

PULSE ELECTRONICS CORP
Form 10-Q
August 05, 2014

UNITED STATES
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

The Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 27, 2014, or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____.

Commission File No. 1-5375

PULSE ELECTRONICS CORPORATION
(Exact name of registrant as specified in its Charter)

PENNSYLVANIA 23-1292472
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification Number)

12220 World Trade Drive
San Diego, CA 92128
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 858-674-8100

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 the 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

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

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

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of August 5, 2014:
17,569,268

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Pulse Electronics Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)
In thousands

| | June 27, 2014 | December 27, 2013 |
|--|------------------|----------------------|
| <u>Assets</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$24,774 | \$26,902 |
| Accounts receivable, net | 64,381 | 62,185 |
| Inventory, net | 30,920 | 36,726 |
| Prepaid expenses and other current assets | 17,490 | 18,966 |
| Total current assets | 137,565 | 144,779 |
| Long-term assets: | | |
| Property, plant and equipment | 96,639 | 96,610 |
| Less accumulated depreciation | 70,984 | 68,655 |
| Net property, plant and equipment | 25,655 | 27,955 |
| Deferred income taxes | 4,557 | 4,557 |
| Intangible assets, net | 2,040 | 2,040 |
| Deferred loan costs and other assets | 10,632 | 9,503 |
| Total assets | \$180,449 | \$188,834 |
| <u>Liabilities and Shareholders' Deficit</u> | | |
| Current liabilities: | | |
| Accounts payable | \$69,112 | \$70,871 |
| Accrued expenses and other current liabilities | 38,089 | 36,335 |
| Current portion of long-term debt | - | 22,315 |
| Total current liabilities | 107,201 | 129,521 |
| Long-term liabilities: | | |
| Long-term debt | 116,231 | 90,030 |
| Deferred income taxes | 11,786 | 11,786 |
| Other long-term liabilities | 12,029 | 11,055 |
| Total liabilities | 247,247 | 242,392 |
| Commitments and contingencies (Note 7) | | |
| Shareholders' deficit | | |
| Pulse Electronics Corporation shareholders' deficit: | | |
| Preferred stock, no par value, 2,000 shares authorized; 0 and 1,000 shares outstanding at June 27, 2014 and December 27, 2013, respectively | - | - |
| Common stock, \$0.125 par value, 31,000,000 shares authorized; 17,303,839 and 7,955,508 outstanding at June 27, 2014 and December 27, 2013, respectively | 2,152 | 995 |
| Additional paid-in capital | 260,832 | 257,816 |
| Accumulated deficit | (356,472) | (339,618) |
| Accumulated other comprehensive income | 20,514 | 21,057 |
| Total Pulse Electronics Corporation shareholders' deficit | (72,974) | (59,750) |
| Non-controlling interest | 6,176 | 6,192 |

| | | |
|-----------------------------|-----------|-----------|
| Total shareholders' deficit | (66,798) | (53,558) |
| | \$180,449 | \$188,834 |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Operations
(Unaudited)

In thousands, except per share data

| | Three Months | | Six Months Ended | |
|--|---------------------------|------------------|------------------|------------------|
| | Ended June 27, 2014 | June 28, 2013 | June 27, 2014 | June 28, 2013 |
| Net sales | \$93,567 | \$88,258 | \$175,219 | \$173,064 |
| Cost of sales | 73,830 | 67,508 | 137,956 | 132,133 |
| Gross profit | 19,737 | 20,750 | 37,263 | 40,931 |
| Selling, general and administrative expenses | 17,026 | 19,008 | 34,948 | 38,182 |
| Severance, impairment and other associated costs | 976 | 93 | 1,937 | 112 |
| Legal reserve | 11 | 37 | 22 | 75 |
| Operating profit | 1,724 | 1,612 | 356 | 2,562 |
| Other expense: | | | | |
| Interest expense, net | (6,361) | (6,774) | (13,479) | (11,888) |
| Other income (expense), net | 318 | (408) | 245 | (2,940) |
| Total other expense | (6,043) | (7,182) | (13,234) | (14,828) |
| Loss before income taxes | (4,319) | (5,570) | (12,878) | (12,266) |
| Income tax (expense) benefit | (3,520) | 349 | (3,992) | (84) |
| Net loss | (7,839) | (5,221) | (16,870) | (12,350) |
| Less: Net (loss) earnings attributable to non-controlling interest | (30) | 9 | (16) | (5) |
| Net loss attributable to Pulse Electronics Corporation | \$(7,809) | \$(5,230) | \$(16,854) | \$(12,345) |
| Basic loss per share: | | | | |
| Basic shares outstanding | 17,322 | 7,994 | 14,992 | 7,976 |
| Basic loss per share | \$(0.45) | \$(0.65) | \$(1.12) | \$(1.55) |
| Diluted loss per share: | | | | |
| Diluted shares outstanding | 17,322 | 7,994 | 14,992 | 7,976 |
| Diluted loss per share | \$(0.45) | \$(0.65) | \$(1.12) | \$(1.55) |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries
 Condensed Consolidated Statements of Comprehensive Loss
 (Unaudited)
 In thousands

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | June 27, 2014 | June 28, 2013 | June 27, 2014 | June 28, 2013 |
| Comprehensive loss: | | | | |
| Net loss | \$(7,839) | \$(5,221) | \$(16,870) | \$(12,350) |
| Other comprehensive (loss) income: | | | | |
| Currency translation adjustment | (591) | 626 | (543) | 113 |
| Total comprehensive loss | (8,430) | (4,595) | (17,413) | (12,237) |
| Less: Comprehensive (loss) earnings attributable to non-controlling interests | (30) | 9 | (16) | (5) |
| Comprehensive loss attributable to Pulse Electronics Corporation | \$(8,400) | \$(4,604) | \$(17,397) | \$(12,232) |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
In thousands

| | Six Months Ended | |
|--|------------------|------------------|
| | June 27, 2014 | June 28, 2013 |
| Cash flows from operating activities: | | |
| Net loss | \$(16,870) | \$(12,350) |
| Adjustment to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 3,631 | 3,611 |
| Stock incentive plan expense | 743 | 1,002 |
| Amortization and write-off of deferred loan costs | 1,542 | 764 |
| Amortization of debt discount | 2,665 | 2,378 |
| Payment-in-kind interest on debt | 7,498 | 6,056 |
| Change in fair value on warrant liability | - | 2,878 |
| Severance, impairment and other associated costs, net of cash payments | 1,306 | (553) |
| Other, net | 566 | 623 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,461) | 485 |
| Inventory | 5,705 | 547 |
| Prepaid expenses and other current assets | 1,401 | 924 |
| Accounts payable and accrued expenses | (1,673) | (7,053) |
| Net cash provided by (used in) operating activities | 4,053 | (688) |
| Cash flows from investing activities: | | |
| Capital expenditures | (1,423) | (5,717) |
| Proceeds from sale of assets | 402 | 133 |
| Net cash used in investing activities | (1,021) | (5,584) |
| Cash flows from financing activities: | | |
| Principal repayments of debt | (3,956) | - |
| Debt issuance costs | (1,631) | (1,519) |
| Taxes paid related to net share settlement of equity awards | (47) | - |
| Change in restricted cash | 500 | (500) |
| Net cash used in financing activities | (5,134) | (2,019) |
| Net effect of exchange rate changes on cash | (26) | (21) |
| Net decrease in cash and cash equivalents | (2,128) | (8,312) |
| Cash and cash equivalents at beginning of period | 26,902 | 31,475 |
| Cash and cash equivalents at end of period | \$24,774 | \$23,163 |
| Supplemental cash flows disclosures of non-cash investing and financing activity: | | |
| Capital expenditures included in accounts payable and accrued liabilities | \$517 | \$660 |
| Debt issuance costs included in accounts payable and accrued liabilities | \$2,186 | \$1,060 |
| Conversion of senior convertible notes to common stock | \$3,477 | \$- |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

(1) General

Basis of presentation

The accompanying Unaudited Condensed Consolidated Financial Statements of Pulse Electronics Corporation (“Pulse Electronics”, “Pulse”, or “the Company”, which may be referred to as “we” or “our”) have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete consolidated financial statements. In the opinion of management, all adjustments, consisting principally of normal recurring adjustments, considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from these estimates. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto in the Company's Annual Report on Form 10-K for the year ended December 27, 2013. Results for the six month period ended June 27, 2014 are not necessarily indicative of annual results.

