MECHANICAL TECHNOLOGY INC
Form 10-Q
August 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2012

OR

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

FOR THE TRANSITION PERIOD FROM ____ TO ______

Mechanical Technology, Incorporated

(Exact name of registrant as specified in its charter)

New York	-	**0-6890**	-	**14-1462255**
(State or Other Jurisdiction of Incorporation)		**(Commission File Number)**		**(IRS Employer Identification No.)**

325 Washington Avenue Extension, Albany, New York 12205

(Address of registrant s principal executive office)

(518) 218-2550

(Registrant s telephone number, including area code)

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 x No o

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 x No o

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 definition of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a small reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12B-2 of the Act). Yes oNo x

The number of shares of common stock, par value of $0.01 per share, outstanding as of August 3, 2012 was 5,256,883.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Mechanical Technology, Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets as of June 30, 2012 (Unaudited) and December 31, 2011

(Dollars in thousands)	June 30, 2012	December 31, 2011
Assets		
Current Assets:		
Cash	$ 1,444	$ 1,669
Accounts receivable	650	1,881
Inventories	1,169	957
Deferred income taxes, net	20	20
Prepaid expenses and other current assets	133	102
Total Current Assets	3,416	4,629
Deferred income taxes, net	1,515	1,515
Property, plant and equipment, net	183	258
Total Assets	$ 5,114	$ 6,402
Liabilities and Equity		
Current Liabilities:		
Accounts payable	$ 307	$ 191
Accrued liabilities	1,066	1,238
Deferred revenue	58	58
Total Current Liabilities	1,431	1,487
Commitments and Contingencies (Note 11)		
Equity:		
Common stock, par value $0.01 per share, authorized 75,000,000; 6,261,975 and 6,259,975 issued in 2012 and 2011, respectively	63	63
Additional paid-in-capital	135,502	135,389
Accumulated deficit	(121,488)	(120,097)

Common stock in treasury, at cost, 1,005,092 shares in both 2012 and 2011		(13,754	)		(13,754	)
Total MTI stockholders equity		323			1,601	
Non-controlling interest		3,360			3,314	
Total Equity		3,683			4,915	
Total Liabilities and Equity	$	5,114		$	6,402	

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Mechanical Technology, Incorporated and Subsidiaries

Condensed Consolidated Statements of Operations (Unaudited)

For the Three and Six Months Ended June 30, 2012 and 2011

(Dollars in thousands, except per share)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Product revenue	$ 1,366	$ 2,140	$ 2,570	$ 4,679
Funded research and development revenue				13
Total revenue	1,366	2,140	2,570	4,692
Operating costs and expenses:				
Cost of product revenue	740	850	1,318	1,789
Research and product development expenses:				
Funded research and product development				25
Unfunded research and product development	337	373	710	758
Total research and product development expenses	337	373	710	783
Selling, general and administrative expenses	978	1,318	2,070	2,625
Operating loss	(689)	(401)	(1,528)	(505)
Gain on derivatives		29		73
Other income (expense), net	180	(23)	183	(24)
Loss before income taxes and non-controlling interest	(509)	(395)	(1,345)	(456)
Income tax benefit				
Net loss, net of tax	(509)	(395)	(1,345)	(456)
Plus: Net (income) loss attributed to non-controlling interest	(61)	298	(46)	553
Net (loss) income attributed to MTI	$ (570)	$ (97)	$ (1,391)	$ 97
(Loss) earnings per share attributable to MTI (Basic and Diluted)	$ (.11)	$ (.02)	$ (.26)	$ .02
Weighted average shares outstanding (Basic and Diluted)	5,256,246	4,771,658	5,255,564	4,771,658

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES

Condensed Consolidated Statements of Changes in Equity

For the Year Ended December 31, 2011

and the Six Months Ended June 30, 2012 (Unaudited)

