes post-injection monitoring to assess the bio-barrier s ability to treat contaminated groundwater. Implementation of the groundwater pilot study is currently underway with post-injection effectiveness monitoring expected to continue through the third quarter of 2015.

As previously reported, the Company is currently participating in environmental assessments and cleanups at a number of sites. One of these sites is a commercial facility, located in Wayne, New Jersey. Contaminated soil and groundwater has undergone remediation with NJDEP and LSRP oversight, but contaminants of concern ( COCs ) in groundwater and surface water, which extend off-site, still remain above applicable NJDEP remediation standards. A soil remedial action plan has been developed to remove the new soil source contamination that continues to impact groundwater. Our LSRP filed a RAWP and permit application with the NJDEP to implement a supplemental groundwater remedial action that will likely consist of additional in-situ injections of food grade product into on-site groundwater. The NJDEP has issued a permit authorizing the remedial action to proceed which is scheduled to occur in the fourth quarter of 2014. Estimates have been developed by the Company s consultants, which includes costs to enhance the existing vapor intrusion system, remedial injections, soil excavation and additional tests and remedial activities. Costs related to this site are recorded as part of discontinued operations, net of tax. The Remedial Investigation deadline for this site has been extended to May 7, 2016.

The Company has reported soil and groundwater contamination at the facility of SL-MTI located on its property in Montevideo, Minnesota. An analysis of the contamination has been completed and a remediation plan has been implemented at the site pursuant to the remedial action plan approved by the Minnesota Pollution Control Agency.

**Table of Contents**

A soil vapor extraction system has been operating at the site since October 2008. In 2013 the regulatory and screening levels for soil vapor and groundwater were lowered for some of the contaminants at the site. In response to this regulatory change, SL-MTI's consultants are conducting additional testing to delineate site impacts and update the site conceptual model. Costs related to this site are recorded as a component of continuing operations.

As of June 30, 2014 and December 31, 2013, environmental accruals of \$19,413,000 and \$21,789,000, respectively, have been recorded by the Company in accrued liabilities other and in other long-term liabilities, as appropriate (see Notes 11 and 12 for additional information).

**14. Segment Information**

The Company currently operates under four business segments: SL Power Electronics Corp. ( SLPE ), the High Power Group, SL-MTI and RFL Electronics Inc. ( RFL ). TEAL Electronics Corp ( TEAL ) and MTE Corporation ( MTE ) are combined into one business segment, which is reported as the High Power Group. The Company aggregates operating business subsidiaries into a single segment for financial reporting purposes if aggregation is consistent with the objectives of ASC 280 Segment Reporting. Business units are also combined if they have similar characteristics in each of the following areas:

nature of products and services

nature of production process

type or class of customer

methods of distribution

SLPE designs, manufactures and markets high-reliability power conversion products in internal and external footprints. The Company's power supplies provide a reliable and safe power source for the customer's specific equipment needs. SLPE, which sells products under three brand names (SL Power Electronics, Condor and Ault), is a major supplier to the original equipment manufacturers ( OEMs ) of medical, industrial/instrumentation, military and information technology equipment. The High Power Group sells products under two brand names (TEAL and MTE). TEAL designs and manufactures custom power conditioning and distribution units for OEMs of medical imaging, medical treatment, military aerospace, semiconductor, solar and advanced simulation systems. MTE designs and manufactures power quality products used to protect equipment from power surges, bring harmonics into compliance and improve the efficiency of variable speed motor drive systems. SL-MTI designs and manufactures high power density precision motors that are used in numerous applications, including military and commercial aerospace, oil and gas, and medical and industrial products. RFL designs and manufactures communication and power protection products/systems that are used to protect electric utility transmission lines and apparatus by isolating faulty transmission lines from a transmission grid. The Unallocated Corporate Expenses segment includes corporate related items, financing activities and other costs not allocated to reportable segments, which includes but is not limited to certain treasury, risk management, legal, litigation and public reporting charges and certain legacy costs. The accounting policies for the business units are the same as those described in the summary of significant accounting policies. For additional information, see Note 1 of the Notes to the Consolidated Financial Statements included in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.





**Table of Contents**

Business segment operations are conducted through domestic subsidiaries. For all periods presented, sales between business segments were not material. Each of the segments has certain major customers, the loss of any of which would have a material adverse effect on such segment.

The unaudited comparative results for the three and six month periods ended June 30, 2014 and June 30, 2013 are as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(in thousands)		(in thousands)	
<b>Net sales</b>				
SLPE	\$ 19,099	\$ 18,386	\$ 36,683	\$ 35,980
High Power Group	22,452	17,607	42,762	34,700
SL-MTI	10,118	9,060	20,970	18,154
RFL	5,080	4,733	8,919	10,047
Net sales	\$ 56,749	\$ 49,786	\$ 109,334	\$ 98,881

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(in thousands)		(in thousands)	
<b>Income from operations</b>				
SLPE	\$ 2,293	\$ 1,131	\$ 3,232	\$ 2,181
High Power Group	3,921	2,038	6,838	4,152
SL-MTI	1,808	1,569	3,903	2,882
RFL	479	393	440	1,329
Unallocated Corporate Expenses <sup>(1)</sup>	(1,726)	(1,500)	(3,229)	(2,927)
Income from operations	\$ 6,775	\$ 3,631	\$ 11,184	\$ 7,617

(1) Unallocated Corporate Expenses includes corporate related items, financing activities and other costs not allocated to reportable segments, which includes but is not limited to certain legal, litigation and public reporting charges and certain legacy costs.

Total assets as of June 30, 2014 and December 31, 2013 are as follows:

June 30,	December 31,
2014	2013
(in thousands)	

<b>Total assets</b>		
SLPE	\$ 34,112	\$ 36,835
High Power Group	32,997	29,506
SL-MTI	15,423	14,601
RFL	14,182	13,503
Unallocated Corporate Assets	23,546	18,889
<b>Total assets</b>	<b>\$ 120,260</b>	<b>\$ 113,334</b>

**Table of Contents**

Goodwill and other intangible assets, net, as of June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014	December 31, 2013
	(in thousands)	
<b>Goodwill and other intangible assets, net</b>		
SLPE	\$ 4,532	\$ 4,528
High Power Group	9,982	9,976
SL-MTI	90	106
RFL	5,364	5,402
 Goodwill and other intangible assets, net	 \$ 19,968	 \$ 20,012

**15. Retirement Plans and Deferred Compensation**

During the six months ended June 30, 2014 and June 30, 2013, the Company maintained a defined contribution pension plan covering all full-time, U.S. employees of SLPE, the High Power Group, including TEAL and MTE, SL-MTI, RFL, and the corporate office. The Company's contributions to this plan are based on a percentage of employee contributions and/or plan year gross wages, as defined. Costs incurred under these plans amounted to \$153,000 and \$382,000 during the three and six months ended June 30, 2014 compared to \$150,000 and \$337,000 during the three and six months ended June 30, 2013.

The Company has agreements with certain retired directors, officers and key employees providing for supplemental retirement benefits. The liability for supplemental retirement benefits is based on the most recent mortality tables available and discount rates ranging from 6% to 12%. The amount charged to expense in connection with these agreements amounted to \$87,000 and \$151,000 for the three month and six month periods ended June 30, 2014 compared to \$90,000 and \$132,000 for the three month and six month periods ended June 30, 2013.

**16. Discontinued Operations**

For the three and six months ended June 30, 2014, total loss from discontinued operations before income taxes was \$210,000 and \$436,000 (\$127,000 and \$265,000, net of tax). For the three and six months ended June 30, 2013, total loss from discontinued operations before income taxes was \$390,000 and \$748,000 (\$237,000 and \$455,000, net of tax), respectively. The loss from discontinued operations in 2014 and 2013 relates to environmental remediation costs, consulting fees, and legal expenses associated with the past operations of the Company's five environmental sites (See Note 13 - Commitments and Contingencies for further information concerning the environmental sites).

**17. Fair Value Measurement and Financial Instruments**

ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing

the asset or liability.

## **Table of Contents**

As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Currently, the Company uses foreign currency forward contracts to hedge its foreign currency risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including spot rates and market forward points. The fair value of the foreign currency forward contracts is based on interest differentials between the currencies being traded, spot rates and market forward points.

To comply with the provisions of ASC 820, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees, where applicable.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of June 30, 2014, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**Table of Contents**

In conjunction with its implementation of updates to the fair value measurements guidance, the Company made an accounting policy election to measure derivative financial instruments subject to master netting agreements on a net basis.

During the third quarter of 2013, the Company purchased publicly traded equity securities which had been classified as available-for-sale securities. Fair values for these investments were based on closing stock prices from active markets for identical assets and therefore were classified within Level 1 of the fair value hierarchy. The fair value of available-for-sale securities was included in other current assets in the Company's Consolidated Balance Sheets at December 31, 2013 (see Note 9 for additional information). During the six months ended June 30, 2014, the Company sold all of its available-for-sale securities.

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, aggregated by the level in the fair value hierarchy within which those measurements fall:

	Quoted Prices in Markets for Identical Assets and Liabilities (Level 1)	Significant Observable Inputs (Level 2)	Other Significant Unobservable Inputs (Level 3)	Balance at June 30, 2014
	(in thousands)			
<b>Liabilities</b>				
Derivative financial instruments	\$	\$	69	\$ 69
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2013
	(in thousands)			
<b>Assets</b>				
Available-for-sale securities	\$ 4,101	\$	\$	\$ 4,101
Derivative financial instruments		152		152
<b>Total Assets</b>	\$ 4,101	\$ 152	\$	\$ 4,253

The Company believes that the fair values of its current assets and current liabilities (cash and cash equivalents, receivables, net, short-term borrowings and current portion of long-term debt, accounts payable, and accrued liabilities) and the fair value of its long-term debt, less current maturities, approximate their reported carrying amounts.