Reclassifications

We have reclassified certain items in our Unaudited Condensed Consolidated Financial Statements to conform to the current year presentation.

New accounting pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. (“ASU”) 2014-09, Revenue from Contracts with Customers, a new topic in the FASB Accounting Standards Codification (“ASC”) Topic 606 (“FASB ASC Topic 606”). The standard implements a five step process for revenue recognition in order 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. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either a full retrospective or modified retrospective transition method. The Company is currently evaluating the impact that the adoption will have on the condensed consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In April 2014, the FASB issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, an amendment to FASB ASC Topic 205, Presentation of Financial Statements (“FASB ASC Topic 205”) and FASB ASC Topic 360, Property, Plant and Equipment (“FASB ASC Topic 360”). The update revises the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results, removing the lack of continuing involvement criteria and requiring discontinued operations reporting for the disposal of an equity method investment that meets the definition of discontinued operations. The update also requires expanded disclosures for discontinued operations, including disclosure of pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2014. The

Company will apply the guidance prospectively to disposal activity occurring after the effective date of this ASU.

(2) Inventory

Inventory consisted of the following (in thousands):

| | June 27, 2014 | December 27, 2013 |
|----------------------------|------------------|----------------------|
| Finished goods | \$19,212 | \$ 21,573 |
| Work in progress | 3,219 | 3,570 |
| Raw materials and supplies | 8,489 | 11,583 |
| | \$30,920 | \$ 36,726 |

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

(3) Intangible assets, net

Intangible assets consisted of the following (in thousands):

| | June 27, 2014 | December 27, 2013 |
|---|---------------------|----------------------|
| Intangible assets subject to amortization (definite lives): | | |
| Customer relationships | \$3,300 | \$ 3,300 |
| Technology | 2,000 | 2,000 |
| Total | 5,300 | 5,300 |
| Accumulated amortization: | | |
| Customer relationships | (3,300) | (3,300) |
| Technology | (2,000) | (2,000) |
| Total | (5,300) | (5,300) |
| Net intangible assets subject to amortization | - | - |
| Intangible assets not subject to amortization (indefinite lives): | | |
| Tradename | 2,040 | 2,040 |
| | \$2,040 | \$ 2,040 |

As of December 27, 2013, our intangible assets with finite lives were fully amortized. Amortization expense for intangible assets was \$0.2 million for the six months ended June 28, 2013.

(4) Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

| | June 27, 2014 | December 27, 2013 |
|---------------------------------------|------------------|----------------------|
| Income taxes payable | \$6,798 | \$ 6,493 |
| Accrued compensation | 10,528 | 10,003 |
| Accrued restructuring costs (Note 11) | 1,799 | 493 |
| Legal reserve | 5,288 | 5,302 |
| Other accrued expenses | 13,676 | 14,044 |
| | \$38,089 | \$ 36,335 |

(5) Income taxes

The income tax expense for the six months ended was as follows (in thousands):

| June 27, 2014 | June 28, 2013 |
|---------------------|---------------------|
| | |

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| | | |
|--------------------|---------|--------|
| Income tax expense | \$3,992 | \$84 |
| Effective tax rate | (31.0)% | (0.7)% |

The Company's effective tax rate is a blended rate for different jurisdictions in which the Company operates, and could vary significantly based on the distribution of earnings. We provide a full valuation allowance against losses in the majority of jurisdictions in which we operate. We will continue to evaluate the realizability of our net deferred tax assets on an ongoing basis to identify whether any significant changes in circumstances or assumptions have occurred that could materially affect the realizability of deferred tax assets. We expect to release the valuation allowance when we have sufficient positive evidence, including, but not limited to, cumulative earnings in successive recent periods to overcome the negative evidence the Company has encountered with its recent history of cumulative losses. The change in the effective tax rate for the six months ended June 27, 2014 versus the prior year comparative period was primarily due to the change in the distribution of where income was earned by the Company's operating entities, as well as the greater allocation of losses to jurisdictions for which no income tax benefit can be recognized. There could be volatility in the quarterly effective tax rate in future quarters due to changes in the forecasted distribution of earnings and losses amongst the Company's various tax jurisdictions.

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

At June 27, 2014, we had approximately \$3.6 million of unrecognized tax benefits, which is an increase of \$0.1 million from the year ended December 27, 2013. We expect our unrecognized tax benefits to decrease by \$1.7 million within the next twelve months due to the expiration of statutes of limitation. We recognize interest and penalties, if any, related to income tax matters as income tax expense. As of June 27, 2014, we have approximately \$0.4 million accrued for interest and penalties related to uncertain income tax positions. The accrual balance for interest and penalties decreased by less than \$0.1 million during the six months ended June 27, 2014.

(6) Defined benefit plans

We maintain defined benefit pension plans for certain U.S. and non-U.S. employees. The benefits under our domestic defined benefit plan were frozen as of December 31, 2010. Accrued benefits were based on years of service and average final compensation. We do not provide any post-retirement benefits outside of the U.S. except as may be required by certain foreign jurisdictions. Depending on the investment performance of our plan assets and other contributing factors, funding in a given year may not be required.

Our net periodic pension expense (income) related to our defined benefit plans was \$0.1 million and less than \$(0.1) million for the six months ended June 27, 2014 and June 28, 2013, respectively.

(7) Commitments and contingencies

We are a party to various legal proceedings, claims and assessments that arise in the ordinary course of business, and may continue to incur significant costs in defending or settling legal matters. The total amount and timing of the expected future payments related to these matters cannot be estimated due to the uncertainty of the duration of the legal proceedings and the ultimate scope of other claims. However, an unfavorable outcome in a single matter or in multiple legal matters could have a material adverse effect on our consolidated financial position, results from operations and cash flows.

We are a defendant in a lawsuit filed in March 2007 by Halo Electronics, Inc. ("Halo") in the United States District Court, District of Nevada. The case is captioned Halo Electronics, Inc. v. Pulse Electronics, Inc. and Pulse Electronics Corp., Case No. 2:07-cv-00331-PMP-PAL. The plaintiff, Halo, claims that we infringed certain U.S. patents related to an electronic surface mount package, and is seeking injunctive relief and damages. On November 26, 2012, the jury returned a verdict ruling in favor of Halo and found that Pulse willfully infringed on three different patents, specifically U.S. Patent Nos. 5,656,985; 6,297,720; and 6,344,785. The jury verdict also found Pulse liable for approximately \$2.0 million for past damages and interest and for a royalty on all future domestic sales under licenses to use these patents.

On May 29, 2013, the District Court entered final judgment in the case. Halo and Pulse have filed cross appeals with the Court of Appeals for the Federal Circuit. The appeals were fully briefed and completed on May 1, 2014. A hearing before the Federal Circuit will occur on August 4, 2014.

In relation to the appeal filed in the Halo legal matter, Pulse was required by the Court to post a \$1.6 million bond in the third quarter of 2013. The amount of the bond is held in an interest-bearing account in the Company's name, but is restricted and has been classified within prepaid expenses and other current assets in our Unaudited Condensed Consolidated Balance Sheet. The restriction will continue until the resolution of this legal matter.

During the three months ended June 27, 2014 and June 28, 2013, we incurred \$0.1 million and \$0.3 million of legal expenses, respectively, related to this matter. During the six months ended June 27, 2014 and June 28, 2013, we

incurred \$0.4 million and \$0.6 million of legal expenses, respectively, related to this matter.

We are also subject to ongoing tax examinations and governmental assessments in various foreign and domestic jurisdictions. In January 2013, we received a court ruling from the federal tax court in Turkey relating to prior year non-income tax related assessments relating to our former operations, which was upheld in December 2013. The ruling was based on our inability to present certain notarized documents required under Turkish tax law. In January 2014, we appealed the decision and requested an annulment of the penalties. The initial judgment ordered us to pay approximately \$3.7 million for fines, penalties, and interest on this matter. Accordingly, we recorded a charge to our legal reserve of approximately \$3.7 million during fiscal year 2012. During the six months ended June 27, 2014, we recorded a decrease to the legal reserve of less than a \$0.1 million due to foreign currency revaluation.