	Common Stock				Treasury Stock			
			Additional Paid-	Accumulated			Non-Controlling Interest	Total
(Dollars in thousands)	Shares	Amount	In-Capital	Deficit	Shares	Amount	(NCI)	Equity
December 31, 2010	5,776,750	$ 58	$ 134,733	$ (122,483)	1,005,092	$ (13,754)	$ 3,405	$ 1,959
Net income attributed to MTI	-	-	-	2,386	-	-	-	2,386
Stock based compensation	-	-	360	-	-	-	-	360
Issuance of shares restricted stock	483,225	5	296	-	-	-	-	301
Net loss attributed to NCI	-	-	-	-	-	-	(738)	(738)
Equity contribution to NCI	-	-	-	-	-	-	647	647
December 31, 2011	6,259,975	$ 63	$ 135,389	$ (120,097)	1,005,092	$ (13,754)	$ 3,314	$ 4,915
Net loss attributed to MTI	-	-	-	(1,391)	-	-	-	(1,391)
Stock based compensation	-	-	112	-	-	-	-	112
Issuance of shares common stock	2,000	-	1	-	-	-	-	1

Net income attributed to NCI	-	-	-	-	-	-	46	46
June 30, 2012	6,261,975	$ 63	$ 135,502	$ (121,488)	1,005,092	$ (13,754)	$ 3,360	$ 3,683

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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MECHANICAL TECHNOLOGY, INCORPORATED AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the Six Months Ended June 30, 2012 and 2011

(Dollars in thousands)	**Six Months Ended June 30,**	
	2012	2011
Operating Activities		
Net loss	$ (1,345)	$ (456)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Gain on derivatives		(73)
Depreciation	73	187
(Gain) loss on disposal of equipment	(130)	35
Stock based compensation	113	202
Provision for excess and obsolete inventories	68	16
Changes in operating assets and liabilities:		
Accounts receivable	1,231	82
Inventories	(280)	(258)
Prepaid expenses and other current assets	20	27
Accounts payable	116	118
Deferred revenue		32
Accrued liabilities	(172)	212
Net cash (used in) provided by operating activities	(306)	124
Investing Activities		
Purchases of equipment	(10)	(108)
Proceeds from sale of equipment	91	
Net cash provided by (used in) investing activities	81	(108)
Financing Activities		
Proceeds from the sale of subsidiary equity and warrants issued		458
Net cash provided by financing activities		458
(Decrease) increase in cash and cash equivalents	(225)	474
Cash - beginning of period	1,669	1,118
Cash - end of period	$ 1,444	$ 1,592

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

MECHANICAL TECHNOLOGY, INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Nature of Operations

Description of Business

Mechanical Technology, Incorporated (MTI or the Company), a New York corporation, was incorporated in 1961. MTI operates in two segments, the Test and Measurement Instrumentation segment, which is conducted through MTI Instruments, Incorporated (MTI Instruments), a wholly-owned subsidiary, and the New Energy segment, which is conducted through MTI MicroFuel Cells Incorporated (MTI Micro), a variable interest entity (VIE) that is included in these condensed consolidated financial statements and described further below in Note 2.

MTI Instruments was incorporated in New York on March 8, 2000 and is a worldwide supplier of precision non-contact physical measurement solutions, portable balancing equipment and wafer inspection tools. MTI Instruments products use a comprehensive array of technologies to solve complex, real world applications in numerous industries including manufacturing, semiconductor, solar, commercial and military aviation, automotive and data storage. MTI Instruments products consist of electronic gauging instruments for position, displacement and vibration application within the design, manufacturing/production, test and research market; wafer characterization of semi-insulating and semi-conducting wafers within both the semiconductor and solar industries; tensile stage systems for materials testing at academic and industrial settings; and engine vibration analysis systems for both military and commercial aircraft.