The Company does not have any fair value measurements using significant unobservable inputs (Level 3) as of June 30, 2014.

*Credit Risk Contingent Features*

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults or is capable of being declared in default on any of its indebtedness, then the Company could also be declared in default on its derivative obligations.



**Table of Contents****18. Derivative Instruments and Hedging Activities**

ASC Topic 815, as amended and interpreted, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by ASC Topic 815, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to variability in expected future cash flows related to forecasted foreign exchange-based risk are considered economic hedges of the Company's forecasted cash flows.

*Risk Management Objective of Using Derivatives*

The Company is a U.S. dollars (USD) functional currency entity that manufactures products in the USA, Mexico and China. The Company's sales are priced in USD and its costs and expenses are priced in USD, Mexican pesos (MXN) and Chinese Yuan (CNH). As a result, the Company has exposure to changes in exchange rates between the time when expenses in the non-functional currencies are initially incurred and the time when the expenses are ultimately paid. The Company's objective in using derivatives is to add stability and to manage its exposure to foreign exchange risks. To accomplish this objective, the Company uses foreign currency forward contracts to manage its exposure to fluctuations in the exchange rates. Foreign currency forward contracts involve fixing the USD-MXN and USD-CNH exchange rates for delivery of a specified amount of foreign currency on a specified date.

During 2013 and 2014, the Company entered into a series of foreign currency forward contracts to hedge its exposure to foreign exchange rate movements in its forecasted expenses in China and Mexico. The foreign currency forwards are not speculative and are being used to manage the Company's exposure to foreign exchange rate movements. Foreign currency forward contracts involve fixing the USD-MXN and USD-CNH exchange rates for delivery of a specified amount of foreign currency on a specified date. The Company has elected not to apply hedge accounting to these derivatives and they are marked to market through earnings. Therefore, gains and losses resulting from changes in the fair value of these contracts are recognized at the end of each reporting period directly in earnings. The gains and losses associated with the foreign currency forward contracts are included in other gain (loss), net on the Consolidated Statements of Income. As of June 30, 2014, the fair value of the foreign currency forward contracts was recorded as a \$69,000 liability in other current liabilities on the Consolidated Balance Sheets. As of December 31, 2013, the fair value of the foreign currency forward contracts was recorded as a \$152,000 asset in other current assets on the Consolidated Balance Sheets.

*Non-designated Hedges of Foreign Exchange Risk*

The notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The following table summarizes the notional values of the Company's derivative financial instruments as of June 30, 2014.

Product	Number of Instruments	Notional (in thousands)
Mexican Peso (MXN) Forward Contracts	17	MXN 86,632
Chinese Yuan (CNH) Forward Contracts	18	CNH 93,019



**Table of Contents**

The following table details the location in the financial statements of the gain or loss recognized on foreign currency forward contracts that are marked to market for the three and six months ended June 30, 2014 and June 30, 2013:

	Location of Income (Loss) Recognized in	Three Months Ended	Three Months Ended
		June 30, 2014	June 30, 2013
Derivatives Not Designated as Hedging Instruments	Recognized in Income on Derivative	Amount of Income Recognized in Income on Derivative (in thousands)	Amount of Income Recognized in Income on Derivative (in thousands)
Foreign Exchange Contracts	Other gain (loss), net	\$ 142	Other gain (loss), net \$ (301)
		Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
		Amount of Income (Loss)	Amount of Income (Loss)
Derivatives Not Designated as Hedging Instruments	Location of Income (Loss) Recognized in Income on Derivative	Recognized in Income on Derivative (in thousands)	Location of Income (Loss) Recognized in Income on Derivative (in thousands)
Foreign Exchange Contracts	Other gain (loss), net	\$ (221)	Other gain (loss), net \$ (327)

**19. Other Gain (Loss), net**

Other gain (loss), net for the six months ended June 30, 2014 includes a \$1,691,000 gain recognized from the sale of available-for-sale securities (see Note 9 – Investments for further information) and \$9,000 of dividend income received from investments in available-for-sale securities, which were partially offset by a \$221,000 unrealized loss on foreign currency forward contracts. Other gain (loss), net for the six months ended June 30, 2013 includes a \$327,000 unrealized loss on foreign currency forward contracts.

**20. Foreign Operations**

As a result of a work stoppage at the Company's Xianghe manufacturing facilities from March 7, 2013 through March 20, 2013, revenues for the quarter ended March 31, 2013 were adversely impacted by approximately \$900,000. The Company realized those sales during the second quarter of 2013. Additionally, certain incremental costs were incurred during the six months ended June 30, 2013 related to the work stoppage, including employee, travel, consulting and legal costs of \$535,000. No incremental costs were incurred during the six months ended June 30, 2014.

## **21. Shareholders' Equity**

On November 16, 2010, the Board of Directors authorized a plan that allows for the repurchase up to an aggregate of 470,000 shares of the Company's outstanding common stock (the 2010 Repurchase Plan). Any repurchases pursuant to the 2010 Repurchase Plan would be made in the open market or in negotiated transactions. During the first six months of 2014, the Company purchased approximately 4,000 shares of Company stock at an average price of \$24.68 a share. As a result, as of June 30, 2014, approximately 239,000 shares remained available for purchase under the 2010 Repurchase Plan.

**Table of Contents****22. Related Party Transactions**

On May 1, 2014, the Company renewed the Management Services Agreement ( Management Services Agreement ) with SP Corporate Services LLC ( SP Corporate ). SP Corporate is an affiliate of SPH Group Holdings LLC ( SPHG ). A member of the Company s Board of Directors, Warren G. Lichtenstein, is affiliated with SPHG. Also, the Company s Chairman of the Board, Glen M. Kassan is affiliated with SPHG. Pursuant to the Management Services Agreement, SP Corporate agreed to provide, at the direction of the Company s Chief Executive Officer, non-exclusive services to support the Company s growth strategy, business development, planning, execution assistance and related support services. The monthly fee for these services is \$10,400 paid in advance. The Management Services Agreement has a term of one year and has been approved by the Audit Committee of the Board of Directors and a majority of the disinterested directors of the Company.

**23. Restructuring Costs**

Restructuring activity for the period ended June 30, 2014 was as follows:

	Accrual at Beginning of the Year	Charged to Earnings	Cash Payments	Accrual at June 30, 2014
	(in thousands)			
<b>2014 Plan</b>				
Severance and other employee-related charges	\$	\$ 463	\$ 453	\$ 10

No restructuring activity was recognized during 2013.

*2014 Restructuring Plan*

During the first quarter of 2014, the Company announced to its employees a restructuring plan ( 2014 Plan ) to align its costs with current and projected sales activity. The costs reductions were primarily production, engineering, selling and administration employees at the High Power Group. As of June 30, 2014, there was a consolidated charge to earnings of \$463,000, which was composed of severance and other employee related charges. The total number of employees affected by the restructuring plan was 11, all of which had been terminated during the first quarter of 2014.

**24. Subsequent Event**

On July 25, 2014, the Company entered into an Asset Purchase Agreement (the Agreement ) to purchase certain assets and assume certain liabilities of Dynetic Systems, Inc. ( Dynetic Systems ), for an initial purchase price of \$4,000,000. The agreement provides for certain target working capital adjustments and an earn-out provision commencing on the closing date through December 31, 2017. Dynetic Systems designs, develops and manufactures precision quality, instrument grade motion control products. Dynetic Systems provides custom motor and motion control solutions to the aerospace, defense, medical, commercial and industrial markets. The financial results from the acquisition will be included in the SL-MTI segment.



**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following section highlights significant factors impacting the consolidated operations and financial condition of the Company and its subsidiaries. The following discussion should be read in conjunction with the Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q.

**Forward-Looking Statements**

In addition to other information in this Quarterly Report on Form 10-Q, this Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and the current economic environment. These statements are not guarantees of future performance. They involve a number of risks and uncertainties that are difficult to predict, including, but not limited to, the Company's ability to implement its business plan, retain key management, anticipate industry and competitive conditions, realize operating efficiencies, secure necessary capital facilities and obtain favorable determinations in various legal and regulatory matters. Actual results could differ materially from those expressed or implied in the forward-looking statements. Some important assumptions and other critical factors that could cause actual results to differ materially from those in the forward-looking statements are specified in the Company's filings with the Securities and Exchange Commission (the SEC), including the Company's Annual Report on Form 10-K for the year ended December 31, 2013, and Current Reports on Form 8-K.

**Overview**

SL Industries, Inc., through its subsidiaries, designs, manufactures and markets power electronics, motion control, power protection, power quality, and specialized communication equipment that is used in a variety of medical, commercial and military aerospace, solar, computer, datacom, industrial, telecom, transportation, utility, rail and highway equipment applications. Its products are generally incorporated into larger systems to improve operating performance, safety, reliability and efficiency. The Company's products are largely sold to Original Equipment Manufacturers (OEMs), the utility industry and, to a lesser extent, to commercial distributors. The Company is comprised of four domestic business segments, three of which have significant manufacturing operations in Mexico. SL Power Electronics Corp. (SLPE) has manufacturing, engineering and sales capability in China. Most of the Company's sales are made to customers who are based in the United States. The Company places an emphasis on highly engineered, well-built, high quality, dependable products and is dedicated to continued product enhancement and innovation.

