SL INDUSTRIES INC
Form 10-Q
October 29, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

Commission file number 1-4987

SL INDUSTRIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**21-0682685**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

520 Fellowship Road, Suite A114, Mt. Laurel, NJ	**08054**
(Address of principal executive offices)	**(Zip Code)**

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

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting Company x

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

The number of shares of common stock outstanding as of October 22, 2013 was 4,122,000.

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Item 1. Financial Statements

SL INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,032,000	$ 3,196,000
Receivables, net	33,671,000	30,306,000
Inventories, net	25,756,000	22,102,000
Other current assets	5,498,000	2,098,000
Deferred income taxes, net	3,704,000	3,415,000
Total current assets	70,661,000	61,117,000
Property, plant and equipment, net	10,830,000	9,593,000
Deferred income taxes, net	9,238,000	9,719,000
Goodwill	22,723,000	22,735,000
Other intangible assets, net	2,342,000	2,670,000
Other assets and deferred charges, net	1,399,000	1,303,000
Total assets	$ 117,193,000	$ 107,137,000
LIABILITIES		
Current liabilities:		
Debt, current portion	$ 3,500,000	$
Accounts payable	18,592,000	18,838,000
Accrued income taxes	94,000	429,000
Accrued liabilities:		
Payroll and related costs	5,420,000	4,955,000
Other	11,386,000	10,586,000
Total current liabilities	38,992,000	34,808,000
Deferred compensation and supplemental retirement benefits	1,755,000	1,930,000
Other long-term liabilities	18,470,000	19,967,000
Total liabilities	59,217,000	56,705,000
Commitments and contingencies		

SHAREHOLDERS EQUITY		
Preferred stock, no par value; authorized, 6,000,000 shares; none issued		
Common stock, $.20 par value; authorized, 25,000,000 shares; issued, 6,656,000 and 6,656,000 shares, respectively	1,331,000	1,331,000
Capital in excess of par value	22,007,000	21,578,000
Retained earnings	60,213,000	52,280,000
Accumulated other comprehensive (loss)	(132,000)	(452,000)
Treasury stock at cost, 2,525,000 and 2,517,000 shares, respectively	(25,443,000)	(24,305,000)
Total shareholders equity	57,976,000	50,432,000
Total liabilities and shareholders equity	$ 117,193,000	$ 107,137,000

See accompanying notes to consolidated financial statements.

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SL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales	$ 52,999,000	$ 50,886,000	$ 151,880,000	$ 149,125,000
Cost and expenses:				
Cost of products sold	35,772,000	34,572,000	100,735,000	101,099,000
Engineering and product development	3,187,000	3,182,000	10,362,000	9,157,000
Selling, general and administrative	8,757,000	8,081,000	26,668,000	27,729,000
Depreciation and amortization	578,000	666,000	1,793,000	2,038,000
Restructuring charges		852,000		852,000
Total cost and expenses	48,294,000	47,353,000	139,558,000	140,875,000
Income from operations	4,705,000	3,533,000	12,322,000	8,250,000
Other income (expense):				
Amortization of deferred financing costs	(21,000)	(46,000)	(60,000)	(118,000)
Interest income	8,000	1,000	11,000	4,000
Interest expense	(21,000)	(8,000)	(71,000)	(39,000)
Other gain (loss), net	(21,000)	312,000	(348,000)	142,000
Income from continuing operations before income taxes	4,650,000	3,792,000	11,854,000	8,239,000
Income tax provision	1,216,000	927,000	3,184,000	2,520,000
Income from continuing operations	3,434,000	2,865,000	8,670,000	5,719,000
(Loss) from discontinued operations, net of tax	(282,000)	(464,000)	(737,000)	(902,000)
Net income	$ 3,152,000	$ 2,401,000	$ 7,933,000	$ 4,817,000
Basic net income (loss) per common share				
Income from continuing operations	$ 0.83	$ 0.69	$ 2.09	$ 1.31
(Loss) from discontinued operations, net of tax	(0.07)	(0.11)	(0.18)	(0.21)
Net income	$ 0.76	$ 0.58	$ 1.91	$ 1.10
Diluted net income (loss) per common share				
Income from continuing operations	$ 0.82	$ 0.69	$ 2.07	$ 1.30
(Loss) from discontinued operations, net of tax	(0.07)	(0.11)	(0.18)	(0.20)

Net income	$ 0.75	$ 0.58	$ 1.89	$ 1.10
Shares used in computing basic net income (loss) per common share	4,134,000	4,121,000	4,144,000	4,375,000
Shares used in computing diluted net income (loss) per common share	4,184,000	4,133,000	4,190,000	4,390,000

SL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$ 3,152,000	$ 2,401,000	$ 7,933,000	$ 4,817,000
Other comprehensive income, net of tax:				
Foreign currency translation	22,000	28,000	115,000	(66,000)
Net unrealized gain on available-for-sale securities	205,000		205,000	
Comprehensive income	$ 3,379,000	$ 2,429,000	$ 8,253,000	$ 4,751,000

See accompanying notes to consolidated financial statements.