MTI Micro was incorporated in Delaware on March 26, 2001, and has been developing Mobion®, a handheld energy-generating device to replace current lithium-ion and similar rechargeable battery systems in many handheld electronic devices for the military and consumer markets. Mobion® handheld generators are based on direct methanol fuel cell (DMFC) technology, which has been recognized as an enabling technology for advanced portable power sources by the scientific community and industry analysts. As the need for advancements in portable power increases, MTI Micro has been developing Mobion® as a solution for advancing current and future electronic device power needs of the portable electronics market. As of June 30, 2012, the Company owned approximately 47.6% of MTI Micro s outstanding common stock. Although MTI Micro continues to believe in the potential of its Mobion® based power solutions, it has suspended its MTI Micro operations until such time as market demand and other deciding factors, including obtaining additional external financing, the successful completion of customer trials, a new development program with a government agency, and/or a customer order, come to fruition. MTI Micro will continue to seek additional capital from external sources to resume operations and fund future development, if any. If MTI Micro is unable to secure additional financing, a new development program or customer order, the MTI Micro Board of Directors will assess other options for MTI Micro, including the sale of its intellectual property portfolio and other assets.

Liquidity

The Company has historically incurred significant losses, the majority stemming from the direct methanol fuel cell product development and commercialization programs of MTI Micro, and had a consolidated accumulated deficit of $121.5 million as of June 30, 2012. During the six months ended June 30, 2012, the Company generated a net loss attributed to MTI of $1.4 million and cash used in operating activities totaling $306 thousand. As of June 30, 2012, the Company had approximately $1.4 million of cash available to fund future operations and working capital of approximately $2.0 million, a $1.1 million decrease from $3.1 million at December 31, 2011. The Company currently has no debt outstanding. While it cannot be assured, management believes that, due in part to our current backlog and cost control initiatives, the Company will resume positive cash flows in the second half 2012 to fund the Company s operations for the foreseeable future.

The Company expects to continue funding its operations from current cash, its projected 2012 cash flow pursuant to management s current plan, and possible draw downs from its existing line of credit, if necessary. The Company may also seek to supplement its resources through the sales of additional assets (including its investment in MTI Micro). Besides the line of credit at MTI Instruments, the Company has no other commitments for funding future needs of the organization at this time and such additional financing during 2012 may not be available to the Company on acceptable terms, if at all.

2. Basis of Presentation

In the opinion of management, the Company s condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair statement of the results for the periods presented in accordance with United States of America Generally Accepted Accounting Principles (U.S. GAAP) and with the instructions to Form 10-Q in Article 10 of the Securities Exchange Commissions (SEC) Regulation S-X. The results of operations for the interim periods presented are not necessarily indicative of results for the full year.

Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

The information presented in the accompanying condensed consolidated balance sheet as of December 31, 2011 has been derived from the Company s audited consolidated financial statements. All other information has been derived from the Company s unaudited condensed consolidated financial statements for the three and six months ended June 30, 2012 and June 30, 2011.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, MTI Instruments and its VIE, MTI Micro. The Company is the primary beneficiary of the VIE. All intercompany balances and transactions are eliminated in consolidation. The Company reflects the impact of the equity securities issuances in its investment in the VIE and additional paid-in-capital accounts for the dilution or anti-dilution of its ownership interest in the VIE.

The Company has performed an analysis under the VIE accounting model and determined that MTI Micro is a VIE. One of the criteria for determining whether an entity is a VIE is determining if the entity, MTI Micro, has equity at risk. Management has concluded that MTI Micro does not have equity at risk to fund operations into its next phase of development. Further, the Company has determined that it is the primary beneficiary of MTI Micro, and therefore should include MTI Micro s results of operations in the Company s consolidated financial statements.