The Company's business strategy has been to enhance the growth and profitability of each of its businesses through the penetration of attractive new market niches, further improvement of operations through the implementation of lean manufacturing principles, expansion of lean principles into the transactional side of the business, and expansion of global capabilities. The Company intends to focus on improving efficiencies that better leverage the Company's resources. Lean initiatives, both on the factory floor and throughout the organization, are ongoing. The Company expects to pursue its goals during the next twelve months principally through organic growth. The Company also continues to pursue strategic alternatives to maximize shareholder value. Some of these alternatives have included, and could continue to include, selective acquisitions, divestitures and the sale of certain assets. The Company has provided, and may from time to time in the future provide, information to interested parties.





## **Table of Contents**

In the sections that follow, statements with respect to the quarter ended 2014 or six months ended 2014 refer to the three month and six month periods ended June 30, 2014. Statements with respect to the quarter ended 2013 or six months ended 2013 refer to the three month and six month periods ended June 30, 2013. Also, statements with respect to operating costs refer to engineering and product development costs, selling, general and administrative costs and depreciation and amortization ( operating costs ).

## **Significant Transactions and Financial Trends**

During the third quarter of 2013, the Company purchased publicly traded equity securities which were classified as available-for-sale securities. During the six months ended June 30, 2014, the Company sold all of its available-for-sale securities for total proceeds of \$4,054,000. The gross realized gains on these sales totaled \$1,585,000 (\$997,000 net of tax), and \$1,691,000 (\$1,063,000 net of tax), for the three and six months ended June 30, 2014 (see Note 9 for additional information).

During the second quarter of 2013, the Company reached an agreement with both the United States Department of Justice ( DOJ ) and EPA related to its liability for both OU-1 and OU-2 pursuant to the terms of a Consent Decree which governs the agreement. On May 20, 2014, the Company made the second payment related to its obligation under the Consent Decree in the amount of \$2,211,000, which included interest. The next three payments will be made on the anniversary of the prior year s payment plus ten days in the same amount of \$2,141,000, plus interest.

## **Business Trends**

Demand for the Company s products and services increased during 2014 compared to 2013. Sales for the six months ended June 30, 2014, increased by \$10,453,000 or 11%, and income from operations increased by \$3,567,000, or 47%.

Sales increased during the six months ended June 30, 2014 due to increases at the High Power Group, Montevideo Technology, Inc. ( SL-MTI ), and SL Power Electronics Corp. ( SLPE ), which were partially offset by a decrease at RFL Electronics Inc.

Income from operations increased during the six months ended June 30, 2014 due to increases at the High Power Group, SLPE, and SL-MTI, which were partially offset by a decrease at RFL. In addition, Unallocated Corporate Expenses increased in 2014 compared to 2013.

During the six months ended June 30, 2014, the Company s backlog decreased to \$70,778,000 from \$72,125,000 for the same period in the prior year, for a change of 2% on a comparative basis. The decrease in backlog in 2014 was attributable to SLPE and the High Power Group, who recorded 24% and 1% decreases, respectively. The decrease in backlog was partially offset by increases at RFL and SL-MTI of 55% and 17%, respectively. The Company s net new orders for the six months ended June 30, 2014 increased by 3%, compared to the six months ended June 30, 2013.

## **Table of Contents**

The Company's management is taking numerous actions to improve sales through the deployment of numerous growth tools aimed at identifying attractive market segments and penetrating those markets through aggressive new product introduction. The Company is also identifying and penetrating selected geographic opportunities. The Company is continuing to emphasize lean initiatives at all of its facilities in manufacturing as well as in the transactional and reporting processes.

While these items are important in understanding and evaluating financial results and trends, other transactions or events, which are disclosed in this Management's Discussion and Analysis, may have a material impact on continuing operations. A complete understanding of these transactions is necessary in order to estimate the likelihood that these trends will continue.

## **Critical Accounting Policies**

The Company's consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States (GAAP). GAAP requires management to make estimates and assumptions that affect the amounts of reported and contingent assets and liabilities at the date of the consolidated financial statements and the amounts of reported net sales and expenses during the reporting period.

The SEC has issued disclosure guidance for critical accounting policies. The SEC defines critical accounting policies as those that are most important to the portrayal of the Company's financial condition and results, and that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The Company's significant accounting policies are described in Note 1 in the Notes to Consolidated Financial Statements included in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies are deemed to be critical within the SEC definition. The Company's senior management has reviewed these critical accounting policies and estimates and the related Management's Discussion and Analysis of Financial Condition and Results of Operations with the Audit Committee of the Board of Directors.

## **Revenue Recognition**

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the purchase price is fixed or determinable and collectability is reasonably assured. Revenue is recorded in accordance with Staff Accounting Bulletin (SAB) No. 104 and in certain circumstances in accordance with the guidance provided by ASC 605-25 Revenue Recognition Multiple-Element Arrangements. The major portion of the Company's revenue is derived from equipment sales. The Company recognizes equipment revenue upon shipment or delivery, depending upon the terms of the order, and transfer of title. Generally, the revenue recognition criteria are met at the time the product is shipped. The Company does not currently have any multiple-element arrangements.

## **Table of Contents**

Provisions are established for product warranties, principally based on historical experience. At times the Company establishes reserves for specific warranty issues known by management. Customer service and installation revenue is recognized when completed. RFL has customer service revenue, which accounted for less than one percent of consolidated net revenue for the six months ended 2014 and 2013.

SLPE has two sales programs with distributors, pursuant to which credits are issued to distributors: (1) a re-stocking program and (2) a competitive discount program. The distributor re-stocking program allows distributors to rotate up to a pre-determined percentage of their purchases over the previous six month period. SLPE provides for this allowance as a decrease to revenue based upon the amount of sales to each distributor and other historical factors. The competitive discount program allows a distributor to sell a product out of its inventory at a negotiated price in order to meet certain competitive situations. SLPE records this discount as a reduction to revenue based on the distributor's eligible inventory. The eligible distributor inventory is reviewed at least quarterly. No cash is paid under either distributor program. These programs affected consolidated gross revenue for each of the six month periods ended 2014 and 2013 by approximately 0.3% and 0.5%, respectively.

Certain judgments affect the application of the Company's revenue policy, as mentioned above. Revenue recognition is significant because net revenue is a key component of results of operations. In addition, revenue recognition determines the timing of certain expenses, such as commissions, royalties and certain incentive programs. Revenue results are difficult to predict. Any shortfall in revenue or delay in recognizing revenue could cause operating results to vary significantly from year to year and quarter to quarter.

## **Allowance For Doubtful Accounts**

The Company's estimate for the allowance for doubtful accounts related to trade receivables is based on two methods. The amounts calculated from each of these methods are combined to determine the total amount reserved. First, the Company evaluates specific accounts where it has information that the customer may have an inability to meet its financial obligations (e.g., bankruptcy or insolvency). In these cases, the Company uses its judgment, based on the best available facts and circumstances, and records a specific reserve for that customer against amounts due to reduce the receivable to the amount that is expected to be collected. These specific reserves are reevaluated and adjusted as additional information is received that impacts the amount reserved. Second, a general reserve is established for all customers based on several factors, including historical write-offs as a percentage of sales. If circumstances change (e.g., higher than expected defaults or an unexpected material adverse change in a major customer's ability to meet its financial obligation), the Company's estimates of the recoverability of amounts due could be reduced by a material amount. Receivables are charged off against the reserve when they are deemed uncollectible. The Company's allowance for doubtful accounts equaled 1.1% and 1.9% of gross trade receivables as of June 30, 2014 and December 31, 2013.

---

**Table of Contents****Inventories**

The Company values inventory at the lower of cost or market, and continually reviews the book value of discontinued product lines to determine if these items are properly valued. The Company identifies these items and assesses the ability to dispose of them at a price greater than cost. If it is determined that cost is less than market value, then cost is used for inventory valuation. If market value is less than cost, then related inventory is adjusted to market value. If a write down to the current market value is necessary, the market value cannot be greater than the net realizable value, which is defined as selling price less costs to complete and dispose, and cannot be lower than the net realizable value less a normal profit margin. The Company also continually evaluates the composition of its inventory and identifies obsolete, slow-moving and excess inventories. Inventory items identified as obsolete, slow-moving or excess are evaluated to determine if reserves are required. If the Company were not able to achieve its expectations of the net realizable value of the inventory at current market value, it would have to adjust its reserves accordingly. The Company attempts to accurately estimate future product demand to properly adjust inventory levels. However, significant unanticipated changes in demand could have a significant impact on the value of inventory and of operating results.

**Investments**

The Company determines the appropriate classification of its investments in equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Marketable securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value, with unrealized gains and losses recognized in earnings. Marketable equity securities not classified as trading are classified as available for sale, and are carried at fair market value, with the unrealized gains and losses, net of tax, included in the determination of comprehensive income and reported in shareholders' equity. The fair value of all securities held by the Company is determined by quoted market prices.

**Derivative Instruments and Hedging Activities**

FASB ASC 815, *Derivatives and Hedging* (ASC 815), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company's objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. Certain of the Company's foreign operations expose the Company to fluctuations of foreign interest rates and exchange rates. These fluctuations may impact the value of the Company's revenues, expenses, cash receipts and payments in terms of the Company's functional currency. The Company enters into derivative financial instruments to protect the value or fix the amount of certain cash flows in terms of the functional currency of the business unit with that exposure.

## **Table of Contents**

As required by ASC 815, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. The Company enters into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting. Currently, the Company does not apply hedge accounting to any of its foreign currency derivatives.