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SL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30,

(Unaudited)

	2013	2012
OPERATING ACTIVITIES:		
Net income	$ 7,933,000	$ 4,817,000
Adjustment for losses from discontinued operations	737,000	902,000
Income from continuing operations	8,670,000	5,719,000
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation	1,345,000	1,316,000
Amortization	448,000	722,000
Amortization of deferred financing costs	60,000	118,000
Stock-based compensation	446,000	909,000
Excess tax benefit on stock compensation	(120,000)	
Loss (gain) on foreign exchange contracts	348,000	(142,000)
Provisions for losses on accounts receivable	38,000	54,000
Deferred compensation and supplemental retirement benefits	223,000	265,000
Deferred compensation and supplemental retirement benefit payments	(388,000)	(404,000)
Deferred income taxes	191,000	(412,000)
Loss on sale of equipment		21,000
Changes in operating assets and liabilities, excluding effects of business combinations:		
Accounts receivable	(3,339,000)	(1,237,000)
Inventories	(3,568,000)	133,000
Other assets	(823,000)	(542,000)
Accounts payable	(389,000)	(154,000)
Other accrued liabilities	2,343,000	(249,000)
Accrued income taxes	(349,000)	234,000
Net cash provided by operating activities from continuing operations	5,136,000	6,351,000
Net cash (used in) operating activities from discontinued operations	(3,607,000)	(780,000)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,529,000	5,571,000
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(2,541,000)	(1,432,000)
Purchases of available-for-sale securities	(2,362,000)	
Acquisition of a business, net of cash acquired		(756,000)

Purchases of other assets	(223,000)	(202,000)
NET CASH (USED IN) INVESTING ACTIVITIES	(5,126,000)	(2,390,000)
FINANCING ACTIVITIES:		
Proceeds from Senior Revolving Credit Facility	25,090,000	
Payments of Senior Revolving Credit Facility	(21,590,000)	
Proceeds from Revolving Credit Facility		4,100,000
Payments of Revolving Credit Facility		(4,100,000)
Payments of deferred financing costs	(42,000)	(316,000)
Repurchase and retirement of common stock		(4,262,000)
Treasury stock purchases	(1,803,000)	(2,468,000)
Proceeds from stock options exercised	631,000	
Excess tax benefit on stock compensation	120,000	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	2,406,000	(7,046,000)
Effect of exchange rate changes on cash	27,000	16,000
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,164,000)	(3,849,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	3,196,000	5,632,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 2,032,000	$ 1,783,000
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$ 66,000	$ 39,000
Income taxes	$ 2,765,000	$ 2,256,000

See accompanying notes to consolidated financial statements.

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SL INDUSTRIES, INC.

Notes to Consolidated Financial Statements (Unaudited)

1. Basis Of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These financial statements should be read in conjunction with the Company s audited financial statements and notes thereon included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012. Unless the context requires otherwise, the terms the Company, SL Industries, we, us and our mean SL Industries, Inc., a Delaware corporati and its consolidated subsidiaries after Reincorporation (defined and described below) and SL Industries, Inc., a New Jersey corporation prior to Reincorporation. In the context of describing the Reincorporation, SL-NJ means SL Industries, Inc., a New Jersey corporation, and SL-DE means SL Industries, Inc., a Delaware corporation and wholly owned subsidiary of SL-NJ.

On May 9, 2013, the Company s shareholders voted to approve a proposal to change the state of incorporation of SL Industries from the State of New Jersey to the State of Delaware by merging SL-NJ with and into SL-DE (the Reincorporation). On June 20, 2013 (the Effective Date), the Reincorporation was effected by merging SL-NJ with and into SL-DE pursuant to an Agreement and Plan of Merger, dated June 3, 2012, between SL-NJ and SL-DE. SL-DE survived the merger and SL-NJ ceased to exist. The principal reason for the Reincorporation was to give the Company a greater measure of flexibility and simplicity in corporate governance and provide greater clarity and predictability with respect to the Company s corporate legal affairs. The Reincorporation did not result in any change in the name, business, management, fiscal year, accounting, location of the principal executive officers, assets or liabilities or net worth (other than the costs of reincorporation which were immaterial) of the Company.