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

(8) Debt

Long-term debt, net of discount, consisted of the following (in thousands):

| | June 27, 2014 | December 27, 2013 |
|---------------------------|------------------|----------------------|
| Term A Loan | \$89,578 | \$83,155 |
| Term B Loan | 48,195 | 31,082 |
| Senior convertible notes | - | 22,315 |
| Less: Term Loan discounts | (21,542) | (24,207) |
| | 116,231 | 112,345 |
| Less: current portion | - | (22,315) |
| | \$116,231 | \$90,030 |

The interest rate on the Term A Loan is 12.0% per annum, and the interest rate on the Term B Loans is 10.0% per annum. Interest on the term loans may, at our election, be paid in cash or paid in kind ("PIK") (in the form of additional principal) through November 20, 2015. Interest is due on the last business day of the calendar quarter. During the six months ended June 27, 2014, the principal balance on the term loans increased by \$6.9 million due to PIK interest elections made on December 31, 2013 and March 31, 2014. The PIK interest election for the second quarter of 2014 was made subsequent to our fiscal quarter-end; therefore, interest accrued during the second quarter of \$3.8 million was classified within other long-term liabilities at June 27, 2014 in our Unaudited Condensed Consolidated Balance Sheet.

The Term A and B Loans mature on November 20, 2017 and are secured by a first lien on the collateral, which includes the shares and assets of certain domestic and international subsidiaries. The term loans are non-amortizing and may be prepaid without any penalty. While the Term B Loans are not junior in relative lien priority to the Term A Loan, the Term B Loan may not be repaid until the Term A Loan is paid in full.

On February 21, 2014, we amended the credit agreement with Oaktree Capital Management L.P. and affiliates (collectively, "Oaktree"), including modifications to the financial covenants. Under the amendment, we are no longer subject to the minimum liquidity and the total net debt leverage ratio covenants through the maturity date. The amendment also extended the waiver of any default with respect to the judgments in the Halo Electronics case and the Turkish legal matter through the maturity date, subject to certain conditions specified in the credit agreement.

Under the credit agreement, as amended in February 2014, the secured leverage ratio requirements, as defined in the agreement, are set forth in the table below:

| Test Period End Date(s) | Secured Leverage Ratio |
|--|---------------------------|
| March 31, 2014 through December 31, 2014 | 11.00 to 1.00 |
| March 31, 2015 through December 31, 2015 | 9.50 to 1.00 |
| March 31, 2016 through December 31, 2016 | 8.00 to 1.00 |
| March 31, 2017 through December 31, 2017 | 5.00 to 1.00 |

In addition, our capital expenditures are limited to \$12.0 million in fiscal 2014 and \$14.0 million in fiscal 2015 and in each fiscal year thereafter. As of June 27, 2014, we were in compliance with these financial covenants.

In consideration for the covenant modification, we paid Oaktree a fee of 1.5% of its term loan principal, or approximately \$1.8 million, which was added to the principal of the outstanding Term A Loan and Term B Loan on a pro rata basis. These costs have been capitalized and will be amortized over the remaining term of these loans using the effective interest rate method.

On February 21, 2014, we entered into agreements with the holders of approximately \$20.7 million of our \$22.3 million outstanding senior convertible notes to exchange their notes for various combinations of Term B Loans, shares of our common stock, and cash (collectively, the “Exchange Transaction”). In aggregate, we exchanged approximately \$14.9 million of new Term B Loans, 1.1 million shares of our common stock, and \$2.4 million in cash for approximately \$20.7 million of the outstanding \$22.3 million senior convertible notes. The new Term B Loans are identical to the Term B Loans issued in our refinancing transaction with Oaktree in November 2012.

On May 1, 2014, we repaid the \$1.6 million of outstanding principal on our remaining senior convertible notes. Pursuant to the Series A preferred stock conversion and the resulting issuance of 8.2 million shares of common stock to Oaktree, a “change in control” under the terms of the senior convertible notes was deemed to have occurred since Oaktree beneficially owns a majority of the outstanding shares of our common stock. Such change in control triggered our obligation to repurchase all remaining outstanding senior convertible notes.

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

Debt Issuance and Extinguishment Costs

We incurred approximately \$1.5 million of debt issuance costs in connection with the issuance of the new Term B Loans, which have been capitalized as a deferred loan cost and will be amortized to interest expense over the term of the loans using the effective interest method.

As of June 27, 2014 and December 27, 2013, we have \$11.5 million and \$9.3 million, respectively, of unamortized deferred loan costs. The short-term portion of these unamortized deferred loan costs are classified in prepaid expenses and other current assets and the long-term portion is classified in deferred loan costs and other assets in our Unaudited Condensed Consolidated Balance Sheets.

During the six months ended June 27, 2014, interest expense included debt extinguishment costs of \$1.0 million, which included a \$0.2 million write-off of unamortized debt issuance costs and \$0.8 million of legal fees primarily attributed to the extinguishment of the senior convertible notes. During the six months ended June 27, 2013, interest expense included \$0.6 million of debt extinguishment costs for lender fees incurred in connection with post-closing obligations under the Oaktree credit agreement.

(9) Preferred stock

As of December 27, 2013, Oaktree held 1,000 shares of Series A preferred stock. In accordance with the Investment Agreement, subject to certain conditions, the preferred stock was automatically convertible into such number of shares of our common stock that would result in Oaktree having received 67.9% of our total common stock (on a pro forma fully diluted basis as of November 20, 2012, and without giving effect to shares of common stock and warrants previously owned by Oaktree).

In conjunction with the Exchange Transaction, we amended the Investment Agreement in February 2014 such that the 1,000 shares of Series A preferred stock held by Oaktree was convertible into shares of common stock at such time that we acquired and cancelled at least 90% of the \$22.3 million of our outstanding senior convertible notes. In accordance with the Investment Agreement, as amended, the Series A preferred stock was converted into 8.2 million shares of our common stock upon completion of the Exchange Transaction on February 21, 2014.

Pursuant to the amendment, we agreed to grant Oaktree an expansion of its right to nominate individuals to serve as members of our Board of Directors. As such, we agreed to appoint three of Oaktree's designees to the Board and to expand the current number of directors of the Board from seven to nine. We also agreed that, in connection with any meeting of our shareholders at which directors are to be elected, Oaktree shall have the right to designate individuals to our slate of director nominees in proportion to its equity ownership of the Company. So long as Oaktree beneficially owns a majority of our outstanding common stock, it will have the right to designate no less than a majority of the individuals comprising the members of such slate.

(10) Per share amounts

Net loss per share calculations was as follows (in thousands, except per share amounts):

| Three Months | | Six Months Ended | |
|--------------|------|------------------|----------|
| Ended | | June 27, | June 28, |
| June 27, | June | 2014 | 2013 |
| 2014 | 28, | 2014 | 2013 |

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| | 2013 | | | |
|--|------------|------------|-------------|-------------|
| Net loss | \$(7,839) | \$(5,221) | \$(16,870) | \$(12,350) |
| Less: Net (loss) earnings attributable to non-controlling interest | (30) | 9 | (16) | (5) |
| Net loss attributable to Pulse Electronics Corporation | \$(7,809) | \$(5,230) | \$(16,854) | \$(12,345) |
| Basic loss per share: | | | | |
| Shares | 17,322 | 7,994 | 14,992 | 7,976 |
| Per share amount | \$(0.45) | \$(0.65) | \$(1.12) | \$(1.55) |
| Diluted loss per share: | | | | |
| Shares | 17,322 | 7,994 | 14,992 | 7,976 |
| Per share amount | \$(0.45) | \$(0.65) | \$(1.12) | \$(1.55) |

As we had net losses in the three and six months ended June 27, 2014 and June 28, 2013, we did not include any common stock equivalents related to stock options, restricted shares, and restricted share units in our calculation of diluted loss per share. There were approximately 0.3 million and 0.4 million stock options outstanding as of June 27, 2014 and June 28, 2013, respectively, and unvested restricted shares and restricted share units outstanding of approximately 0.9 million and 0.1 million as of June 27, 2014 and June 28, 2013, respectively, that were excluded from the computation of weighted average shares outstanding.