## **Accounting For Income Taxes**

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. Net deferred tax assets as of June 30, 2014 and December 31, 2013 were \$12,400,000 and \$13,043,000, respectively, net of valuation allowances of \$1,926,000 and \$2,003,000 as of June 30, 2014 and December 31, 2013, respectively. The 2014 and 2013 valuation allowances were primarily related to discontinued operations. The carrying value of the Company's net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income in certain tax jurisdictions. Valuation allowances are attributable to uncertainties related to the Company's ability to utilize certain deferred tax assets prior to expiration. These deferred tax assets primarily consist of the state tax expense on certain expenses and loss carryforwards. The valuation allowance is based on estimates of taxable income, expenses and credits by the jurisdictions in which the Company operates and the period over which deferred tax assets will be recoverable. In the event that actual results differ from these estimates or these estimates are adjusted in future periods, the Company may need to establish an additional valuation allowance that could materially impact its consolidated financial position and results of operations. Each quarter, management evaluates the ability to realize the deferred tax assets and assesses the need for additional valuation allowances.

The Company applies the provisions of ASC 740-10-55 to all tax positions for which the statute of limitations remain open. The amount of gross unrecognized tax benefits, excluding interest and penalties, as of June 30, 2014 and December 31, 2013 was \$859,000 and \$834,000, respectively. This amount represents unrecognized tax benefits, which, if ultimately recognized, will reduce the Company's effective tax rate. As of June 30, 2014 and December 31, 2013, the Company reported accrued interest and penalties related to unrecognized tax benefits of \$126,000 and \$100,000, respectively. For additional disclosures related to accounting for income taxes, see Note 11 in the Notes to the Consolidated Financial Statements included in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

## **Table of Contents**

### **Legal Contingencies**

The Company is currently involved in certain legal proceedings. As discussed in Note 13 of the Notes to the Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q, the Company has accrued an estimate of the probable costs for the resolution of these claims. This estimate has been developed based on the current stage of negotiations and data from the Company's environmental engineering consultants. Management does not believe these proceedings will have a further material adverse effect on the Company's consolidated financial position, except as discussed in Note 13. As with litigation, generally the outcome is inherently uncertain. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in these assumptions, or the effectiveness of these strategies, related to these proceedings.

### **Goodwill**

The Company has allocated its adjusted goodwill balance to its reporting units. The Company tests goodwill for impairment annually at fiscal year-end and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired, such as a significant adverse change in business climate, an adverse action or assessment by a regulator or the decision to sell a business, that would make it more likely than not that an impairment may have occurred. The goodwill impairment test is a two-step process. The first step of the impairment analysis compares the fair value to the net book value. In determining fair value, the accounting guidance allows for the use of several valuation methodologies, although it indicates that quoted market prices are the best evidence of fair value. The Company uses a combination of expected present values of future cash flows and comparative market multiples. It has also performed a review of market capitalization with estimated control premiums at December 31, 2013. If the fair value of a reporting unit is less than its net book value, the Company would perform a second step in its analysis, which compares the implied fair value of goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, the Company recognizes an impairment loss equal to that excess amount. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount and growth rates, operating margins and working capital requirements, selecting comparable companies within each reporting unit and market and determining control premiums. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

The assumptions about future cash flows and growth rates are based on the budget and long-term business plans of each reporting unit. Such assumptions take into account numerous factors including but not limited to historical experience, anticipated economic conditions, new product introductions, product cost and cost structure of each reporting unit. The growth rates assumptions were generally consistent with those utilized in prior year forecasted periods, except in certain circumstances where operational strategies support otherwise.

There were no impairment charges for the six months ended 2014 and 2013. As of June 30, 2014 and December 31, 2013, goodwill totaled \$17,670,000 and \$17,666,000 (representing 15% and 16% of total assets), respectively.

## **Table of Contents**

There can be no assurance that the economic conditions currently affecting the world economy or other events may not have a negative material impact on the long-term business prospects of any of the Company's reporting units. In such case, the Company may need to record an impairment loss, as stated above. The next annual impairment test will be conducted as of December 31, 2014, unless management identifies a triggering event in the interim.

Management has not identified any triggering events, as defined by ASC 350 Intangibles Goodwill and Other, during 2014. Accordingly, no interim impairment test has been performed.

## **Impairment Of Long-Lived And Intangible Assets**

The Company's long-lived and intangible assets primarily consist of fixed assets, goodwill and other intangible assets. The Company periodically reviews the carrying value of its long-lived assets held and used, other than goodwill and intangible assets with indefinite lives, and assets to be disposed of whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. The Company assesses the recoverability of the asset by estimated cash flows and at times by independent appraisals. It compares estimated cash flows expected to be generated from the related assets, or the appraised value of the asset, to the carrying amounts to determine whether impairment has occurred. If the estimate of cash flows expected to be generated changes in the future, the Company may be required to record impairment charges that were not previously recorded for these assets. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Asset impairment evaluations are by nature highly subjective.

## **Environmental Expenditures**

The Company is subject to United States, Mexican, Chinese and United Kingdom environmental laws and regulations concerning emissions to the air, discharges to surface and subsurface waters, and generation, handling, storage, transportation, treatment and disposal of waste materials. The Company is also subject to other federal, state and local environmental laws and regulations, including those that require it to remediate or mitigate the effects of the disposal or release of certain chemical substances at various sites, mostly at sites where the Company has ceased operations. It is impossible to predict precisely what effect these laws and regulations will have in the future.

Expenditures that relate to current operations are charged to expense or capitalized, as appropriate. Expenditures that relate to an existing condition caused by formerly owned operations are expensed and recorded as part of discontinued operations, net of tax. Expenditures include costs of remediation, consulting, legal fees to defend against claims for environmental liability and certain costs to assist the Company with compliance matters and administrative tasks. Liabilities are recorded when remedial efforts are probable and the costs can be reasonably estimated. The liability for remediation expenditures includes, as appropriate, elements of costs such as site investigations, consultants' fees, feasibility studies, outside contractor expenses and monitoring expenses. Estimates are not discounted and they are not reduced by potential claims for recovery from insurance carriers. The Company does not currently have any outstanding claims against insurance carriers related to remediation expenditures. The liability is periodically reviewed and adjusted to reflect current remediation progress, prospective estimates of required activity and other relevant factors, including changes in technology or regulations. For additional information related to environmental matters, see Note 16 of the Notes to the Consolidated Financial Statements included in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and Note 13 to this Quarterly Report.

**Table of Contents**

The above listing is not intended to be a comprehensive list of all of the Company's accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP with no need for management's judgment in its application. There are also areas in which management's judgment in selecting any available alternatives would not produce a materially different result. For a discussion of accounting policies and other disclosures required by GAAP, see the Company's audited Consolidated Financial Statements and Notes thereto included in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and Part 1 to this Quarterly Report.

**Liquidity And Capital Resources**

	June 30, 2014	December 31, 2013	\$ Variance	% Variance
	(in thousands)			
Cash and cash equivalents	\$ 15,790	\$ 7,163	\$ 8,627	120%
Bank debt	\$	\$ 1,000	\$ (1,000)	(100%)
Capital leases	\$ 212	\$ 235	\$ (23)	(10%)
Working capital	\$ 39,128	\$ 37,051	\$ 2,077	6%
Shareholders' equity	\$ 66,531	\$ 59,175	\$ 7,356	12%

The Company's liquidity needs have related to, and are expected to continue to relate to, capital investments, product development costs, acquisitions, working capital requirements, and certain environmental and legal remediation costs. The Company has met its liquidity needs primarily through cash generated from operations and, to a lesser extent, through bank borrowings. The Company believes that cash provided by operating activities from continuing operations and funding available under the 2012 Credit Facility will be adequate to service debt and meet working capital needs, capital investment requirements, and product development requirements for the next twelve months.

At June 30, 2014, the Company reported \$15,790,000 of cash, compared to \$7,163,000 of cash and cash equivalents as of December 31, 2013. Cash and cash equivalents increased in 2014 due to \$9,762,000 of cash provided by operating activities from continuing operations and \$2,850,000 of cash provided by investing activities, which were partially offset by \$2,833,000 of cash used in operating activities from discontinued operations and \$1,130,000 of cash used in financing activities.

Net cash provided by operating activities from continuing operations during the six month period ended June 30, 2014 was \$9,762,000 as compared to net cash provided by operating activities from continuing operations of \$621,000 during the six month period ended June 30, 2013. The primary sources of cash from operating activities for the six month period ended June 30, 2014 were income from continuing operations of \$8,320,000, an increase in accounts payable of \$2,912,000, a decrease in other assets of \$1,716,000, and an increase in accrued income taxes of \$1,305,000. In addition, depreciation and amortization expense of \$1,250,000, non-cash stock based compensation of \$334,000, and an unrealized loss on foreign exchange contracts of \$221,000 were added to income from continuing operations. All of the Company's operating segments recorded increases in accounts payable.



---

**Table of Contents**

The increase in accounts payable was primarily due to increased sales and related inventory purchases to meet customer demand during 2014. The decrease in other assets was primarily due to the sale of available-for-sale securities and the collection of prepaid value-added tax in China during 2014. The increase in accrued income taxes was primarily due to an increase in income from continuing operations before income taxes coupled with a realized gain from the sale of common stock classified as available-for-sale securities during 2014. These sources of cash from operating activities were partially offset by a \$3,949,000 increase in accounts receivable, a gain from the sale of common stock classified as available-for-sale securities of \$1,691,000, and a \$967,000 decrease in other accrued liabilities. The largest increases in accounts receivable occurred at TEAL and MTE, which comprise the High Power Group, and SL-MTI. The increases at TEAL, MTE, and SL-MTI were primarily due to increases in sales during the second quarter of 2014 as compared to the fourth quarter of 2013. The increase at the SL-MTI was also due to strong collections during December 2013. The decrease in other accrued liabilities was primarily due to the payment of 2013 bonuses during March 2014.