The Company's analysis to determine the primary beneficiary of MTI Micro focused primarily on determining which variable interest holder has the power to direct the activities that would have the most significant impact on the financial performance of MTI Micro. MTI Micro is governed by its own Board of Directors and significant decisions are made by a majority vote of this board. MTI does not have control of the MTI Micro Board of Directors; however, as of June 30, 2012, the Company s Board of Directors and the MTI Micro Board of Directors consist of the same members, except for one additional director on the Company Board. Under the Articles of Incorporation of MTI Micro, each share of MTI Micro stock is entitled to a vote, and further, holders of a majority of the shares of MTI Micro's common stock have the ability to reconstitute the board. As of June 30, 2012, MTI, Counter Point Ventures Fund II, LP (Counter Point), Dr. Walter L. Robb, a member of the Company s and MTI Micro s Board of Directors, and Peng Lim, CEO and board member own 47.6%, 45.2%, 5.1% and 0.5% of the common shares of MTI Micro, respectively. Counter Point is a venture capital fund sponsored and managed by Dr. Robb. Since no entity of the related parties has power but, as a group, the Company and its related parties have the power, then the party within the related party group that is most closely associated with the VIE, MTI Micro, is the primary beneficiary. Even though Dr. Robb and Counterpoint combined control a majority of the outstanding common stock, and they have the ability to elect the directors of MTI Micro and decide whether to continue to seek business opportunities for MTI Micro or instead seek opportunities to sell the intellectual property, they have not elected to do so. The Company continues to oversee the day to day operations, exercise management decision making, seek opportunities to sell intellectual property, and has a vested interest in the commercialization of MTI Micro s fuel cell technology. Since inception in 2001, the Company has made the largest investment and been the principal funder of MTI Micro. The Company has also been exposed to losses and has the ability to benefit from MTI Micro. Considering the facts and circumstances, management believes the Company is most closely associated with the VIE, MTI Micro, and therefore, it is the primary beneficiary.

Should there be a change in the facts and circumstances (such as undertaking additional activities, a change in governance or a change to the related party group) in the future, management will reassess whether the Company remains the primary beneficiary and should continue to include MTI Micro in the Company s condensed consolidated financial statements.

Non-controlling interests (NCI) are classified as stockholders equity in the condensed consolidated financial statements. The condensed consolidated income statement presents condensed net income (loss) for both the Company and the non-controlling interests. The calculation of earnings per share is based on net income (loss) attributable to the Company.

Reclassifications

It is the Company s policy to reclassify prior year consolidated financial statements to conform to current year presentation, if applicable. Prior period amounts related to prototype evaluation agreements have been reclassified. The three months ended June 30, 2011 and the six months ended June 30, 2011 were adjusted by $14 thousand and $100 thousand, respectively. The financial statement lines impacted in the Condensed Consolidated Statements of Operations were reductions to Unfunded and Total research and product development expenses and Operating loss and increased expenses to Other income (expense), net.

3. Accounts Receivable

Receivable balances consist of the following at:

(Dollars in thousands)	Test and Measurement Instrumentation		New Energy		Consolidated Totals	
June 30, 2012						
U.S. Government	$	6	$		$	6
Commercial		644				644
Total	$	650	$		$	650
December 31, 2011						
U.S. Government	$	990	$		$	990
Commercial		887		4		891
Total	$	1,877	$	4	$	1,881

For the six months ended June 30, 2012 and 2011, the largest commercial customer represented 9.6% and 17.1%, respectively, and a U.S. governmental agency represented 14.7% and 7.7%, respectively, of the Company s Test and Measurement Instrumentation segment product revenue. As of June 30, 2012 and December 31, 2011, the largest commercial customer represented 10.5% and 10.0%, respectively, and a U.S. governmental agency represented 0.3% and 52.7%, respectively, of the Company s Test and Measurement Instrumentation segment accounts receivable.

As of June 30, 2012, there were no outstanding receivables for the New Energy segment. The balance as of December 31, 2011 represents minimal amounts due for service contracts.

As of June 30, 2012 and December 31, 2011, the Company had no allowance for doubtful uncollectible accounts receivable.