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

Prior to repayment of the senior convertible notes and conversion of the Series A preferred stock into common shares, the effect of these instruments was antidilutive and therefore excluded from our diluted loss per share calculation for the six months ended June 27, 2014 and June 28, 2013.

(11) Severance, impairment and other associated costs

The changes in the accrual related to severance, impairment and other associated costs were as follows (in thousands):

| | |
|--------------------------------------|---------|
| Balance accrued at December 27, 2013 | \$493 |
| Net expense | 1,937 |
| Cash payments | (631) |
| Non-cash charges | - |
| Balance accrued at June 27, 2014 | \$1,799 |

During the six months ended June 27, 2014 and June 28, 2013, we incurred costs of \$1.9 million and \$0.1 million, respectively, associated with restructuring actions.

During the first six months of 2014, we incurred \$1.7 million of costs related to our operating expense reduction program initiated in the second quarter of 2013 to make progress towards our targeted operating expense model. These costs included severance costs associated with consolidation of certain general and administrative functions, elimination of certain positions within our executive management team, and workforce reductions in our Wireless segment. In addition, we incurred \$0.2 million of severance costs related to a program we initiated in the third quarter of 2013 to lower overhead costs and reorganize certain indirect labor functions in China. We have substantially completed both of these programs as of June 27, 2014.

(12) Fair Value Measurements

During the six months ended June 27, 2014, there were no changes in the fair value level used in the valuation of our financial assets and liabilities measured at fair value on a recurring basis. We categorize our financial assets and liabilities on our Unaudited Condensed Consolidated Balance Sheets into a three-level fair value hierarchy based on inputs used for valuation, which are categorized as follows:

Level 1 Financial assets and liabilities whose values are based on quoted prices for identical assets or liabilities in an active public market.

Level 2 Financial assets and liabilities whose values are based on quoted prices in markets that are not active or a valuation using model inputs that are observable for substantially the full term of the asset or liability.

Level 3 Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's assumptions and judgments when pricing the asset or liability.

The following tables presents our fair value hierarchy for those assets measured at fair value on a recurring basis in our Unaudited Condensed Consolidated Balance Sheets (in millions):

Fair Value Measurements at
June 27, 2014

| | Quoted Prices in Active Markets | Significant for Other Identifiable Assets | Observable Inputs | Significant Unobservable Inputs |
|---------------------------------|---|--|----------------------|---------------------------------------|
| | Level 1 | Level 2 | | Level 3 |
| Assets: | | | | |
| Long-lived assets held for sale | \$ - | \$ - | | \$ 1.8 |
| Total assets | \$ - | \$ - | | \$ 1.8 |

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Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

| | Fair Value Measurements at December 27, 2013 | | |
|---------------------------------|---|--|--|
| | Quoted Prices in Active Markets for Identifiable Assets Level | | |
| | Significant Observable Inputs Level 1 | Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| Assets: | | | |
| Long-lived assets held for sale | \$ - | \$ - | \$ 1.9 |
| Total assets | \$ - | \$ - | \$ 1.9 |

Long-lived assets held for sale are reported at fair value, if, on an individual basis, the fair value of the asset is less than cost. The fair value of assets held for sale is estimated using Level 3 inputs, such as broker quotes for like-kind assets or other market indications of a potential selling value that approximates fair value. During the six months ended June 27, 2014, our long-lived assets held for sale decreased by \$0.1 million due to effects of changes in foreign currency and no fair value adjustments were made during the period.

The majority of our financial instruments and financial assets approximate fair value, as presented on our Unaudited Condensed Consolidated Balance Sheets. As of June 27, 2014, the estimated fair value of our term loans was approximately \$112.2 million. The fair value of the term loans was estimated using a discounted cash flow approach. The discounted cash flow approach uses a risk-adjusted yield to present value the contractual cash flows of the term loans. The fair value of the notes would be classified as Level 3 within the fair value measurement hierarchy. These liabilities are not measured at their fair value in our Unaudited Condensed Consolidated Balance Sheets for any period presented.

(13) Business segment information

Our segments' net sales and operating profit (loss) excluding severance, impairment and other associated costs, and legal reserve costs were as follows (in thousands):

| | Three Months Ended | | Six Months Ended | |
|-----------------|-----------------------|------------------|------------------|------------------|
| | June 27, 2014 | June 28, 2013 | June 27, 2014 | June 28, 2013 |
| Net sales: | | | | |
| Network | \$42,157 | \$38,454 | \$77,099 | \$74,285 |
| Power | 28,086 | 29,554 | 54,573 | 57,139 |
| Wireless | 23,324 | 20,250 | 43,547 | 41,640 |
| Total net sales | \$93,567 | \$88,258 | \$175,219 | \$173,064 |

Operating profit (loss) excluding severance, impairment and other associated costs, and legal reserve costs:

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| | | | | |
|---|------------|------------|-------------|-------------|
| Network | \$2,078 | \$922 | \$3,009 | \$2,254 |
| Power | 2,195 | 1,910 | 3,512 | 3,079 |
| Wireless | (1,562) | (1,090) | (4,206) | (2,584) |
| Operating profit (loss) excluding severance, impairment and other associated costs, and legal reserve costs | 2,711 | 1,742 | 2,315 | 2,749 |
| Severance, impairment and other associated costs | 976 | 93 | 1,937 | 112 |
| Legal reserve | 11 | 37 | 22 | 75 |
| Operating profit | 1,724 | 1,612 | 356 | 2,562 |
| Interest expense, net | (6,361) | (6,774) | (13,479) | (11,888) |
| Other income (expense), net | 318 | (408) | 245 | (2,940) |
| Loss before income taxes | \$(4,319) | \$(5,570) | \$(12,878) | \$(12,266) |

(14) Subsequent events

On July 14, 2014, we announced that Ralph E. Faison resigned from our Board of Directors and as our Chief Executive Officer and President. In connection with his termination of employment on July 14, 2014, Mr. Faison is entitled to an aggregate severance payment of \$2.6 million payable in equal installments over a twenty-four month period, subject to Section 409A of the Internal Revenue Code of 1986. Mr. Faison will also receive full vesting in respect of 271,083 restricted stock units and 93,645 stock options that we previously granted to him. Our Board of Directors has named Alan H. Benjamin, Chief Operating Officer, as interim Chief Executive Officer, and John E. Major, lead independent member of our Board of Directors, as interim Chairman of the Board. We are undertaking a search for a permanent Chief Executive Officer.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

This discussion and analysis of our financial condition and results of operations as well as other sections of this report contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and involve a number of risks and uncertainties. Actual results may differ materially from those anticipated in these forward-looking statements for many reasons, including the risks we face described in the "Risk Factors" section of this report and our other reports filed with the Securities and Exchange Commission. Except to the extent required by law, we assume no obligation to update or revise any forward-looking statements.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires us to make judgments, assumptions and estimates that affect the amounts reported in the Unaudited Condensed Consolidated Financial Statements and accompanying notes. Note 1, Summary of significant accounting policies, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the period ended December 27, 2013 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements.

Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the period ended December 27, 2013 describes the following critical accounting policies, which are significantly impacted by judgments, assumptions and estimates used in the preparation of our Consolidated Financial Statements:

Inventory valuation;
Revenue recognition;
Divestiture accounting;
Intangible assets;
Income taxes;
Defined benefit plans;
Contingency accruals; and
 Severance, impairment and other
 associated costs.

Actual results could differ from our estimates as described in the significant and critical accounting policies in our Annual Report on Form 10-K for the period ended December 27, 2013.

Overview

We are a global producer of precision-engineered electronic components and modules. Based on our estimates of the total annual revenues in our primary markets and our share of those markets relative to our competitors, we believe we are a leading global producer of electronic components and modules in the primary markets we serve. We operate our business in three segments:

our Network product group, which we refer to as Network;
our Power product group, which we refer to as Power; and
our Wireless product group, which we refer to as Wireless.