Net cash provided by operating activities from continuing operations during the six month period ended June 30, 2013 was \$621,000. The primary source of cash from operating activities for the six month period ended June 30, 2013 was income from continuing operations of \$5,236,000. In addition, depreciation and amortization expense of \$1,215,000, non-cash stock compensation expense of \$332,000, and an unrealized loss on foreign exchange contracts of \$327,000 were added to income from continuing operations. These sources of cash from operating activities were partially offset by an increase in inventory of \$2,507,000, an increase in accounts receivable of \$1,820,000, an increase in other assets of \$1,049,000, and a decrease in accounts payable of \$1,045,000. The largest increases in inventory occurred at SLPE and TEAL, which were partially offset by a large decrease at MTE. The increase at SLPE was primarily due to delays in customer shipments until the third quarter of 2013. The increase at TEAL was primarily due to the rollout of several new products in 2013. The decrease in inventory at MTE was primarily due to an increase in sales during the second quarter of 2013 as compared to the fourth quarter of 2012 coupled with the completion of a large domestic customer project during the second quarter of 2013. The largest increases in accounts receivable occurred at SL-MTI and MTE, which were partially offset by large decrease at RFL. The increases at SL-MTI and MTE were primarily due to an increase in sales during the second quarter of 2013 as compared to the fourth quarter of 2012 while the decrease at RFL was primarily due to a decrease in sales during the second quarter of 2013 as compared to the fourth quarter of 2012. The increase in other assets was primarily due to an increase in payments related to purchase agreements for copper at MTE and TEAL. The increase in other assets was also due to the renewal of certain insurance policies during the first half of 2013. The largest decrease in accounts payable occurred at SLPE, which was partially offset by large increase at SL-MTI. The decrease at SLPE was primarily due to the extending of 2012 payments until 2013. The increase in accounts payable at SL-MTI was primarily due to a large payment in December 2012 without a comparable payment in June 2013.

---

**Table of Contents**

Net cash used in operating activities from discontinued operations during the six month period ended June 30, 2014 was \$2,833,000 as compared to cash used in operating activities from discontinued operations of \$2,934,000 during the six month period ended June 30, 2013. Cash used in operating activities from discontinued operations during 2014 and 2013 was primarily related to payments of \$2,211,000 and \$2,185,000, which included interest, for the EPA's past cost for OU-2 and a portion of the EPA's past cost for OU-1 according to the terms set forth in the Consent Decree (See Note 13 Commitments and Contingencies for the terms and conditions of the Consent Decree). The remaining payments in 2014 and 2013 were related to environmental remediation costs, consulting fees, and legal expenses associated with the past operations of the Company's five environmental sites.

Net cash provided by investing activities during the six month period ended June 30, 2014 was \$2,850,000 as compared to net cash used in investing activities of \$1,863,000 during the six month period ended June 30, 2013. Cash provided by investing activities during 2014 was primarily related to the proceeds from the sale of common stock classified as available-for-sale securities of \$4,054,000, which was partially offset by purchases of property, plant and equipment of \$940,000 and for the purchase of other assets of \$264,000. Purchases of property, plant and equipment were primarily used to upgrade production capabilities and technology. Purchases of other assets were primarily related to the purchase of a patent from a third party at MTE and the purchase of software. Cash used in investing activities during 2013 was for the purchases of property, plant and equipment of \$1,801,000 and for the purchase of other assets of \$62,000. Purchases of property, plant and equipment were primarily used to upgrade production capabilities and technology. Purchases of other assets were primarily related to the purchase of software.

Net cash used in financing activities during the six month period ended June 30, 2014 was \$1,130,000 as compared to net cash provided by financing activities of \$1,930,000 during the six month period ended June 30, 2013. Cash used in financing activities during 2014 was primarily related to \$1,000,000 of payments made under the 2012 Credit Facility and the purchase of Company stock pursuant to the Company's 2010 Repurchase Plan (described in Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds) in the amount of \$106,000. Cash provided by financing activities during 2013 was primarily related to \$2,490,000 of net borrowings under the 2012 Credit Facility and proceeds from the stock option exercises, which were partially offset by the purchase of Company stock pursuant to the Company's 2010 Repurchase Plan in the amount of \$792,000.

As of June 30, 2014, the Company's total debt equaled \$212,000, which was related to capital leases. As of December 31, 2013, the Company's total debt equaled \$1,235,000, which was comprised of \$1,000,000 under the 2012 Credit Facility and \$235,000 related to capital leases. At June 30, 2014 and December 31, 2013, the Company had total availability under the 2012 Credit Facility of \$39,527,000 and \$38,526,000, respectively. The Company's percentage of total debt to total shareholders' equity was 0.3% and 2.1% as of June 30, 2014 and December 31, 2013, respectively.

The Company's current ratio was 1.99 to 1 at June 30, 2014 and 2.10 to 1 at December 31, 2013. Current assets increased by \$7,900,000 from December 31, 2013, while current liabilities increased by \$5,823,000 during the same period.

**Table of Contents**

Capital expenditures were \$940,000 in 2014, which represented a decrease of \$861,000 from the capital expenditure levels of 2013. The Company anticipates spending approximately \$3,758,000 on property, plant and equipment during the remainder of 2014, used primarily to upgrade production capabilities and technology and for the relocation to a new manufacturing facility in Xianghe, China. The 2014 capital additions are expected to be funded primarily through cash from operating activities.

With the exception of the segment reported as Unallocated Corporate Expenses (which consists primarily of corporate office expenses, financing activities, certain treasury, risk management, legal, litigation, public reporting costs, legacy costs and costs not specifically allocated to the reportable business segments), all of the Company's operating segments recorded income from operations for the six months ended June 30, 2014.

**Contractual Obligations**

The following is a summary of the Company's contractual obligations at June 30, 2014 for the periods indicated:

	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years	Total
	(in thousands)				
Capital Leases <sup>(1)</sup>	\$ 28	\$ 112	\$ 106	\$	\$ 246
Operating leases	855	2,252	1,264	777	5,148
Payments to EPA <sup>(2)</sup>	2,193	4,334			6,527
	\$ 3,076	\$ 6,698	\$ 1,370	\$ 777	\$ 11,921

(1) Includes interest payments through maturity of \$34,000.

(2) In accordance with the Consent Decree, the Company has agreed to pay a fixed sum for the EPA's past cost for OU-2 and a portion of the EPA's past cost for OU-1. The payments are to be made in five equal payments of \$2,141,000, for a total \$10,705,000, plus interest. On May 10, 2013, the Company made the first payment related to its obligation under the Consent Decree in the amount of \$2,185,000, which included interest. On May 20, 2014, the Company made the second payment related to its obligation under the Consent Decree in the amount of \$2,211,000, which included interest. The next three payments will be made on the anniversary of the prior year's payment plus ten days in the same amount of \$2,141,000, plus interest (See Note 13 Commitments and Contingencies for the terms and conditions of the Consent Decree).

The table above excludes the Company's gross liability for uncertain tax positions of \$859,000 including accrued interest and penalties, which totaled \$126,000 as of June 30, 2014, since the Company cannot predict with reasonable reliability the timing or certainty of cash settlements to the respective taxing authorities.

**Off-Balance Sheet Arrangements**

It is not the Company's usual business practice to enter into off-balance sheet arrangements such as guarantees on loans and financial commitments, indemnification arrangements and retained interests in assets transferred to an unconsolidated entity for securitization purposes. Consequently, the Company has no off-balance sheet arrangements which have, or are reasonably likely to have, a material current or future effect on its financial condition, changes in

financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, except for operating lease commitments disclosed in the table above and inventory purchase commitments.

**Table of Contents**

In an attempt to limit the volatility of copper costs, the Company has in the past, and may in the future, enter into purchase agreements for copper. As of June 30, 2014, inventory purchase commitments for copper totaled \$1,344,000. As of June 30, 2014, no purchase commitments for copper were greater than nine months.

**Results of Operations****Three months ended June 30, 2014 compared with three months ended June 30, 2013**

The tables below show the comparisons of net sales and income from operations for the quarter ended June 30, 2014 ( 2014 ) and the quarter ended June 30, 2013 ( 2013 ):

	<b>Net Sales</b>			
	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	\$ Variance From Same Quarter Last Year	% Variance From Same Quarter Last Year
	(in thousands)			
SLPE	\$ 19,099	\$ 18,386	\$ 713	4%
High Power Group	22,452	17,607	4,845	28
SL-MTI	10,118	9,060	1,058	12
RFL	5,080	4,733	347	7
<b>Net Sales</b>	<b>\$ 56,749</b>	<b>\$ 49,786</b>	<b>\$ 6,963</b>	<b>14%</b>

	<b>Income from Operations</b>			
	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	\$ Variance From Same Quarter Last Year	% Variance From Same Quarter Last Year
	(in thousands)			
SLPE	\$ 2,293	\$ 1,131	\$ 1,162	103%
High Power Group	3,921	2,038	1,883	92
SL-MTI	1,808	1,569	239	15
RFL	479	393	86	22
Unallocated Corporate Expenses	(1,726)	(1,500)	(226)	(15)
<b>Income from Operations</b>	<b>\$ 6,775</b>	<b>\$ 3,631</b>	<b>\$ 3,144</b>	<b>87%</b>

During 2014, consolidated net sales increased by \$6,963,000 or 14%, compared to net sales during the second quarter of 2013. When compared to 2013, net sales of SLPE increased by \$713,000, or 4%; net sales of the High Power Group increased by \$4,845,000, or 28%; net sales of SL-MTI increased by \$1,058,000, or 12%; and net sales at RFL increased by \$347,000, or 7%.