2. Receivables

Receivables consist of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Trade receivables	$ 32,392	$ 29,284
Less: allowance for doubtful accounts	(626)	(591)
Trade receivables, net	31,766	28,693
Other	1,905	1,613
Receivables, net	$ 33,671	$ 30,306

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3. Inventories

Inventories consist of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Raw materials	$ 18,499	$ 15,726
Work in process	5,566	4,623
Finished goods	4,374	4,819
Gross inventory	28,439	25,168
Less: allowances	(2,683)	(3,066)
Inventories, net	$ 25,756	$ 22,102

4. Income Per Share

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

Diluted net income per common share is computed by dividing reported net income available to common shareholders by the weighted average shares outstanding for the period, adjusted for the dilutive effect of common stock equivalents, which consist of stock options, using the treasury stock method.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands, except per share amounts)			
Basic net income available to common shareholders:				
Net income available to common shareholders from continuing operations	$ 3,434	$ 2,865	$ 8,670	$ 5,719
Diluted net income available to common shareholders from continuing operations	$ 3,434	$ 2,865	$ 8,670	$ 5,719
Shares:				
Basic weighted average number of common shares outstanding	4,134	4,121	4,144	4,375
Common shares assumed upon exercise of stock options	50	12	46	15
Diluted weighted average number of common shares outstanding	4,184	4,133	4,190	4,390
Basic net income (loss) per common share:				
Income from continuing operations	$ 0.83	$ 0.69	$ 2.09	$ 1.31
(Loss) from discontinued operations (net of tax)	(0.07)	(0.11)	(0.18)	(0.21)
Net income	$ 0.76	$ 0.58	$ 1.91	$ 1.10
Diluted net income (loss) per common share:				
Income from continuing operations	$ 0.82	$ 0.69	$ 2.07	$ 1.30
(Loss) from discontinued operations (net of tax)	(0.07)	(0.11)	(0.18)	(0.20)
Net income	$ 0.75	$ 0.58	$ 1.89	$ 1.10

For the three and nine months ended September 30, 2013, no stock options were excluded from the dilutive computation because the option exercise prices were not greater than the average market price of the Company s common stock.

For the three and nine months ended September 30, 2012, 9,000 and 6,000 stock options were excluded from the dilutive computation, respectively, because the option exercise prices were greater than the average market price of the Company s common stock.

5. Stock-Based Compensation

At September 30, 2013, total compensation expense (included in selling, general and administrative expense) related to stock-based compensation plans for the three and nine months ended September 30, 2013 was $114,000 and $446,000 ($85,000 and $326,000 net of tax), respectively. For the three and nine months ended September 30, 2012, total compensation expense was $165,000 and $909,000 ($154,000 and $631,000, net of tax), respectively.

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During the first quarter of 2013, the Company implemented a Long-Term Incentive Plan (the 2013 LTIP) pursuant to the 2008 Incentive Stock Plan (the 2008 Plan) which awarded restricted stock units (RSUs) to eligible executives. Under the terms of the 2013 LTIP, the number of RSUs that may vest, if any, will be based on, among other things, the Company achieving certain sales and return on invested capital (ROIC), as defined, targets during the January 2013 to December 2015 performance period. Earned RSUs, if any, cliff vest at the end of fiscal 2015 (100% of earned RSUs vest at December 31, 2015). The final value of these RSUs will be determined by the number of shares earned. The value of these RSUs is charged to compensation expense on a straight-line basis over the three year vesting period with periodic adjustments to account for changes in anticipated award amounts. The weighted-average price for these RSUs was $19.17 per share based on the grant date of March 5, 2013. During the three and nine months ended September 30, 2013, $31,000 and $74,000 was charged to compensation expense, respectively. As of September 30, 2013, total unamortized compensation expense for this grant was $292,000. As of September 30, 2013, the maximum number of achievable RSUs under the 2013 LTIP was 28,000 RSUs.

On May 9, 2013, the Company granted each Director 3,000 restricted shares pursuant to the 2008 Plan. The shares vest upon the first anniversary of the grant date. Based on the terms of the awards the value of these restricted shares is charged to compensation expense on a straight-line basis over the one year vesting period. As a result, the Company recognized $77,000 and $122,000 of stock compensation expense during the three and nine months ended September 30, 2013, respectively. As of September 30, 2013, total unamortized compensation expense for this grant was $187,000. The weighted-average price of these restricted stock grants was $20.60 per share based on the grant date of May 9, 2013. As of September 30, 2013, no shares were granted under this award.

Stock Options

Option activity under the principal option plans as of September 30, 2013 and changes during the nine months ended September 30, 2013 were as follows:

	Outstanding Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2012	135	$ 12.79	4.33	$ 670
Granted				
Exercised	(46)	13.64		
Forfeited				
Expired				
Outstanding as of September 30, 2013	89	$ 12.35	3.58	$ 1,129
Exercisable as of September 30, 2013	83	$ 11.99	3.54	$ 1,074

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the third quarter of fiscal 2013 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2013. This amount changes based on the fair market value of the Company s stock. The total intrinsic value of options exercised for the nine months ended September 30, 2013 was $563,000. No options were exercised during the nine months ended September 30, 2012.

As of September 30, 2013, $10,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 0.2 years.

Tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows. Cash received from option exercises for the nine months ended September 30, 2013 was $631,000. The actual tax benefit realized for the tax deduction from option exercises of share-based payment arrangements totaled $203,000 for the nine months ended September 30, 2013. No options were exercised during the nine months ended September 30, 2012. The Company has applied the Short-cut method in calculating the historical windfall tax benefits. All tax shortfalls will be applied against this windfall before being charged to earnings.

6. Income Tax

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

For the nine months ended September 30, 2013 and September 30, 2012, the estimated income tax rate from continuing operations was 27% and 31%, respectively. The decrease in the effective tax rate was primarily due to the recording of a research and development tax benefit of $906,000 in 2013, of which $431,000 was related to the retroactive reinstatement of the federal research and development tax credits from the enactment of the American Tax Relief Act of 2012. These credits were not available to the Company in 2012.

During the three months ended September 30, 2013, the Company recorded additional benefits from federal and state research and development tax credits of $245,000 and $67,000 respectively. During the nine months ended September 30, 2013, the Company recorded additional benefits from federal and state research and development tax credits of $741,000 and $165,000 respectively. The Company did not record additional benefits from federal and state research and development tax credits during the three and nine months ended September 30, 2012.

As of September 30, 2013, the Company s gross research and development tax credit carryforwards totaled approximately $1,120,000. Of these credits, approximately $453,000 can be carried forward for 15 years and will expire between 2015 and 2028, and approximately $667,000 of state credits can be carried forward indefinitely.

The Company has recorded gross unrecognized tax benefits, excluding interest and penalties, as of September 30, 2013 and December 31, 2012 of $819,000 and $595,000, respectively. Tax benefits are recorded pursuant to the provisions of ASC 740   Income Taxes.   If such unrecognized tax benefits are ultimately recorded in any period, the Company   s effective tax rate would be reduced accordingly for such period.

The Company has been examined by the Internal Revenue Service (the   IRS   ) through the calendar year 2010. State income tax statutes are generally open for periods back to and including the calendar year 2008.

It is reasonably possible that the Company   s gross unrecognized tax benefits balance may change within the next twelve months due to the expiration of the statutes of limitation of the federal government and various state governments by a range of zero to $38,000. The Company records such unrecognized tax benefits upon the expiration of the applicable statute of limitations or the settlement with tax authorities. As of September 30, 2013, the Company has a liability for unrecognized benefits of $529,000 for federal taxes and $290,000 for state taxes. Such benefits relate primarily to expenses incurred in those jurisdictions.

The Company classifies interest and penalties related to unrecognized tax benefits as income tax expense. At September 30, 2013, and December 31, 2012, the Company has accrued approximately $97,000 and $62,000 for the payment of interest and penalties, respectively.

The final regulations regarding the deduction and capitalization of expenditures related to tangible property were issued during the third quarter of 2013 by the IRS. The Company has reviewed these regulations and does not intend to early adopt or amend any previously filed returns. The implementation of these regulations did not have a material impact on the Company   s consolidated financial statements for the year ending December 31, 2013.

7. Recently Adopted and Issued Accounting Pronouncements

In July 2012, the FASB issued ASU 2012-02   Intangibles-Goodwill and Other:
Testing Indefinite-Lived Intangible Assets for Impairment,   which amends the guidance on impairment testing for indefinite-lived intangible assets. The amended guidance will allow companies to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. A company no longer will be required to test the fair value of an intangible asset unless the company determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU 2012-02 is effective for interim and annual periods beginning after September 15, 2012. The implementation of this guidance did not have a material impact on the Company   s consolidated financial statements.

In October 1, 2012, the FASB issued ASU 2012-04   Technical Corrections and Improvements,   which makes certain technical corrections and improvements and conforming amendments related to fair value measurements. The amendments represent changes to clarify, correct unintended application of, or make minor improvements to the FASB Accounting Standards Codification that are not expected to have a significant effect on current accounting practice. ASU 2012-04 is effective for fiscal periods beginning after December 15, 2012. The implementation of this guidance did not have a material impact on the Company   s consolidated financial statements.

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In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220) Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income, which requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety in the same reporting period. ASU 2013-02 is effective for fiscal periods beginning after December 15, 2012. The implementation of this guidance did not have a material impact on the Company s consolidated financial statements.

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matter (Topic 830): Parent s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity a consensus of the FASB Emerging Issues Task Force, which permits an entity to release cumulative translation adjustments into net income when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided, or, if a controlling financial interest is no longer held. ASU 2013-05 is effective for fiscal periods beginning after December 15, 2013. The implementation of this guidance is not expected to have a material impact on the Company s consolidated financial statements.

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

8. Goodwill And Intangible Assets

Acquisition in Fiscal 2012

On February 27, 2012, the Company purchased certain assets of Pro-Dex Astromec, Inc. (Astromec), a subsidiary of Pro-Dex Inc. (Pro-Dex), for approximately $1,050,000, which includes the assumption of liabilities for an estimated earn-out of $294,000. The acquisition was paid for in cash. SL Montevideo Technology, Inc. (SL-MTI) recorded direct acquisition costs of approximately $10,000 and $432,000 during the three and nine months ended September 30, 2012, respectively. Direct acquisition costs were recorded within selling, general and administrative expenses in the Consolidated Statements of Income.