Network produces a variety of passive components that manage and regulate electronic signals for use in various devices used in local area and wide area networks, such as connectors, filters, filtered connectors, transformers, splitters, micro-filters, baluns and chokes. Power primarily manufactures products that adjust and ensure proper current and voltage, limit distortion of voltage, sense and report current and voltage and cause mechanical movement or actuation, which includes power transformers, chokes, current and voltage sensors, ignition coils, automotive coils and military and aerospace products. Wireless manufactures products related to the capture or transmission of wireless communication signals, such as antennas, antenna modules and antenna mounting components.

Historically, our gross margin has been significantly affected by product mix and capacity utilization. The markets served by each of our segments are characterized by varying product life cycles, which in some cases cause significant product turnover each year and, subsequently, frequent variations in the prices of products sold. Due to the constantly changing quantity of parts each segment offers and the frequent changes in our average selling prices, we cannot isolate the impact of changes in unit volume and unit prices on our net sales or gross margin in any given period. In addition, our operations are subject to changes in foreign exchange rates, especially the U.S. dollar as compared to the euro and Chinese renminbi, which affect our U.S. dollar reported results of operations.

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Technology and Strategic Investments. Our products evolve along with changes in technology, changes in the availability and price of raw materials and changes in design preferences of the end users of our products. In addition, regulatory requirements can occasionally impact the design and functionality of our products. We address these dynamic conditions, as well as our customers' desires, by continually investing in the development of each of our segments' products and by maintaining a diverse product portfolio, which contains both mature and emerging technologies. We remain committed to technological development through investing in research, development and engineering activities focused on designing next generation products, improving our existing products and improving our manufacturing processes. If we determine that any of our segments' manufacturing processes would benefit from capital investment, we may allocate resources to fund the expansion of property, plant and equipment used in these processes. For example, we have committed capital to drive higher levels of automation throughout our manufacturing operations. We also committed capital to the implementation of our new enterprise resource planning ("ERP") system to enhance visibility, reduce cost, and enhance customer service. The majority of our sites are now live on our new ERP system.

Cost Reduction Programs. We continue to simplify our operations to optimally match our capacity to the current and anticipated revenues and unit demand of each of our operating segments. Specific actions to simplify our operations will dictate the future expenses associated with our cost reduction programs. Actions taken over the past several years, such as divestitures, plant closures, plant relocations, and reduction in personnel, have resulted in the elimination of a variety of future costs. The majority of these costs, not related to the impairment of long-lived assets, represent the annual salaries and benefits of terminated employees, including both those related to manufacturing and those that provided selling, general and administrative services. Also, we have experienced depreciation savings from disposed equipment and reductions in rental expense from the termination of lease agreements. Historically, we have also reduced labor and overhead costs as a result of relocating factories with higher wage rates, such as those in southern China, to lower-cost areas in the central regions of China. The savings created by these cost reduction programs impact cost of goods sold and selling, general and administrative expenses, but the timing of such savings may not be apparent due to other performance factors such as unanticipated changes in demand, changes in unit selling prices, operational challenges, changes in operating strategies, and rising labor costs. Wage rates in China, which are mandated by the government, have been steadily increasing. There were minimum wage increases implemented in a portion of our manufacturing locations in the second quarter of 2013, with wage increases in our remaining locations taking effect in the third quarter of 2013. In 2014, there will be an increase in minimum wages which will take effect in the third quarter. Such wage rate increases have and will continue to have an unfavorable impact on our overall profit margin in the future.

Income Taxes. Our effective income tax rate is affected by the proportion of our income earned in higher tax jurisdictions, such as those in certain European countries and the United States, and income earned in lower tax jurisdictions, such as Hong Kong and China. This mix of income can vary significantly from one period to another. Additionally, our effective income tax rate will be impacted from period to period by significant transactions and the deductibility or non-deductibility of severance and impairment costs and other similar costs as well as by changes in our net deferred tax assets valuation allowance. Changes in operations, tax legislation, estimates, judgments and forecasts may also affect our tax rate from period to period.

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Results of Operations

Three months ended June 27, 2014 compared to the three months ended June 28, 2013

The following table below shows our results of operations and sets forth the components of net income as a percentage of net sales for the periods indicated (in thousands):

| | Three Months | | | | Results as % of | | |
|--|------------------|------------------|-----------|---------|-----------------|--------|--------|
| | Ended | | Change | Change | net sales | | |
| | June 27, 2014 | June 28, 2013 | | | \$ | % | 2014 |
| Net sales | \$93,567 | \$88,258 | \$5,309 | 6.0 | % | 100.0% | 100.0% |
| Cost of sales | 73,830 | 67,508 | (6,322) | (9.4) |) | (78.9) | (76.5) |
| Gross profit | 19,737 | 20,750 | (1,013) | (4.9) |) | 21.1 | 23.5 |
| Selling, general and administrative expenses | 17,026 | 19,008 | 1,982 | 10.4 | | (18.2) | (21.5) |
| Severance, impairment and other associated costs | 976 | 93 | (883) | (949.5) |) | (1.0) | (0.1) |
| Legal reserve | 11 | 37 | 26 | 70.3 | | (0.0) | (0.0) |
| Operating profit | 1,724 | 1,612 | 112 | (6.9) |) | 1.8 | 1.8 |
| Interest expense, net | (6,361) | (6,774) | 413 | 6.1 | | (6.8) | (7.7) |
| Other income (expense), net | 318 | (408) | 726 | 177.9 | | 0.3 | (0.5) |
| Loss before income taxes | (4,319) | (5,570) | 1,251 | 22.5 | | (4.6) | (6.3) |
| Income tax (expense) benefit | (3,520) | 349 | (3,869) | 1,108.6 | | (3.8) | 0.4 |
| Net loss | \$(7,839) | \$(5,221) | \$(2,618) | (50.1) |)% | (8.4) | (5.9) |

Net sales. Net sales increased by \$5.3 million, or 6.0%, to \$93.6 million compared with \$88.3 million in the prior year quarter, mainly due to broadly increased industry demand in our Network segment and higher demand in smartphone programs in our Wireless segment, which were partially offset by lower automotive product sales in our Power segment.

Net sales for our three segments for the three months ended were as follows (in thousands):

| | June 27, 2014 | June 28, 2013 |
|-----------|------------------|------------------|
| Network | \$42,157 | \$38,454 |
| Power | 28,086 | 29,554 |
| Wireless | 23,324 | 20,250 |
| Net sales | \$93,567 | \$88,258 |

Gross profit. Gross profit decreased by \$1.0 million to \$19.7 million compared to \$20.8 million in the prior year quarter. Gross profit as a percentage of net sales decreased to 21.1% for the three months ended June 27, 2014 as compared to 23.5% in the prior year quarter. The lower gross profit margin was mainly due to higher production costs, particularly labor costs in China, as well as lower pricing for our Wireless products.

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Selling, general and administrative expenses. Total selling, general and administrative expenses decreased by \$2.0 million, or 10.4%, to \$17.0 million, compared to \$19.0 million in the prior year quarter, mainly due to results of actions related to previously announced expense reduction initiatives.

Research, development and engineering expenses (“RD&E”) are included in selling, general and administrative expenses. For the three months ended, RD&E was as follows (in thousands):

| | June | June |
|---------------------|---------|---------|
| | 27, | 28, |
| | 2014 | 2013 |
| RD&E | \$4,852 | \$5,748 |
| Percentage of sales | 5.2 % | 6.5 % |

Our RD&E spending as a percentage of sales in the three months ended June 27, 2014 decreased slightly in amount and as a percentage of sales compared to the prior year quarter primarily due to results of actions related to previously announced expense reduction initiatives.

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Severance, impairment and other associated costs. During the three months ended June 27, 2014, we incurred costs of \$1.0 million, of which \$0.8 million related to our operating expense reduction program initiated in the second quarter of 2013, including severance costs associated with consolidation of certain general and administrative functions, elimination of certain positions within our executive management team, and workforce reductions in our Wireless segment. The remaining \$0.2 million of costs related to severance associated with a program initiated in the third quarter of 2013 to lower overhead costs and reorganize certain indirect labor functions in China. During the three months ended June 28, 2013, we incurred \$0.1 million of restructuring expenses.