4. Inventories

Inventories consist of the following at:

(Dollars in thousands)	June 30, 2012	December 31, 2011
Finished goods	$ 423	$ 310
Work in process	302	211
Raw materials	444	436
	$ 1,169	$ 957

As of June 30, 2012 and December 31, 2011, the Company had an inventory reserve of $311 thousand and $243 thousand, respectively.

5. Property, Plant and Equipment

Property, plant and equipment consist of the following at:

	June 30, 2012	**December 31, 2011**
(Dollars in thousands)		
Leasehold improvements	$ 954	$ 1,213
Computers and related software	1,719	2,130
Machinery and equipment	1,392	3,541
Office furniture and fixtures	277	457
	4,342	7,341
Less accumulated depreciation	4,159	7,083
	$ 183	$ 258

Depreciation expense was $73 thousand and $307 thousand for the six months ended June 30, 2012 and the year ended December 31, 2011, respectively. In conjunction with the suspension of MTI Micro in late 2011, sales of certain surplus equipment on hand were made during the three months ended June 30, 2012. This resulted in a net gain on sale of $130 thousand. As of June 30, 2012, $91 thousand of the sales proceeds have been received and $51 thousand was due to the Company and included in   Prepaid expenses and other current assets   on the Condensed Consolidated Balance Sheet as of June 30, 2012.

6. Income Taxes

During the quarter ended June 30, 2012, the Company   s effective income tax rate was 0%. The projected annual effective tax rate is less than the Federal statutory rate of 35%, primarily due to the permanent difference related to the stock-based compensation expense for employees of MTI Micro who transferred to MTI. For the quarter ended June 30, 2011, the Company   s effective income tax rate was also 0%. The difference between the annual effective tax rate and the Federal statutory rate was the result of the change in the valuation allowance and the gain on derivative.

During the six months ended June 30, 2012, the Company   s effective income tax rate was 0%. The projected annual effective tax rate is less than the Federal statutory rate of 35%, primarily due to the permanent difference related to the stock-based compensation expense for employees of MTI Micro who transferred to MTI. For the six months ended June 30, 2011, the Company   s effective income tax rate was also 0%. The difference between the annual effective tax rate and the Federal statutory rate was the result of the change in the valuation allowance and the gain on derivative.

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

As a result of our analyses in 2011, the Company released a portion of our valuation allowance against its deferred tax assets. The partial release of the valuation allowance caused an incremental tax benefit of $1.5 million to be recognized in the fourth quarter of 2011. The release of a portion of the valuation allowance was based upon a recent cumulative income history for MTI and its subsidiary exclusive of MTI Micro (MTI Micro files separate federal and state tax returns) causing the Company to evaluate what portion of the Company's deferred tax assets it believes are more likely than not to be realized. The Company has determined that it expects to generate sufficient levels of pre-tax earnings in the future to realize the net deferred tax assets recorded on the balance sheet at June 30, 2012. The Company has projected such pre-tax earnings utilizing a combination of historical and projected results, taking into consideration existing levels of permanent differences, non-deductible expense and the reversal of significant temporary differences. The Company needs to generate approximately $225 thousand of taxable income in each year over the next twenty years to ensure the realizability of the approximately $1.5 million of deferred tax assets recorded on the condensed consolidated balance sheet at June 30, 2012.

The Company believes that the accounting estimate for the valuation of deferred tax assets is a critical accounting estimate because judgment is required in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns. The Company based the estimate of deferred tax assets and liabilities on current tax laws and rates and, in certain cases, business plans and other expectations about future outcomes. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to adjust the recorded valuation allowance, which could materially impact our financial position and results of operations. The valuation allowance was approximately $18 million at June 30, 2012 and $20 million at December 31, 2011, respectively. This decrease was primarily the result of a one-time adjustment in the deferred tax asset related to stock compensation expense for options that have lapsed or been voluntarily surrendered to the Company. The Company will continue to evaluate the ability to realize its deferred tax assets and related valuation allowances on a quarterly basis.