At December 31, 2012, the financial statements reflected the final purchase price based on estimated fair values at the date of acquisition, including $670,000 in inventories, $202,000 in equipment, and $10,000 in other current assets. The acquisition resulted in intangible assets of $168,000 while no goodwill was recognized. Intangible assets were composed of a customer list with a useful life of 5 years. The purchase price also included $294,000 in liabilities related to an estimated earn-out, which is comprised of quarterly payments based on the performance of the acquired business over the three year period immediately following the date of acquisition. The total liability for the earn-out as of September 30, 2013 and December 31, 2012 was $130,000 and $221,000, respectively. During 2013, $119,000 was paid related to the earn-out. The results from the acquisition date through September 30, 2013 are included in the SL-MTI segment.

Goodwill And Intangible Assets

Intangible assets consist of the following:

		September 30, 2013			December 31, 2012		
	Amortizable Life (years)	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
				(in thousands)			
Finite-lived intangible assets:							
Customer relationships [1]	5 to 8	$ 3,868	$ 3,347	$ 521	$ 3,868	$ 3,078	$ 790
Patents [2]	5 to 20	1,291	1,211	80	1,285	1,187	98
Developed technology	5 to 6	1,700	1,700		1,700	1,700	
Licensing fees	5 to 10	450	381	69	450	340	110
Total amortized finite-lived intangible assets		7,309	6,639	670	7,303	6,305	998
Indefinite-lived intangible assets:							
Trademarks		1,672		1,672	1,672		1,672
Other intangible assets, net		$ 8,981	$ 6,639	$ 2,342	$ 8,975	$ 6,305	$ 2,670

(1) On February 27, 2012, the Company purchased certain assets of Astromec, a subsidiary of Pro-Dex. Included in the purchase price is a customer list valued at $168,000. The estimated useful life of the asset is 5 years.

(2) During 2013 and 2012, the Company s MTE division capitalized legal fees related to a new patent application. The estimated useful life of the asset is 20 years.

In accordance with ASC 350 Intangibles Goodwill and Other, goodwill and other indefinite-lived intangible assets are not amortized, but are tested for impairment. Such impairment testing is undertaken annually, or more frequently upon the occurrence of some indication that an impairment has taken place. The Company conducted an annual impairment test as of December 31, 2012.

A two-step process is utilized to determine if goodwill has been impaired. In the first step, the fair value of each reporting unit is compared to the net asset value recorded for such unit. If the fair value exceeds the net asset value,

the goodwill of the reporting unit is not adjusted. However, if the recorded net asset value exceeds the fair value, the Company performs a second step to measure the amount of impairment loss, if any. In the second step, the implied fair value of the reporting unit s goodwill is compared with the goodwill recorded for such unit. If the recorded amount of goodwill exceeds the implied fair value, an impairment loss is recognized in the amount of the excess.

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For the testing conducted as of December 31, 2012, the Company concluded that no impairment charge was warranted. Going forward there can be no assurance that economic conditions or other events may not have a negative material impact on the long-term business prospects of any of the Company s reporting units. In such case, the Company may need to record an impairment loss, as stated above. The next annual impairment test will be conducted as of December 31, 2013, unless management identifies a triggering event in the interim.

Management has not identified any triggering events, as defined by ASC 350, during 2013. Accordingly, no interim impairment test has been performed.

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

	Amortization Expense (in thousands)
2013	$ 440
2014	$ 401
2015	$ 59
2016	$ 40
2017	$ 11

Total amortization expense, excluding the amortization of deferred financing costs, consists of amortization expense related to intangible assets and software. Amortization expense related to intangible assets for the three months ended September 30, 2013 and September 30, 2012 was $110,000 and $202,000 respectively. Amortization expense related to intangible assets for the nine months ended September 30, 2013 and September 30, 2012 was $334,000 and $603,000, respectively. Amortization expense related to software for the three months ended September 30, 2013 and September 30, 2012 was $41,000 and $40,000, respectively. Amortization expense related to software for the nine months ended September 30, 2013 and September 30, 2012 was $114,000 and $119,000, respectively.

Changes in goodwill balances by segment (defined below) are as follows:

	Balance December 31, 2012	Translation Adjustment (in thousands)	Balance September 30, 2013
SL Power Electronics Corp.	$ 4,242	$ (12)	$ 4,230
High Power Group:			
MTE Corporation	8,189		8,189
Teal Electronics Corp.	5,055		5,055
RFL Electronics Inc.	5,249		5,249
Goodwill	$ 22,735	$ (12)	$ 22,723

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9. Investments

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

Available-for-sale securities consist of the following:

	September 30, 2013 (in thousands)		
	Amortized Cost	Gains in Accumulated Other Comprehensive Income	Estimated Fair Value
Common stock	$ 2,362	$ 326	$ 2,688

The Company had no available-for-sale securities as of December 31, 2012.