Interest expense, net. Net interest expense decreased by \$0.4 million to \$6.4 million compared with \$6.8 million in the prior year quarter, primarily attributable to a reduction in the non-U.S. withholding taxes we paid on behalf of our lenders with respect to the PIK interest. The decrease in the non-U.S. withholding tax is due to tax status changes made by our lenders during the three months ended June 27, 2014. These savings were partially offset by increases in our interest expense due to higher borrowing rates and debt levels, as well as an increase in our loan fee and debt discount amortization.

Other, net. Net other expense for the three months ended June 27, 2014 and June 28, 2013 is primarily attributable to our foreign currency exchange activity related to changes in the various currencies of our intercompany lending program. During the three months ended June 27, 2014, we incurred \$0.3 million in foreign currency gains compared to \$0.4 million losses in the prior year, primarily due to the strengthening of various foreign currencies against the U.S. dollars, resulting in favorable gains on intercompany advances and loans held by our non-U.S. dollar-functional subsidiaries.

Income taxes. The income tax expense for the three months ended was as follows (in thousands):

| | June 27, 2014 | June 28, 2013 |
|------------------------------|---------------------|---------------------|
| Income tax expense (benefit) | \$3,520 | \$(349) |
| Effective tax rate | (81.5)% | 6.3% |

The change in the effective tax rate for the three months ended June 27, 2014 versus the prior year comparative period was primarily due to the change in the distribution of where income was earned by our operating entities, as well as the greater allocation of losses to jurisdictions for which no income tax benefit can be recognized.

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Results of Operations

Six months ended June 27, 2014 compared to the six months ended June 28, 2013

The following table below shows our results of operations and sets forth the components of net income as a percentage of net sales for the periods indicated (in thousands):

| | Six Months Ended | | | | Results as % of net sales | |
|--|------------------|------------------|--------------|-------------|---------------------------|----------|
| | June 27, 2014 | June 28, 2013 | Change \$ | Change % | 2014 | 2013 |
| Net sales | \$175,219 | \$173,064 | \$2,155 | 1.2 | % 100.0% | 100.0% |
| Cost of sales | 137,956 | 132,133 | (5,823) | (4.4) |) (78.7) | (76.3) |
| Gross profit | 37,263 | 40,931 | (3,668) | (9.0) |) 21.3 | 23.7 |
| Selling, general and administrative expenses | 34,948 | 38,182 | 3,234 | 8.5 | (19.9) | (22.1) |
| Severance, impairment and other associated costs | 1,937 | 112 | (1,825) | (1,629.5) | (1.1) | (0.1) |
| Legal reserve | 22 | 75 | 53 | 70.7 | (0.0) | (0.0) |
| Operating profit | 356 | 2,562 | (2,206) | 86.1 | 0.2 | 1.5 |
| Interest expense, net | (13,479) | (11,888) | (1,591) | (13.4) |) (7.7) | (6.9) |
| Other income (expense), net | 245 | (2,940) | 3,185 | (108.3) |) 0.1 | (1.7) |
| Loss before income taxes | (12,878) | (12,266) | (612) | (5.0) |) (7.3) | (7.1) |
| Income tax expense | (3,992) | (84) | (3,908) | (4,652.4) | (2.3) | (0.0) |
| Net loss | \$(16,870) | \$(12,350) | \$(4,520) | (36.6) |)% (9.6) |)% (7.1) |

Net sales. Net sales increased by \$2.2 million, or 1.2%, to \$175.2 million compared with \$173.1 million in the prior year period, mainly due to broadly increased industry demand in our Network segment and higher demand in smartphone programs in our Wireless segment, which were partially offset by lower automotive product sales in our Power segment.

Net sales for our three segments for the six months ended were as follows (in thousands):

| | June 27, 2014 | June 28, 2013 |
|-----------|------------------|------------------|
| Network | \$77,099 | \$74,285 |
| Power | 54,573 | 57,139 |
| Wireless | 43,547 | 41,640 |
| Net sales | \$175,219 | \$173,064 |

Gross profit. Gross profit decreased by \$3.7 million to \$37.3 million compared to \$40.9 million in the prior year quarter. Gross profit as a percentage of net sales decreased to 21.3% for the six months ended June 27, 2014 as compared to 23.7% in the prior year period. The lower gross profit margin was mainly due to lower pricing for our Wireless products and higher production costs, particularly labor costs in China.

Selling, general and administrative expenses. Total selling, general and administrative expenses decreased by \$3.2 million, or 8.5%, to \$34.9 million, compared to \$38.2 million in the prior year period, mainly due to results of actions

related to previously announced expense reduction initiatives.

Research, development and engineering expenses (“RD&E”) are included in selling, general and administrative expenses. For the six months ended, RD&E was as follows (in thousands):

| | June 27, 2014 | June 28, 2013 |
|---------------------|------------------|------------------|
| RD&E | \$10,301 | \$11,282 |
| Percentage of sales | 5.9 % | 6.5 % |

Our RD&E spending as a percentage of sales in the six months ended June 27, 2014 decreased slightly in amount and as a percentage of sales compared to the prior year quarter primarily due to decreases in spending in our Wireless segment.

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Severance, impairment and other associated costs. During the six months ended June 27, 2014, we incurred costs of \$1.9 million, of which \$1.7 million related to our operating expense reduction program initiated in the second quarter of 2013, including severance costs associated with consolidation of certain general and administrative functions, elimination of certain positions within our executive management team, and workforce reductions in our Wireless segment. The remaining \$0.2 million of costs related to severance associated with a program initiated in the third quarter of 2013 to lower overhead costs and reorganize certain indirect labor functions in China. During the six months ended June 28, 2013, we incurred \$0.1 million of restructuring expenses.

Interest expense, net. Net interest expense increased by \$1.6 million to \$13.5 million compared with \$11.9 million in the prior year period, mainly due to higher borrowing rates and debt levels, as well as an increase in our loan fee and debt discount amortization expense. Additionally, interest expense compared to the prior year increased \$0.4 million due to higher debt extinguishment costs incurred on the senior convertible note exchange transaction, which included the write-off of unamortized loan costs and legal fees expensed as part of the transaction.

Other, net. During the six months ended June 27, 2014, we generated \$0.2 million of other income, net, primarily related to gains on our foreign currency exchange activity related to changes in varying currencies of our intercompany lending program. During the six months ended June 28, 2013, we incurred \$2.9 million of other expense, net, which consisted of a \$2.9 million loss for the change in fair value on the warrant liability we issued to Oaktree in connection with the Oaktree recapitalization, as well as foreign currency losses related to changes in the varying currencies of our intercompany lending program of \$0.3 million; partially offset by a \$0.2 million gain on the sale of assets related to two manufacturing plants in China.

Income taxes. The income tax expense for the six months ended was as follows (in thousands):

| | June 27, 2014 | June 28, 2013 |
|--------------------|---------------------|---------------------|
| Income tax expense | \$3,992 | \$84 |
| Effective tax rate | (31.0)% | (0.7)% |

The change in the effective tax rate for the six months ended June 27, 2014 versus the prior year comparative period was primarily due to the change in the distribution of where income was earned by our operating entities, as well as the greater allocation of losses to jurisdictions for which no income tax benefit can be recognized.

Liquidity and Capital Resources

Cash and Cash Equivalents

The Company had \$24.8 million of cash and cash equivalents at June 27, 2014 compared with \$26.9 million at December 27, 2013. The decrease in cash mainly reflects the payment of cash consideration for the convertible bond exchange transactions of \$2.4 million, refinancing transaction fees and expenses of \$1.6 million, and capital expenditures of \$1.4 million, partially offset by \$4.1 million provided by operating activities. Additionally, in the second quarter of 2014 the Company redeemed the remaining senior convertible notes outstanding after the exchange transaction for \$1.6 million in cash.