7. Stockholders Equity

Common Stock

The Company has one class of common stock, par value $.01. Each share of the Company s common stock is entitled to one vote on all matters submitted to stockholders. As of June 30, 2012 and December 31, 2011, there were 5,256,883 and 5,254,883 shares of common stock issued and outstanding, respectively.

Changes in common shares issued and treasury stock outstanding are as follows:

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
Common Shares		
Balance, beginning	6,259,975	5,776,750
Issuance of shares for common stock grants	2,000	
Issuance of shares for restricted stock grants		483,225
Balance, ending	6,261,975	6,259,975
Treasury Stock		
Balance, beginning	1,005,092	1,005,092
Balance, ending	1,005,092	1,005,092

Warrants Issued

On December 20, 2006, the Company issued warrants to investors to purchase 378,472 shares of the Company s common stock at an exercise price of $18.16 per share. These warrants were fair valued by the Company until their expiration on December 19, 2011.

The Company recognized these derivatives as liabilities in the statement of financial position and measured these instruments at fair value. The fair value of the derivative was recorded in the Derivative liability line on the financial statements, and was valued quarterly using the Black-Scholes Option Pricing Model. Gains and losses on derivatives are included in Gain / Loss on derivatives in the Condensed Consolidated Statement of Operations. During the six month period ended June 30, 2011, the Company recognized a gain on derivatives of $73 thousand.

Reservation of Shares

The Company had reserved common shares for future issuance as of June 30, 2012 as follows:

Stock options outstanding	412,555
Common stock available for equity awards or issuance of options	600,000
Number of common shares reserved	1,012,555

Earnings (Loss) per Share

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

Not included in the computation of earnings per share, assuming dilution, for the three and six months ended June 30, 2012, were options to purchase 412,555 shares of the Company s common stock. These potentially dilutive items were excluded because the Company incurred a loss for this period and their inclusion would be anti-dilutive.

Not included in the computation of earnings per share, assuming dilution, for the three and six months ended June 30, 2011, were options to purchase 850,236 shares of the Company s common stock and warrants to purchase 378,472 shares of the Company s common stock. These potentially dilutive items were excluded because the average market price of the common stock did not exceed the exercise prices of the options and warrants for this period.

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

As of June 30, 2012, the Company owned approximately 47.6% of MTI Micro s outstanding common stock, or 75,049,937 shares, and 53.3% of common stock and warrants issued, which includes 32,904,136 outstanding warrants. The number of shares of MTI Micro common stock authorized for issuance is 240,000,000 as of June 30, 2012.

Common Stock Issued MTI Micro

On January 11, 2010, MTI Micro entered into a Purchase Agreement with Counter Point. Counter Point is a venture capital fund sponsored and managed by Dr. Walter L. Robb, a member of the Board of Directors of the Company and MTI Micro, and a current stockholder of MTI Micro. Pursuant to the Purchase Agreement, MTI Micro issued and sold to Counter Point 28,571,429 shares of common stock, par value $0.01 per share (the MTI Micro Common Stock), at a purchase price per share of $0.07, over a period of twelve months, and warrants (MTI Micro Warrants) to purchase shares of MTI Micro Common Stock equal to 20% of the shares of MTI Micro Common Stock purchased under the Purchase Agreement at an exercise price of $0.07 per share. The sale and issuance of the MTI Micro Common Stock and MTI Micro Warrants occurred over multiple closings (each, a Closing). Nine Closings occurred through December 31, 2010, with MTI Micro raising $1.9 million from the sale of 26,952,386 shares of MTI Micro Common Stock and MTI Micro Warrants to purchase 5,390,477 shares of MTI Micro Common Stock to Counter Point. The final Closing occurred on January 5, 2011, with MTI Micro raising $113 thousand from the sale of 1,619,043 shares of MTI Micro Common Stock and MTI Micro Warrants to purchase 323,809 shares of MTI Micro Common Stock to Counter Point.