## **Table of Contents**

In 2014, the Company's income from operations increased by \$3,144,000, or 87%, when compared to 2013. Income from operations was 12% of net sales in 2014 compared to 7% in 2013. All of the Company's operating entities recorded income from operations in 2014 and 2013. In addition, Unallocated Corporate Expenses increased by \$226,000, or 15%, in 2014 compared to 2013.

Income from continuing operations in 2014 was \$5,655,000, or \$1.36 per diluted share, compared to income from continuing operations in 2013 of \$2,252,000, or \$0.54 per diluted share. Income from continuing operations was approximately 10% of net sales in 2014, compared to income from continuing operations of 5% of net sales in 2013.

The Company's business segments and the components of operating expenses are discussed in the following sections.

### **SLPE**

SLPE recorded net sales of \$19,099,000 or 34% of consolidated net sales in 2014, compared to \$18,386,000, or 37%, of consolidated net sales in 2013. SLPE's sales increase was primarily attributable to an increase in domestic distributor sales in the data communications product line. Domestic sales increased by 1% and international sales increased by 54% during 2014. The increase in international sales was primarily due to a general increase in demand in the medical product line. Returns and distributor credits negatively affected net sales, which represented approximately 1% and 2% of SLPE gross sales in 2014 and 2013, respectively.

SLPE reported income from operations of \$2,293,000 in 2014, compared to \$1,131,000 in 2013. Income from operations increased in 2014 primarily due to a 4% increase in sales, a 4% decrease in cost of products sold as a percentage of net sales, and a 2% decrease in operating costs. Operating costs decreased during 2014 primarily due to a decrease in engineering and product development costs of \$134,000, or 10%. Selling, general and administrative expenses and depreciation and amortization were relatively flat during 2014.

### **High Power Group**

The High Power Group reported net sales of \$22,452,000, or 39% of consolidated net sales in 2014, compared to \$17,607,000, or 35% of consolidated net sales in 2013. The High Power Group recognized an increase in net sales in all product lines during 2014. In addition, the MTE unit experienced record sales for a quarter during the second quarter of 2014. The increase in net sales during 2014 was due to an increase in net sales at TEAL of \$2,436,000, or 33%, and an increase at MTE of \$2,409,000, or 24%.

TEAL's sales increase during 2014 was primarily attributable to an increase in new product sales to a large international customer in the medical imaging equipment market, an increase in new product sales to a large international customer in the semi-conductor market, and an increase in sales to a large domestic customer in the solar market. Domestic sales decreased by 18%, while international sales increased by 255% during 2014.

MTE's sales increase during 2014 was primarily attributable to an increase in domestic harmonic filter sales to a large new customer in the electronic equipment industry, and an increase in new product sales within the motor protection filter product line. Domestic sales increased by 17% and international sales increased by 48% during 2014.

**Table of Contents**

The High Power Group reported income from operations of \$3,921,000 in 2014, compared to \$2,038,000 in 2013. The increase in income from operations during 2014 was due to an increase at MTE of \$1,212,000 and an increase at TEAL of \$671,000. Income from operations increased in 2014 primarily due to a 28% increase in sales, a 1% decrease in cost of products sold as a percentage of net sales, and a 5% decrease in operating costs. Operating costs decreased during 2014 primarily due to a decrease in engineering and product development costs of \$294,000, or 28%, which was partially offset by an increase in selling, general and administrative expenses of \$111,000, or 5%.

**SL-MTI**

SL-MTI recorded net sales of \$10,118,000, or 18% of consolidated net sales in 2014, compared to \$9,060,000, or 18% of consolidated net sales in 2013. SL-MTI recognized an increase in net sales in all product lines during 2014. SL-MTI's sales increase was primarily attributable to increases in the commercial aerospace industry, medical industry, and military industry. The increase in the commercial aerospace industry was primarily due to increased sales volumes to two large domestic customers. The increase was also due to sales to a new large international customer located in Europe. The increase in the medical industry was primarily due to an increase in sales to a large international customer located in the United Kingdom. The increase in the military industry was primarily due to an increase in sales to a large international customer located in the United Kingdom. Domestic sales decreased by 2%, while international sales increased by 230% during 2014.

SL-MTI reported income from operations of \$1,808,000 in 2014, compared to \$1,569,000 in 2013. Income from operations increased in 2014 primarily due to a 12% increase in sales and a 3% decrease in operating costs, which were partially offset by a 2% increase in cost of products sold as a percentage of net sales. Operating costs decreased during 2014 primarily due to a decrease in engineering and product development costs of \$99,000, or 13%, which was partially offset by an increase in selling, general and administrative expenses of \$47,000, or 6%.

**RFL**

RFL recorded net sales of \$5,080,000, or 9% of consolidated net sales in 2014, compared to \$4,733,000, or 10% of consolidated net sales in 2013. RFL's sales increase was primarily attributable to an increase in GARD protection products for two large domestic projects, which was partially offset by a decrease in the communications product line primarily due to a decrease in IMUX 2000 related projects. Domestic sales increased by 12%, while international sales decreased by 21% during 2014.

RFL reported income from operations of \$479,000 in 2014, compared to \$393,000 in 2013. Income from operations increased in 2014 primarily due to a 7% increase in sales and a 1% decrease in operating costs, which were partially offset by a 2% increase in cost of products sold as a percentage of net sales. Operating costs decreased in 2014 primarily due to a decrease in engineering and product development costs of \$48,000, or 10%. Selling, general, and administrative expenses were relatively flat during 2014.



---

**Table of Contents****Cost of Products Sold**

Cost of products sold was approximately 65% of net sales in 2014, compared to 66% for the quarter ended 2013. Cost of products sold as a percentage of net sales decreased 1% while net sales increased 14% during 2014.

SLPE and the High Power Group each recorded an improvement in cost of products sold as a percentage of net sales, while SL-MTI and RFL recorded an increase in cost of products sold as a percentage of net sales. SLPE's cost of products sold as a percentage of net sales improved by approximately 4% during 2014 primarily due to an improved product mix and increased sales volumes, which improved overhead absorption. During 2014, cost of products sold as a percentage of net sales improved by 1% at the High Power Group primarily due to an improvement of 4% at MTE, which was partially offset by an increase of 2% at TEAL. The decrease in cost of products sold as a percentage of net sales at MTE was primarily due to increased sales volumes, which improved overhead absorption, an improved product mix, and a shift in manufacturing costs to a lower cost region. The increase in cost of products sold as a percentage of net sales at TEAL was primarily due to an unfavorable product mix during 2014. SL-MTI recorded a 2% increase in its cost of products sold as a percentage of net sales during 2014 primarily due to an unfavorable sales mix, which was partially offset by an increase in sales volumes, which improved overhead absorption. Cost of products sold as a percentage of net sales increased by 2% at RFL primarily due to an unfavorable project mix, which was partially offset by increased sales volumes which improved overhead absorption levels. All operating entities are at various stages of emphasizing lean initiatives throughout the factory floor to reduce costs of products sold.

**Engineering and Product Development Expenses**

Engineering and product development expenses were approximately 5% of net sales in 2014, compared to 7% in 2013. Engineering and product development expenses decreased by \$575,000, or 16% during the second quarter of 2014 due to a decrease of \$294,000 at the High Power Group, a decrease of \$134,000 at SLPE, a decrease of \$99,000 at SL-MTI, and a decrease of \$48,000 at RFL. The decrease in engineering and product development costs at the High Power Group was primarily due to decreased consulting fees for new product development and decreased employee compensation costs at TEAL due to a reduction in staffing levels associated with the implementation of a current year restructuring plan. Engineering and product development costs at MTE were relatively flat during 2014. The decrease in engineering and product development costs at SLPE was primarily due to a decrease in consulting fees related to new product development. The decrease in engineering and product development costs at SL-MTI was primarily due to an increase in customer funding received for prototype projects during 2014. Engineering and product development costs at RFL decreased primarily due to a decrease in hardware prototype costs.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were approximately 17% of net sales for 2014, compared to 18% in 2013. During 2014, selling, general and administrative expenses increased by \$451,000, or 5%, while sales increased by 14%.

## **Table of Contents**

The High Power Group recorded an increase in selling, general and administrative expenses of \$111,000 due to an increase at MTE, which was partially offset by a decrease at TEAL. The increase at MTE was primarily due to increased salaries due to a higher employee headcount and increased commissions and other compensation costs on higher sales volumes. The decrease at TEAL was primarily due to decreased compensation costs due to a reduction in staffing levels associated with the implementation of a current year restructuring plan. Selling, general and administrative expenses at SL-MTI increased by \$47,000 primarily due to an increase in employee headcount and an increase in other employee compensation costs. Selling, general and administrative expenses at SLPE and RFL were relatively flat during 2014. Unallocated Corporate Expenses increased by \$226,000 primarily due to increased compensation costs and stock compensation expense. The increase was also due to the Delaware state franchise tax incurred in 2014 resulting from the Company's reincorporation in Delaware in June 2013.

## **Depreciation And Amortization Expenses**

Depreciation and amortization expenses in 2014 were \$636,000, an increase of \$21,000, or 3%, compared to depreciation and amortization expenses in 2013.

## **Amortization of Deferred Financing Costs**

In connection with entering into the 2012 Credit Facility and related amendments, the Company incurred deferred financing costs which are amortized over the term of the 2012 Credit Facility. During 2014 and 2013, the amortization of deferred financing costs equaled \$22,000 and \$20,000, respectively.

## **Interest Expense**

Interest expense was \$8,000 and \$15,000 in 2014 and 2013, respectively. The Company had no outstanding balance as of June 30, 2014, and an outstanding balance of \$2,490,000 as of June 30, 2013 under the 2012 Credit Facility.