No available-for-sale securities were sold during the nine months ended September 30, 2013. Gross unrealized holding gains on available-for-sale securities for the three and nine months ended September 30, 2013 were $326,000 ($205,000 net of tax), have been included in accumulated other comprehensive income.

10. Debt

Debt as of September 30, 2013 consisted of the following:

	September 30, 2013 (in thousands)
2012 Credit Facility:	
$40 million variable interest rate revolving credit facility maturing in 2016	$ 3,500
Total debt	3,500
Less: current portion	(3,500)
Total long-term debt	$

The Company had no debt outstanding as of December 31, 2012.

On August 9, 2012, the Company entered into a Credit Agreement with PNC Bank, National Association, as administrative agent and lender (PNC Bank), and the lenders from time to time party thereto, as amended (the 2012 Credit Facility), to replace its Amended and Restated Revolving Credit Agreement with Bank of America, N.A, as amended (the 2008 Credit Facility). The 2012 Credit Facility provides for borrowings up to $40,000,000 and under certain conditions maximum borrowings up to $70,000,000. The 2012 Credit Facility included a $5,000,000 sublimit for letters of credit (subsequently amended on March 11, 2013, as described below) and provides for a separate $10,700,000 letter of credit which expires one year from the date of closing, with annual extensions. The 2012 Credit Facility expires on August 9, 2016.

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

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

On March 11, 2013, the Company entered into a First Amendment (the First Amendment) to the 2012 Credit Facility. The First Amendment, among other things, (a) amends the Letter of Credit (LC) sublimit amount to the lesser of (i) an amount equal to $5,000,000 plus the aggregate amount of Designated Usage LC issued and outstanding under the Designated Usage LC sublimit or (ii) $25,000,000 and (b) allows the Company to enter into foreign currency exchange services with Loan Parties on an unsecured basis and that such obligations shall not exceed at any time an aggregate amount equal to $3,500,000. In consideration for this amendment, the Company incurred $14,000 in fees and expenses, which are amortized over the remaining life of the 2012 Credit Facility.

On May 28, 2013 a letter of credit in the amount of $8,564,000 was issued in favor of the Environmental Protection Agency (EPA) to provide financial assurance related to the Company s environmental payments in accordance with the terms of the Consent Decree reached with the United States Department of Justice (DOJ) and EPA related to its liability for both OU-1 and OU-2 (see note 13 for additional information). The letter of credit expires on May 28, 2014 and requires an annual commitment fee of 0.125% and standby commission of 1%, and does not reduce amounts available under the 2012 Credit Facility.

On June 20, 2013, the Company entered into a Second Amendment and Joinder to Credit Agreement and to Security Agreement (the Second Amendment), which amends the 2012 Credit Facility in order to reflect the Reincorporation of the Company. The Second Amendment, among other things, joins the Company as a Borrower under the Credit Agreement and a Debtor under the Security Agreement entered into by SL-NJ in connection with the 2012 Credit Facility. In consideration for the Second Amendment, the Company incurred $28,000 in fees and expenses, which are amortized over the remaining life of the 2012 Credit Facility.

As of September 30, 2013, the Company had an outstanding balance of $3,500,000 under the 2012 Credit Facility. As of December 31, 2012 the Company had no outstanding balance under the 2012 Credit Facility. At September 30, 2013 and December 31, 2012, the Company had total availability under the 2012 Credit Facility of $36,026,000 and $39,510,000, respectively.

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11. Accrued Liabilities Other

Accrued liabilities other consist of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Taxes (other than income) and insurance	$ 667	$ 602
Commissions	634	680
Litigation and legal fees	118	138
Other professional fees	472	418
Environmental	4,820	5,334
Warranty	1,422	1,102
Deferred revenue	83	56
Acquisition earn-out, current	105	164
Other	3,065	2,092
Accrued liabilities other	$ 11,386	$ 10,586

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

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

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

	Nine Months Ended September 30, 2013
	(in thousands)
Liability, beginning of year	$ 1,102
Expense for new warranties issued	919
Warranty claims	(599)
Liability, end of period	$ 1,422

12. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Environmental	$ 17,200	$ 19,033
Unrecognized tax benefits, interest and penalties	916	657
Long-term incentive plan	329	220
Acquisition earn-out, long-term	25	57
Other long-term liabilities	$ 18,470	$ 19,967

13. Commitments and Contingencies

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

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

In 2006 the United States Environmental Protection Agency (the EPA) named the Company as a potential responsible party (a PRP) in connection with the remediation of the Puchack Well Field, which has been designated as a Superfund Site. The EPA is remediating the Puchack Well Field Superfund Site in two separate operable units. The first operable unit (OU-1) consists of an area of chromium groundwater contamination in three aquifers that exceeds the selected cleanup standard. The second operable unit (OU-2) pertains to sites that are allegedly the sources of contamination for the first operable unit. The EPA advised the Company in October 2010 that OU-2 includes soil contamination in the immediate vicinity of the Company s Pennsauken Site.