On February 9, 2011, Amendment No. 1 was entered into between MTI Micro and Counter Point. Pursuant to Amendment No. 1, MTI Micro issued and sold to Counter Point 6,428,574 shares of MTI Micro Common Stock at a purchase price per share of $0.07, through December 31, 2011, and MTI Micro Warrants to purchase shares of MTI Micro Common Stock equal to 20% of the shares of MTI Micro Common Stock purchased under Amendment No. 2 at an exercise price of $0.07 per share. The sale and issuance of the MTI Micro Common Stock and MTI Micro Warrants occurred over multiple closings (each, a Closing) occurring over four one-month closing periods (each, a Closing Period). Four Closings occurred through September 30, 2011, with MTI Micro raising $450 thousand from the sale of 6,428,574 shares of MTI Micro Common Stock and MTI Micro Warrants to purchase 1,285,715 shares of MTI Micro Common Stock to Counter Point.

On September 23, 2011, Amendment No. 2 was entered into between MTI Micro and Counter Point. Pursuant to Amendment No. 2, MTI Micro issued and sold to Counter Point 1,200,000 shares of MTI Micro Common Stock at a purchase price per share of $0.07, through December 31, 2011, and MTI Micro Warrants to purchase shares of MTI Micro Common Stock equal to 20% of the shares of MTI Micro Common Stock purchased under Amendment No. 2 at an exercise price of $0.07 per share. The sale and issuance of the MTI Micro Common Stock and MTI Micro Warrants occurred over multiple closings (each, a Closing) occurring over three one-month closing periods (each, a Closing Period). Three Closings occurred through December 31, 2011, with MTI Micro raising $84 thousand from the sale of 1,200,000 shares of MTI Micro Common Stock and MTI Micro Warrants to purchase 240,000 shares of MTI Micro Common Stock to Counter Point.

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

		MTI		Non Controlling Interest (NCI)		
	Average Price	Shares	Ownership %	Shares	Ownership %	Total Shares
Balance at 12/31/10		75,049,937	50.6	73,325,490	49.4	148,375,427
Stock issued under Purchase Agreement, 2011	$0.07			1,619,043		1,619,043
Balance after Purchase Agreement		75,049,937	50.04	74,944,533	49.97	149,994,470
Stock issued under Amendment No. 1	$0.07			6,428,574		6,428,574
Stock issues under Amendment No. 2	$0.07			1,200,000		1,200,000
Balance at 12/31/11		75,049,937	47.61	82,573,107	52.39	157,623,044
Balance at 6/30/12		75,049,937	47.61	82,573,107	52.39	157,623,044

Reservation of Shares

MTI Micro has reserved common shares for future issuance, broken down between the Company and NCI, as follows as of June 30, 2012:

	MTI	NCI	Total
Stock options outstanding		22,253,560	22,253,560
Warrants outstanding	32,904,136	12,196,411	45,100,547
Number of shares reserved for outstanding options and warrants	32,904,136	34,449,971	67,354,107

In addition, MTI Micro has 15,688,637 stock options available for issuance.

As of June 30, 2012, the Company owned an aggregate of approximately 47.6% of the outstanding shares of MTI Micro or 53.3% of the outstanding common stock and warrants issued of MTI Micro, and Counter Point and Dr. Robb owned approximately 45.2% and 5.1%, respectively of the outstanding shares of MTI Micro or 40.3% and 4.3%, respectively of the outstanding common stock and warrants issued of MTI Micro.

Warrants Issued MTI Micro

On December 9, 2009, MTI Micro issued warrants to the then current shareholders of MTI Micro, including the Company, without consideration, to purchase 32,779,310 shares of MTI Micro Common Stock at an exercise price of $0.07 per share. The warrants became exercisable on December 9, 2010 and expire on December 8, 2017. The warrants have been accounted for as an equity distribution of $2.0 million, including warrants to the Company with a value of $2.0 million, which were eliminated in consolidation.