## **Other Gain (Loss), net**

Other gain (loss), net in 2014 was a net gain of \$1,729,000 compared to net loss of \$301,000 in 2013. Other gain (loss), net in 2014 was primarily due to a \$1,585,000 gain recognized from the sale of available-for-sale securities and \$142,000 unrealized gain on foreign currency forward contracts. Other gain (loss), net in 2013 was due to a \$301,000 unrealized loss on foreign currency forward contracts.

During 2013 and 2014, the Company entered into a series of foreign currency forward contracts to hedge its exposure to foreign exchange rate movements in its forecasted expenses in China and Mexico. The gain recognized in 2014 and the loss recognized in 2013 represents the change in fair value of foreign currency forward contracts that are marked to market at quarter end.

## **Taxes (Continuing Operations)**

The effective tax rate from continuing operations during 2014 was approximately 33% as compared to 32% during 2013. The increase in the effective tax rate was primarily due to the expiration of the federal research and development tax credits in 2014 as compared to the second quarter of 2013.

**Table of Contents****Discontinued Operations**

During 2014, the Company recorded a loss from discontinued operations, net of tax, of \$127,000, compared to a loss of \$237,000, net of tax, in 2013. The loss from discontinued operations during 2014 and 2013 relates to environmental remediation costs, consulting fees, and legal expenses associated with the past operations of the Company's five environmental sites (see Note 13 - Commitments and Contingencies for further information concerning the environmental sites).

**Net Income**

Net income was \$5,528,000, or \$1.33 per diluted share, for 2014 compared to \$2,015,000, or \$0.48 per diluted share, for 2013. The weighted average number of shares used in the diluted earnings per share computation was 4,168,000 and 4,204,000 for 2014 and 2013, respectively.

**Results of Operations****Six months ended June 30, 2014 compared with six months ended June 30, 2013**

The tables below show the comparisons of net sales and income from operations for the six months ended June 30, 2014 ( 2014 ) and the six months ended June 30, 2013 ( 2013 ):

	<b>Net Sales</b>			
	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	\$ Variance From Same Period Last Year	% Variance From Same Period Last Year
	(in thousands)			
SLPE	\$ 36,683	\$ 35,980	\$ 703	2%
High Power Group	42,762	34,700	8,062	23
SL-MTI	20,970	18,154	2,816	16
RFL	8,919	10,047	(1,128)	(11)
<b>Net Sales</b>	<b>\$ 109,334</b>	<b>\$ 98,881</b>	<b>\$ 10,453</b>	<b>11%</b>

	<b>Income from Operations</b>			
	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	\$ Variance From Same Period Last Year	% Variance From Same Period Last Year
	(in thousands)			
SLPE	\$ 3,232	\$ 2,181	\$ 1,051	48%
High Power Group	6,838	4,152	2,686	65
SL-MTI	3,903	2,882	1,021	35

Edgar Filing: SL INDUSTRIES INC - Form 10-Q

RFL	440	1,329	(889)	(67)
Unallocated Corporate Expenses	(3,229)	(2,927)	(302)	(10)
Income from Operations	\$ 11,184	\$ 7,617	\$ 3,567	47%

**Table of Contents**

During 2014, consolidated net sales increased by \$10,453,000 or 11%, compared to net sales during 2013. When compared to 2013, net sales of SLPE increased by \$703,000, or 2%; net sales of the High Power Group increased by \$8,062,000, or 23%; net sales of SL-MTI increased by \$2,816,000, or 16%; while net sales at RFL decreased by \$1,128,000, or 11%.

In 2014, the Company's income from operations increased by \$3,567,000, or 47%, when compared to 2013. Income from operations was 10% of net sales in 2014 compared to 8% in 2013. All of the Company's operating entities recorded income from operations in 2014 and 2013. In addition, Unallocated Corporate Expenses increased by \$302,000, or 10%, in 2014 compared to 2013.

Income from continuing operations in 2014 was \$8,320,000, or \$2.00 per diluted share, compared to income from continuing operations in 2013 of \$5,236,000, or \$1.25 per diluted share. Income from continuing operations was approximately 8% of net sales in 2014, compared to income from continuing operations of 5% of net sales in 2013.

While the Company's income from continuing operations increased by \$3,084,000, or 59% when compared to 2013, the effective tax rate increased to 34% in 2014 compared to 27% in 2013. This is primarily due to federal research and development credits recorded in 2013 that are not currently available in 2014. On a comparative basis, the Company's effective tax rate was negatively impacted by approximately 7% in 2014.

The Company's business segments and the components of operating expenses are discussed in the following sections.

**SLPE**

SLPE recorded net sales of \$36,683,000 or 34% of consolidated net sales in 2014, compared to \$35,980,000, or 36% of consolidated net sales in 2013. SLPE's sales increase was primarily attributable to an increase in sales to a large domestic distributor in the data communications product line. Domestic sales decreased by 3% while international sales increased by 35% during 2014. The increase in international sales was primarily due to a general increase in demand in the medical product line coupled with an increase in sales to a large customer in the industrial product line. Returns and distributor credits also negatively affected net sales, which represented approximately 1% of SLPE gross sales in 2014 and 2013.

SLPE reported income from operations of \$3,232,000 in 2014, compared to \$2,181,000 in 2013. Income from operations increased in 2014 primarily due to a 2% increase in sales, a 1% decrease in cost of products sold as a percentage of net sales, and a 5% decrease in operating costs. Operating costs decreased during 2014 primarily due to a decrease in selling, general and administrative expenses of \$293,000, or 5%, and a decrease in engineering and product development costs of \$109,000, or 4%.

**Table of Contents**

**High Power Group**

The High Power Group reported net sales of \$42,762,000, or 39% of consolidated net sales in 2014, compared to \$34,700,000, or 35% of consolidated net sales in 2013. The High Power Group recognized an increase in net sales in all product lines during 2014. In addition, the MTE unit experienced record sales for the first six months of a year during 2014. The increase in net sales during 2014 was due to an increase in net sales at TEAL of \$4,106,000, or 29%, and an increase at MTE of \$3,956,000, or 19%.

TEAL's sales increase during 2014 was primarily attributable to an increase in new product sales to a large international customer in the semi-conductor market and an increase in new product sales to a large international customer in the medical imaging equipment market. The increase was also due to an increase in sales to a large domestic customer in the military and aerospace market and an increase in sales to a large domestic customer in the solar market. Domestic sales decreased by 12% while international sales increased by 260% during 2014.

MTE's sales increase during 2014 was primarily attributable to an increase in domestic harmonic filter sales to a large new customer in the electronic equipment industry, and an increase in new product sales within the motor protection filter product line. The increase in sales was partially offset by a decrease in domestic harmonic filter sales to a large customer in the oil and gas industry. Domestic sales increased by 18% and international sales increased by 25%.

The High Power Group reported income from operations of \$6,838,000 in 2014, compared to \$4,152,000 in 2013. The increase in income from operations during 2014 was due to an increase at MTE of \$2,164,000, and an increase at TEAL of \$522,000. Income from operations increased in 2014 primarily due to a 23% increase in sales and a 1% decrease in cost of products sold as a percentage of net sales, which were partially offset by a 2% increase in operating costs. Operating costs increased during 2014 primarily due to \$463,000 of restructuring charges incurred during 2014 and an increase in selling, general and administrative expenses of \$174,000, or 4%, which were partially offset by a decrease in engineering and product development costs of \$493,000, or 23%.

**SL-MTI**

SL-MTI recorded net sales of \$20,970,000, or 19% of consolidated net sales in 2014, compared to \$18,154,000, or 19% of consolidated net sales in 2013. SL-MTI's sales increase was attributable to increases in net sales in all product lines during 2014. The increase in the commercial aerospace industry was primarily due to increased sales volumes to two large domestic customers. The increase was also due to sales to a new large international customer located in Europe. The increase in the industrial industry was primarily due to a large domestic customer project in 2014. The increase in the military industry was primarily due to an increase in sales to a large domestic customer while the increase in the medical industry was primarily due to an increase in sales to a large international customer located in the United Kingdom. Domestic sales increased by 8% and international sales increased by 87% during 2014.

---

**Table of Contents**

SL-MTI reported income from operations of \$3,093,000 in 2014, compared to \$2,882,000 in 2013. Income from operations increased in 2014 primarily due to a 16% increase in net sales. Cost of products sold as a percentage of net sales was relatively flat during 2014. Operating costs were also relatively flat during 2014 primarily due to a decrease in engineering and product development costs of \$127,000, or 8%, which was offset by an increase in selling, general and administrative expenses of \$121,000, or 8%.

**RFL**

RFL recorded net sales of \$8,919,000, or 8% of consolidated net sales in 2014, compared to \$10,047,000, or 10% of consolidated net sales in 2013. The decrease in net sales at RFL was primarily due to a decrease in the communications product line due to a decrease in IMUX 2000 related projects. Sales of protection products were relatively flat during 2014 primarily due to an increase in sales of GARD protection products for two large domestic projects, which was partially offset by decreased legacy product sales related to several domestic customer projects in 2013 without projects of comparable size in 2014. Domestic sales decreased by 11% and international sales decreased by 14% during 2014.

RFL reported income from operations of \$440,000 in 2014, compared to income from operations of \$1,329,000 in 2013. Income from operations decreased in 2014 due to an 11% decrease in sales and a 4% increase in cost of products sold as a percentage of net sales, which were partially offset by a 1% decrease in operating costs. Operating costs decreased primarily due to a decrease in engineering and product development costs of \$51,000, or 6%.

**Cost of Products Sold**

Cost of products sold was approximately 66% of net sales in 2014 and 2013. Cost of products sold as a percentage of net sales was flat while net sales increased 11% during 2014.