If earnings from non-U.S. operations were repatriated from our non-U.S. subsidiaries, it may require the payment of additional taxes. At June 27, 2014, a majority-owned foreign subsidiary located in Taiwan and its subsidiaries held approximately \$12.9 million of our total consolidated cash and cash equivalents. Permanent access to funds from this subsidiary could be in the form of a dividend to its shareholders, which could result in income and withholding taxes and distributions to minority shareholders. Repatriation of some of these funds could be subject to delay for local

country approvals and could have potential adverse tax consequences. Management does not believe such restrictions will limit the Company's ability to pursue its intended business strategy. In connection with the on-going simplification and restructuring efforts of the Company, significant amounts of non-U.S. cash on-hand may be used during 2014 to further these objectives and improve the operating efficiency of the Company.

In February 2014, we announced that we had reached agreements with the holders of approximately \$20.7 million of our \$22.3 million of outstanding senior convertible notes due in December 2014 to exchange their notes for \$14.9 million of new Term B Loans, 1.1 million shares of common stock, and \$2.4 million of cash. The exchange transactions reduced our outstanding debt and the amount of cash required for debt service and will extend the maturity of the exchanged debt beyond 2014, allowing us to further focus on our long-term strategy and the execution of our business plans.

We believe that we will maintain sufficient financing from operations and cash on-hand to meet funding requirements for the next twelve months. We continue to focus on cost reduction measures in an effort to generate additional cash flows. In the second quarter of 2013, we initiated a program to reduce operating expenses by approximately \$9.0 million on an annualized basis, which we substantially completed in the second quarter of 2014. Although we have not finalized any specific plans at this time, we continue to review our cost structure and will undertake actions in the future to further reduce our operating expenses and improve profitability.

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There can be no assurance that plans to improve operating performance and financial position will be successful. If we are unable to generate additional cash flows through our cost reduction initiatives and/or are unable to raise sufficient additional capital to fulfill our financial commitments in a timely manner, our business prospects, financial condition and results of operations will likely be materially and adversely affected.

Cash Flow from Operating Activities

Net cash provided by operating activities was \$4.1 million for the six months ended June 27, 2014 compared to net cash used in operating activities of \$0.7 million for the six months ended June 28, 2013. The increase in cash provided by operating activities was mainly due to decreases in inventory levels compared to prior year, as well as lower severance and interest payments.

Cash Flow from Investing Activities

Net cash used in investing activities was \$1.0 million for the six months ended June 27, 2014, consisting of \$1.4 million of capital expenditures, partially offset by \$0.4 million of proceeds received for the sale of a trademark.

Net cash used in investing activities was \$5.6 million for the six months ended June 28, 2013, primarily consisting of capital expenditures of \$5.7 million.

Capital expenditures in both periods include the continuing implementation of our ERP system, initiatives to drive higher levels of automation throughout our manufacturing operations, as well as investments in programs which we believe are essential to our future growth, primarily related to our Wireless segment.

Cash Flows from Financing Activities

Net cash used in financing activities during the six months ended June 27, 2014 was \$5.1 million, mainly consisting of \$2.4 million paid to our senior convertible note holders as part of the exchange transaction, payments of debt issuance costs of \$1.6 million, and \$1.6 million of payments made to settle the remaining senior convertible notes. These payments were partially offset by a decrease in restricted cash of \$0.5 million related to the release of cash held in escrow in connection with our completion of post-closing obligations under the Oaktree credit agreement.

Net cash used in financing activities during the six months ended June 28, 2013 was \$2.0 million, consisting of cash used in the payment of debt issuance costs of \$1.5 million, as well as an increase in restricted cash of \$0.5 million related to amounts held in escrow in connection with certain post-closing obligations under the Oaktree credit agreement.

Financing Transactions

As of June 27, 2014, we have \$137.8 million of outstanding principal on our term loans (\$116.2 million, net of discount). On February 21, 2014, we entered into agreements with the holders of approximately \$20.7 million of the \$22.3 million of our senior convertible notes to exchange their notes for new Term B Loans, shares of our common stock, and cash (collectively “the Exchange Transaction”). In aggregate, the Exchange Transaction resulted in the issuance of \$14.9 million of new Term B Loans, 1.1 million shares of our common stock, and \$2.4 million of cash in exchange for approximately \$20.7 million of the outstanding senior convertible notes. The Term B Loans are identical to the Term B Loan issued to Oaktree in November 2012.

On May 1, 2014, we repaid the \$1.6 million of outstanding principal on our remaining senior convertible notes. Pursuant to the Series A preferred stock conversion and the resulting issuance of 8.2 million shares of common stock to Oaktree, a “change in control” under the terms of the senior convertible notes was deemed to have occurred since Oaktree beneficially owns a majority of the outstanding shares of our common stock. Such change in control triggered

our obligation to repurchase all remaining outstanding senior convertible notes.

The interest rate on the Term A Loan is 12.0% per annum, and the interest rate on the Term B Loan is 10.0% per annum. Interest on each term loan may, at our election, be paid in cash or paid in kind ("PIK") (in the form of additional principal) until November 2015. We plan to pay the interest due on these term loans in the form of additional principal through November 2015. Interest is due on the last business day of the calendar quarter.

During the six months ended June 27, 2014, the principal balance on the term loans increased by \$6.9 million due to PIK interest elections made on December 31, 2013 and March 31, 2014. Additionally, under the credit agreement, we are required to pay non-U.S. withholding tax with respect to the accrued interest on behalf of our lenders. In the first quarter of 2014, we incurred approximately \$0.6 million of foreign withholding taxes on interest accrued on the term loans. In the second quarter of 2014, the majority of our lenders made tax status changes that reduced the foreign withholding taxes incurred on the term loans. For the quarter ended June 27, 2014, we incurred less than \$0.1 million in foreign withholding taxes, and expect to incur a similar amount of costs in future periods.

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These term loans mature on November 20, 2017 and are secured by a first priority lien on the collateral, which includes the shares and assets of certain domestic and international subsidiaries. The term loans are non-amortizing and may be prepaid without any penalty. While the Term B Loan is not junior in relative lien priority to the Term A Loan, the Term B Loan may not be repaid until the Term A Loan is paid in full.

Debt covenants

On February 21, 2014, we amended the credit agreement including modifications to the financial covenants. The amendment also extended the waiver of any default with respect to the judgments in the Halo Electronics case and the Turkish legal matter through the maturity date of our term loans subject to certain specified conditions. In consideration for the February 2014 amendment to the credit agreement, we paid Oaktree a fee of 1.5% of its term loan principal, or approximately \$1.8 million, which was added to the principal of the outstanding Term A Loan and Term B Loan owed to Oaktree on a pro rata basis.

Under the February 2014 amendment to the credit agreement, we are no longer subject to the minimum liquidity and the total net debt leverage ratio covenants through the maturity date. In addition, the secured leverage ratio covenants were modified. The secured leverage ratio is calculated as the ratio of consolidated secured debt, which includes the term loans, and our rolling four quarters' EBITDA (as defined in the credit agreement).

Under the credit agreement, as amended in February 2014, the secured leverage ratio requirements, as defined in the agreement, are set forth in the table below:

| Test Period End Date(s) | Secured Leverage Ratio |
|--|------------------------|
| March 31, 2014 through December 31, 2014 | 11.00 to 1.00 |
| March 31, 2015 through December 31, 2015 | 9.50 to 1.00 |
| March 31, 2016 through December 31, 2016 | 8.00 to 1.00 |
| March 31, 2017 through December 31, 2017 | 5.00 to 1.00 |

In addition, our capital expenditures are limited to \$12.0 million in fiscal 2014 and \$14.0 million in fiscal 2015 and in each fiscal year thereafter. As of June 27, 2014, we were in compliance with these financial covenants.

Stock issuances

In conjunction with the Exchange Transaction, we amended the Investment Agreement in February 2014 such that the Series A preferred stock was convertible into shares of common stock at such time that we acquired and cancelled at least 90% of the \$22.3 million of our outstanding senior convertible notes. In accordance with the Investment Agreement, as amended, the Series A preferred stock was converted into 8.2 million shares of our common stock upon completion of the Exchange Transaction on February 21, 2014. Upon conversion of the Series A Preferred Stock, Oaktree beneficially owns approximately 68.7% of the outstanding common stock (not including shares of common stock and common stock equivalents acquired by Oaktree prior to the transaction contemplated by the Investment Agreement that closed in November 2012).