On December 9, 2009, MTI Micro issued warrants to the Bridge Investors of MTI Micro, including the Company, to purchase 5,081,237 shares of MTI Micro Common Stock at an exercise price of $0.07 per share. The MTI Micro Warrants became exercisable on December 9, 2009 and will expire on the earlier of: (i) April 15, 2014; (ii) immediately prior to a change in control; or (iii) immediately prior to an initial public offering of MTI Micro. The MTI Micro Warrants were issued without consideration and were accounted for as equity and a loss on extinguishment of debt was recorded in the amount of $289 thousand, including warrants to the Company with a value of $57 thousand, which were eliminated in consolidation.

Under the Purchase Agreement entered into on January 11, 2010, MTI Micro issued 5,714,286 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of $0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

Under Amendment No. 1 entered into on February 9, 2011, MTI Micro issued 1,285,715 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of $0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

Under Amendment No. 2 entered into on September 23, 2011, MTI Micro issued 240,000 MTI Micro Warrants to Counter Point to purchase shares of MTI Micro Common Stock at an exercise price of $0.07 per share. The MTI Micro Warrants became exercisable on the date of issuance and will expire on the earlier of: (a) the five (5) year anniversary of the Date of Issuance of the Warrant; (b) immediately prior to a change in control; or (c) the closing of a firm commitment underwritten public offering pursuant to a registration statement under the Securities Act. The MTI Micro Warrants were accounted for as equity.

9. Fair Value Measurement

The Company performs a detailed analysis of financial assets and liabilities in determining the appropriate levels of classification. At each reporting period, all assets and liabilities for which the fair value measurements are based upon significant unobservable inputs are classified as Level 3. The derivative liability was valued using the Black-Sholes Option Pricing Model, which is based upon unobservable inputs. The derivative liability was $0 as of June 30, 2012 and December 31, 2011. The Company had no Level 1 and no Level 2 assets and liabilities as of June 30, 2012 and December 31, 2011.

The following is a rollforward of Level 3 fair value instruments for the twelve months ended December 31, 2011:

(Dollars in thousands)

Instrument	**Beginning Balance as of January 1, 2011**	**Total (Gains) / Losses Realized and Unrealized**	**Purchases, Issuances, Sales and Settlements**	**Ending Balance as of December 31, 2011**
Derivative liability	$73	$ (73)	$	$
Total Level 3 instruments	$73	$ (73)	$	$

10. Segment Information

The Company operates in two business segments**,** Test and Measurement Instrumentation and New Energy. The Test and Measurement Instrumentation segment designs, manufactures, markets and services high performance test and measurement instruments and systems, wafer characterization tools for the semiconductor and solar industries, tensile stage systems for materials testing at academic and industrial settings, and computer-based balancing systems for aircraft engines. The New Energy segment is focused on commercializing direct methanol fuel cells. The Company s principal operations are located in North America.

The accounting policies of the Test and Measurement Instrumentation and New Energy segments are similar to those described in the summary of significant accounting policies in the Company s Annual Report on Form 10-K (Note 2). The Company evaluates performance based on profit or loss from operations before income taxes. Inter-segment sales and expenses are not significant.

Summarized financial information concerning the Company s reportable segments is shown in the following table. The Other column includes corporate related items and items such as income taxes or unusual items, which are not allocated to reportable segments. The Reconciling Items column includes a non-controlling interest in a consolidated entity. In addition, segments non-cash items include any depreciation in reported profit or loss.

(Dollars in thousands)	Test and Measurement Instrumentation	New Energy	Other	Reconciling Items	Condensed Consolidated Totals
Three months ended June 30, 2012					
Product revenue	$ 1,366	$	$	$	$ 1,366

Research and product development expenses	337				337
Selling, general and administrative expenses	433	60	485		978
Segment (loss) profit from operations before non-controlling interest	(345)	116	(280)		(509)
Segment (loss) profit	(345)	116	(280)	(61)	(570)
Total assets	1,984	199	2,931		5,114