In June 2011, the EPA announced a proposed plan for cleaning up the soil at OU-2. The remedy proposed by the EPA is Geochemical Fixation. This remedy involves applying a chemical reductant to the contaminated soil to reduce hexavalent chromium by converting it to immobilized trivalent chromium. The EPA s estimated cost for this remedy is $20,700,000 over seven years. On September 26, 2011 the EPA issued a Record of Decision (ROD) selecting the Geochemical Fixation remedy.

The Company has reached an agreement with both the DOJ and EPA related to its liability for both OU-1 and OU-2 and has entered into a Consent Decree which governs the agreement, the terms of which are described below. The Company has agreed to perform the remediation for OU-2. Also, the Company has agreed to pay a fixed sum for the EPA s past cost for OU-2 and a portion of the EPA s past cost for OU-1. The payments are to be made in five equal payments of $2,141,000, for a total $10,705,000, plus interest. The Company has also agreed to pay the EPA s costs for oversight of the OU-2 remediation. The United States District Court judge signed the Consent Decree effective April 30, 2013, thereby triggering the Company s obligation under the Consent Decree. On May 10, 2013 the Company made the first payment related to its obligation under the Consent Decree in the amount of $2,185,000, which included interest. The next four payments will be made on the anniversary of the first payment plus ten days in the same amount of $2,141,000, plus interest. On May 28, 2013, a letter of credit in the amount of $8,564,000 was issued in favor of the EPA to provide financial assurance related to the Company s remaining obligation to pay for the EPA s past cost as mentioned above. Also, on July 19, 2013 the Company obtained financial assurance as required by the terms of the Consent Decree related to its obligations to remediate OU-2.

On December 3, 2012, the Company received a demand letter from the State of New Jersey. The demand is for $1,300,000 for past and future cleanup costs and $500,000 for natural resource damages (NRD) for a total of $1,800,000 (the New Jersey Claim). Although the Company and its counsel believe that it has meritorious defenses to any claim for reimbursement, the Company has offered to pay $250,000 to fully resolve the claim presented by the State of New Jersey for past costs, future costs and NRD at the Puchack Well Field Superfund site. The State of New Jersey is evaluating the Company s counter-offer. Based on the current available information, the Company has estimated a total combined potential liability for OU-1 and OU-2 and the New Jersey Claim to be in the range of $17,911,000 to $29,295,000 The Company has recorded an accrual of $17,911,000 related to its combined liability related to this site. The estimated OU-2 remediation liability is based upon the EPA s plan for remediation as provided in the ROD for OU-2 and the evaluation of data by the Company s environmental engineering consultants. The liability for OU-1 and OU-2 is based upon the current terms of the Consent Decree.

Other

During 2012, the Company conducted an investigation to determine whether certain employees of SL Xianghe Power Electronics Corporation, SL Shanghai Power Electronics Corporation and SL Shanghai International Trading Corporation, three of the Company s indirect wholly-owned subsidiaries incorporated and operating exclusively in China, may have improperly provided gifts and entertainment to government officials (the China Investigation). The Company had retained outside counsel and forensic accountants to assist in the China Investigation. Based upon the China Investigation, the estimated amounts of such gifts and entertainment were not material to the Company s financial statements. Such estimates did not take into account the costs to the Company of the China Investigation itself, or any other additional costs.

The China Investigation included determining whether there were any violations of laws, including the U.S. Foreign Corrupt Practices Act (FCPA). The Company s outside counsel contacted the DOJ and the Securities and Exchange Commission (the SEC) voluntarily to disclose that the Company was conducting an internal investigation, and agreed to cooperate fully. Additionally, the Company hired outside consultants to provide assistance in implementing a mandatory FCPA compliance program for all of its employees which was completed in December 2012. Also, during the first and second quarters of 2013 the Company engaged outside consultants to perform FCPA compliance tests at its operations in China and Mexico. On September 26, 2013, the DOJ notified the Company that it had closed its inquiry into this matter without filing criminal charges. The Company has not received an update from the SEC regarding the status of its inquiry. The Company cannot predict at this time whether any action may be taken by the SEC.