SLPE and the High Power Group each recorded an improvement in cost of products sold as a percentage of net sales, while RFL recorded an increase in cost of products sold as a percentage of net sales. Cost of products sold as a percentage of net sales at SL-MTI was relatively flat between periods. SLPE's cost of products sold as a percentage of net sales improved by approximately 1% during 2014 primarily due to an improved product mix and increased sales volumes, which improved overhead absorption. The decrease in SLPE's cost of products sold as a percentage of net sales was also due to \$428,000 of additional costs incurred in 2013 due to a work stoppage in China during March 2013. Cost of products sold as a percentage of net sales at the High Power Group improved by approximately 1% during 2014 due to a decrease of 4% at MTE, which was partially offset by an increase of 4% at TEAL. The decrease in cost of products sold as a percentage of net sales at MTE was primarily due to an improved product mix, increased sales volumes, which improved overhead absorption, and a shift in manufacturing costs to a lower cost region. The increase in cost of products sold as a percentage of net sales at TEAL was primarily due to an unfavorable product mix during 2014 and an increase in the inventory reserve. Cost of products sold as a percentage of net sales increased by 4% at RFL primarily due to an unfavorable project mix and unabsorbed factory overhead related to the 11% reduction in sales levels. All operating entities are at various stages of emphasizing lean initiatives throughout the factory floor to reduce costs of products sold.

---

**Table of Contents****Engineering and Product Development Expenses**

Engineering and product development expenses were approximately 6% of net sales in 2014, compared to 7% in 2013. Engineering and product development expenses decreased by \$780,000, or 11% during 2014 primarily due to an decrease of \$493,000 at the High Power Group, a decrease of \$127,000 at SL-MTI, a decrease of \$109,000 at SLPE, and a decrease of \$51,000 at RFL. The decrease in engineering and product development costs at the High Power Group was primarily due to decreased consulting fees for new product development and decreased employee compensation costs at TEAL due to a reduction in staffing levels associated with the implementation of a current year restructuring plan. The decrease at TEAL was partially offset by an increase in engineering staff and employee compensation costs at MTE. The decrease in engineering and product development costs at SL-MTI was primarily due to an increase in customer funding received for prototype projects during 2014. The decrease in engineering and product development costs at SLPE was primarily due to a decrease in consulting fees related to new product development. Engineering and product development costs at RFL decreased primarily due to a decrease in hardware prototype costs.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were approximately 17% of net sales for 2014, compared to 18% in 2013. During 2014, selling, general and administrative expenses increased by \$268,000, or 1%, while sales increased by 11%. The High Power Group recorded an increase in selling, general and administrative expenses of \$174,000 due to an increase at MTE, which was partially offset by a decrease at TEAL. The increase at MTE was primarily due to increased salaries due to a higher employee headcount and increased commissions and other compensation costs on higher sales volumes. The decrease at TEAL was primarily due to decreased compensation costs due to a reduction in staffing levels associated with the implementation of a current year restructuring plan, which was partly offset by increased commissions on higher sales volumes. Selling, general and administrative expenses at SL-MTI increased by \$121,000 primarily due to an increase in employee compensation costs. Selling, general and administrative expenses at SLPE decreased by \$293,000 in 2014 primarily due to a decrease in employee compensation costs and a decrease in the allowance for doubtful accounts. The decrease at SLPE was also due to \$107,000 of additional costs incurred in 2013 due to a work stoppage in China during March 2013. Selling, general and administrative expenses at RFL were relatively flat during 2014. Unallocated Corporate Expenses increased by \$302,000 primarily due to increased compensation costs and stock compensation expense. The increase was also due to the Delaware state franchise tax incurred in 2014 resulting from the Company's reincorporation in Delaware in June 2013.

**Depreciation And Amortization Expenses**

Depreciation and amortization expenses in 2014 were \$1,250,000, an increase of \$35,000, or 3%, compared to depreciation and amortization expenses in 2013.

**Restructuring Costs**

Restructuring costs were \$463,000 in 2014 and consisted of severance costs and other employee related charges. During the first quarter of 2014, the Company announced to its employees a restructuring plan to align its costs with current and projected sales activity. The costs reductions were primarily production, engineering, selling and administration employees at the High Power Group. No restructuring costs were incurred during 2013.



## **Table of Contents**

### **Amortization of Deferred Financing Costs**

In connection with entering into the 2012 Credit Facility and related amendments, the Company incurred deferred financing costs which are amortized over the term of the 2012 Credit Facility. During 2014 and 2013, the amortization of deferred financing costs equaled \$43,000 and \$39,000, respectively.

### **Interest Expense**

Interest expense was \$43,000 and \$50,000 in 2014 and 2013, respectively. The Company had no outstanding balance as of June 30, 2014, and an outstanding balance of \$2,490,000 as of June 30, 2013 under the 2012 Credit Facility.

### **Other Gain (Loss), net**

Other gain (loss), net in 2014 was a net gain of \$1,479,000 compared to net loss of \$327,000 in 2013. Other gain (loss), net in 2014 included a \$1,691,000 gain recognized from the sale of available-for-sale securities and \$9,000 of dividend income received from investments in available-for-sale securities, which were partially offset by a \$221,000 unrealized loss on foreign currency forward contracts. Other gain (loss), net in 2013 included a \$327,000 unrealized loss on foreign currency forward contracts.

During 2013 and 2014, the Company entered into a series of foreign currency forward contracts to hedge its exposure to foreign exchange rate movements in its forecasted expenses in China and Mexico. The loss recognized in 2014 and the loss recognized in 2013 represents the change in fair value of foreign currency forward contracts that are marked to market at quarter end.

### **Taxes (Continuing Operations)**

The effective tax rate from continuing operations during 2014 was approximately 34% as compared to 27% during 2013. The increase in the effective tax rate was primarily due to the expiration of the federal research and development tax credits in 2014 as compared to the first six months of 2013. In 2013, the Company recorded a research and development tax benefit of \$594,000, which was primarily related to the retroactive reinstatement of the federal research and development tax credits from the enactment of the American Tax Relief Act of 2012.

### **Discontinued Operations**

During 2014, the Company recorded a loss from discontinued operations, net of tax, of \$265,000, compared to a loss of \$455,000, net of tax, in 2013. The loss from discontinued operations during 2014 and 2013 relates to environmental remediation costs, consulting fees, and legal expenses associated with the past operations of the Company's five environmental sites (see Note 13 – Commitments and Contingencies for further information concerning the environmental sites).

### **Net Income**

Net income was \$8,055,000, or \$1.93 per diluted share, for 2014 compared to \$4,781,000, or \$1.14 per diluted share, for 2013. The weighted average number of shares used in the diluted earnings per share computation was 4,163,000 and 4,189,000 for 2014 and 2013, respectively.



**Table of Contents**

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

Not applicable.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined in Rules 13a-15e and 15d-15e promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act).

***Conclusion of Evaluation***

Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

***Inherent Limitations on Effectiveness of Controls and Procedures***

In designing and evaluating the Company's disclosure controls and procedures, management recognizes that any control, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

**Changes in Internal Control Over Financial Reporting**

There were no changes in the Company's internal control over financial reporting during the second quarter of 2014 that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

See Note 13 of the Notes to the Consolidated Financial Statements included in Part I to this Quarterly Report on Form 10-Q. Also, see Note 16 of the Notes to the Consolidated Financial Statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2013, for additional disclosure related to the Company's legal proceedings.

**ITEM 1A. RISK FACTORS**

Not applicable.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On November 16, 2010, the Board of Directors authorized a plan that allows for the repurchase up to an aggregate of 470,000 shares of the Company's outstanding common stock (the 2010 Repurchase Plan). Any repurchases pursuant to the 2010 Repurchase Plan would be made in the open market or in negotiated transactions. During the first six months of 2014, the Company purchased approximately 4,000 shares of Company stock at an average price of \$24.68 a share. As a result, as of June 30, 2014, approximately 239,000 shares remained available for purchase under the 2010 Repurchase Plan.

The following table presents information related to the repurchases of common stock that the Company made during the six months ended June 30, 2014:

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased under Publicly Announced Plans or Programs
January 2014				243,000
February 2014	2,000	\$ 24.52	2,000	241,000
March 2014				241,000
April 2014	2,000	\$ 24.80	2,000	239,000
May 2014				239,000
June 2014				239,000
<b>Total</b>	<b>4,000</b>	<b>\$ 24.68</b>	<b>4,000</b>	<b>239,000</b>

(1) The number of shares purchased pursuant to the 2010 Repurchase Plan.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**Table of Contents**

**ITEM 6. EXHIBITS**

10.1 Form of 2014 Restricted Shares Agreement, dated May 12, 2014, between the Company and each director of the Company. Form of Restricted Shares Agreement incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (Registration No. 333-196403), filed with the Securities and Exchange Commission on May 30, 2014. +

10.2 2008 Incentive Stock Plan, as amended. Incorporate by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Registration No. 333-196403), filed with the Securities and Exchange Commission on May 30, 2014. +

31.1 Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*

31.2 Certification by Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*

32.1 Certification by Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted 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 Extension Definition Linkbase Document. \*

101.LAB XBRL Taxonomy Extension Label Linkbase Document. \*

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document. \*

\* Filed herewith.

+ Indicates a management contract or compensatory plan or arrangement.

Table of Contents

SIGNATURES

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

Date: August 1, 2014

SL INDUSTRIES, INC.  
(Registrant)

By: /s/ William T. Fejes  
William T. Fejes  
President and Chief Executive Officer

By: /s/ Louis J. Belardi  
Louis J. Belardi  
Chief Financial Officer, Treasurer and Secretary