Certain Other Matters Relating to Liquidity

On June 25, 2014, the New York Stock Exchange (the "NYSE" or the "Exchange") notified us that we had fallen below one of the Exchange's continued listing standards, which requires companies whose total stockholders' equity is less than \$50.0 million to maintain an average global market capitalization over a consecutive 30-day trading period of not

less than \$50.0 million.

Under applicable NYSE rules, we have 45 days from the receipt of the notice to demonstrate our ability to achieve compliance with the market capitalization listing standards within nine months of receipt of the notice. We intend to work with the NYSE to evaluate our options to cure the deficiency within the prescribed timeframe. If the Exchange grants us the nine-month cure period, our shares of common stock will continue to be listed on the NYSE during such time, subject to the compliance with other NYSE continued listing standards and continued periodic review by the NYSE of our progress. Under the applicable rules, the Exchange has the right to initiate delisting proceedings if we cannot demonstrate our ability to achieve compliance on a timely basis; the NYSE does not grant us the nine-month cure period; or the NYSE grants us the nine-month cure period but we do not make satisfactory progress to cure.

If the common stock ultimately were to be delisted for any reason, it could reduce the liquidity and market price of the common stock and negatively impact our ability to conduct equity financings and access the public capital markets.

We are a party to various legal proceedings, claims and assessments that arise in the ordinary course of business, and may continue to incur significant costs in defending or settling legal matters. The total amount and timing of the expected future payments related to these matters cannot be estimated due to the uncertainty of the duration of the legal proceedings and the ultimate scope of other claims. However, an unfavorable outcome in a single matter or in multiple legal matters during the same reporting period could have a material adverse effect on our consolidated financial position, results from operations and cash flows. Refer to Note 7, Commitments and contingencies, to the Notes to Unaudited Condensed Consolidated Financial Statements for a discussion of certain legal proceedings.

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Our domestic defined benefit retirement plan has been subject to the pursuit of an alleged claim relating to the sale of our former electrical contact business (“Electrical”) in 2010 by the Pension Benefit Guarantee Corporation (“PBGC”). Communications from the PBGC have indicated that the sale of Electrical’s North America operations may have resulted in a partial plan termination. We have had previous discussions with the PBGC regarding potential additional funding of the plan, which would require us to make annual contributions of up to \$0.8 million to the plan until we have funded the plan by \$6.2 million. In July 2014, the PBGC announced a moratorium on the enforcement of ERISA 4062(e) regulation cases until the end of the year. Accordingly, we do not anticipate any additional funding in 2014.

During the six months ended June 27, 2014, we experienced no material changes to our contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 27, 2013, except for contractual severance payments we will make to certain senior executives that terminated their employment with the Company in 2014, including severance payments we will make to our former CEO further described in Note 14, Subsequent events, as follows: \$0.5 million in 2014, \$2.4 million in 2015 and \$0.7 million in 2016.

Our retained earnings are free from legal or contractual restrictions as of June 27, 2014, with the exception of approximately \$26.9 million of subsidiary retained earnings primarily in China that are restricted in accordance with Section 58 of the PRC Foreign Investment Enterprises Law. The \$26.9 million includes approximately \$3.5 million of retained earnings of a majority-owned subsidiary. The amount restricted in accordance with the PRC Foreign Investment Enterprise Law is applicable to all foreign investment enterprises doing business in China. The restriction applies to 10% of our net earnings in China, limited to 50% of the total capital invested.

We do not maintain any off-balance-sheet arrangements, transactions, obligations or other relationships with unconsolidated entities that would be expected to have a material current or future effect on our financial condition or results of operations.

New and Recently Adopted Accounting Pronouncements

Please see Note 1, General, to the Notes to Unaudited Condensed Consolidated Financial Statements for a description of new and recently adopted accounting pronouncements.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our interim Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act of 1934 as of June 27, 2014. Based upon that evaluation, the interim Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit is recorded, processed, summarized and reported, as specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

A company’s internal control over financial reporting is a process designed to provide reasonable, not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide

reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

(b)Changes in Internal Control

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 27, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 7, Commitments and contingencies, to the accompanying Unaudited Condensed Consolidated Financial Statements for a discussion of certain legal proceedings.

Item 1a. Risk Factors

In addition to the other information set forth in this report and the risk factor set forth below, you should carefully consider the factors discussed in Item 1A. Risk Factors, in our Annual Report on Form 10-K for the year ended December 27, 2013, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition and/or operating results. You should also refer to the statement regarding forward-looking statements on page 13 in this Quarterly Report on Form 10-Q.

If we do not meet the New York Stock Exchange continued listing requirements, our common stock may be delisted.

On June 25, 2014, the New York Stock Exchange notified us that we had fallen below one of the Exchange's continued listing standards, which requires companies whose total stockholders' equity is less than \$50.0 million to maintain an average global market capitalization over a consecutive 30-day trading period of not less than \$50.0 million.

Under applicable NYSE rules, we have 45 days from the receipt of the notice to demonstrate our ability to achieve compliance with the market capitalization listing standards within nine months of receipt of the notice. We intend to work with the NYSE to evaluate our options to cure the deficiency within the prescribed timeframe. If the Exchange grants us the nine-month cure period, our shares of common stock will continue to be listed on the NYSE during such time, subject to the compliance with other NYSE continued listing standards and continued periodic review by the NYSE of our progress. Under the applicable rules, the Exchange has the right to initiate delisting proceedings if we cannot demonstrate our ability to achieve compliance on a timely basis; the NYSE does not grant us the nine-month cure period; or the NYSE grants us the nine-month cure period but we do not make satisfactory progress to cure.

If the common stock ultimately were to be delisted for any reason, it could reduce the liquidity and market price of the common stock and negatively impact our ability to conduct equity financings and access the public capital markets.

Item 6. Exhibits

(a) Exhibits

The Exhibit Index is on page 23.

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Exhibit Index

- 3.1 Articles of Incorporation, amended and restated as of May 18, 2011 (incorporated by reference to Exhibit 3.1 to our Form 8-K dated May 24, 2011).
- 3.1(2) Amendment to Amended and Restated Articles of Incorporation of Pulse Electronics Corporation, dated February 21, 2014 (incorporated by reference to Exhibit 3.1(2) to our Form 8-K dated February 21, 2014).
- 3.3 By-Laws, amended and restated as of May 18, 2011 (incorporated by reference to Exhibit 3.3 to our Form 8-K dated May 24, 2011).
- 3.3(1) Amended and Restated Articles of Incorporation of Pulse Electronics Corporation (incorporated by reference to Exhibit 3.3 to our Form 8-K dated May 17, 2013).
- 10.35(2) Amendment to the Pulse Electronics Corporation's 2012 Omnibus Incentive Compensation Plan (incorporated by reference to Exhibit 10.35(2) to our Form 8-K dated May 12, 2014).
- 31.1 Certification of Principal Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Employment Letter, dated July 16, 2014, between Alan Benjamin and Pulse Electronics Corporation (incorporated by reference to Exhibit 99.2 to our Form 8-K dated July 16, 2014).
- 99.3 Separation Agreement and Release of Claims, dated July 16, 2014, between Ralph Faison and Pulse Electronics Corporation (incorporated by reference to Exhibit 99.3 to our Form 8-K dated July 16, 2014).
- 101.1 The following financial statements from the Pulse Electronics Corporation Quarterly Report on Form 10-Q for the quarter ended June 27, 2014, formatted in Extensive Business Reporting Language ("XBRL"): (i) Unaudited Condensed Consolidated Balance Sheets, (ii) Unaudited Condensed Consolidated Statements of Operations, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Loss, (iv) Unaudited Condensed Consolidated Statements of Cash Flows and the (v) the Notes to the Unaudited Condensed Consolidated Financial Statements.

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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.

Pulse Electronics Corporation
(Registrant)

August 7, 2014 /s/ Michael C. Bond
(Date) Michael C. Bond
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)