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

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Environmental Matters: Loss contingencies include potential obligations to investigate and eliminate or mitigate the effects on the environment of the disposal or release of certain chemical substances at various sites, such as Superfund sites and other facilities, whether or not they are currently in operation. The Company is currently participating in environmental assessments and cleanups at a number of sites and in the future may be involved in additional environmental assessments and cleanups. Based upon investigations completed to date by the Company and its independent engineering-consulting firms, management has provided an estimated accrual for all known costs believed to be probable and costs that can be reasonably estimated in the amount of $22,020,000, of which $17,200,000 is included as other long-term liabilities, with the remainder recorded as other short-term accrued liabilities, as of September 30, 2013. However, it is the nature of environmental contingencies that other circumstances might arise, the costs of which are indeterminable at this time due to such factors as changing government regulations and stricter standards, the unknown magnitude of cleanup costs, and the unknown timing and extent of the remedial actions that may be required. These other circumstances could result in additional expenses or judgments, or offsets thereto. The adverse resolution of any one or more of these other circumstances could have a material adverse effect on the business, operating results, financial condition or cash flows of the Company. The Company s environmental costs primarily relate to discontinued operations and such costs have been recorded in discontinued operations, net of tax.

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

With respect to the Camden Site, the Company has reported soil contamination and a groundwater contamination plume emanating from the site. The New Jersey Department of Environmental Protection (NJDEP) approved, and the Company implemented in 2010, an interim remedial action pilot study to inject neutralizing chemicals into the unsaturated soil. Based on an assessment of post-injection data, our consultants believe the pilot study can be implemented as a full scale soil remedy to treat unsaturated contaminated soil. A Remedial Action Workplan for soils (RAWP) is being developed. The RAWP will select the injection remedy as the site wide remedy for unsaturated soils, along with demolition and proper disposal of the former concrete building slab and targeted excavation and disposal of impacted soil immediately underlying the slab. Additionally, the RAWP will address a small area of impacted soil off the property. The RAWP will be submitted to the NJDEP, by the Licensed Site Remediation Professional (LSRP) for the site. The RAWP is scheduled to be implemented in 2014. Also, the Company s environmental consultants finalized an interim remedial action pilot study to treat on-site contaminated groundwater, consisting of injecting food-grade product, into the groundwater at the down gradient property boundary, to create a bio-barrier. The pilot study includes post-injection monitoring to assess the bio-barrier s ability to treat contaminated groundwater. Implementation of the groundwater pilot study is currently underway with post-injection effectiveness monitoring expected to continue through 2014.

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As previously reported, the Company is currently participating in environmental assessments and cleanups at a number of sites. One of these sites is a commercial facility, located in Wayne, New Jersey. Contaminated soil and groundwater has undergone remediation with NJDEP oversight, but contaminants of concern (COCs) in groundwater and surface water, which extend off-site, still remain above applicable NJDEP remediation standards. Certain COCs have also been detected in the indoor air of two commercial buildings, located on the property. One of the buildings (the Main Building) was outfitted with a sub-slab depressurization system as a mitigation measure. The source investigations under the Main Building were completed in June 2012. Soil and groundwater samples collected from underneath the Main Building identified COCs in excess of the NJDEP s applicable remediation standards. Consequently, a soil contaminant source remains under the Main Building that is feeding the groundwater contamination. A soil remedial action plan will be required in order to remove the new soil source contamination by a second building that continues to impact groundwater. Our consultants have reviewed data to determine what supplemental remedial action is necessary for soils, and whether to modify or expand the groundwater remedy that will likely consist of additional in-situ injections of food grade product into the groundwater. Estimates have been developed by the Company s consultants, which includes costs to enhance the existing vapor intrusion system, remedial injections, soil excavation and additional tests and remedial activities. Costs related to this site are recorded as part of discontinued operations, net of tax.

The Company has reported soil and groundwater contamination at the facility of SL-MTI located on its property in Montevideo, Minnesota. An analysis of the contamination has been completed and a remediation plan has been implemented at the site pursuant to the remedial action plan approved by the Minnesota Pollution Control Agency. The remaining steps under this plan are the monitoring of samples. Costs related to this site are recorded as a component of continuing operations.

As of September 30, 2013 and December 31, 2012, environmental accruals of $22,020,000 and $24,367,000, respectively, have been recorded by the Company in accrued liabilities other and in other long-term liabilities, as appropriate (see Notes 11 and 12 for additional information).

14. Segment Information

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

- nature of products and services
- nature of production process
- type or class of customer
- methods of distribution

SLPE designs, manufactures and markets high-reliability power conversion products in internal and external footprints. The Company s power supplies provide a reliable and safe power source for the customer s specific equipment needs. SLPE, which sells products under three brand names (SL Power Electronics, Condor and Ault), is a major supplier to the original equipment manufacturers (OEMs) of medical, industrial/instrumentation, military and information technology equipment. The High Power Group sells products under two brand names (TEAL and MTE). TEAL designs and manufactures custom power conditioning and distribution units for OEMs of medical imaging, medical treatment, military aerospace, semiconductor, solar and advanced simulation systems. MTE designs and manufactures power quality products used to protect equipment from power surges, bring harmonics into compliance and improve the efficiency of variable speed motor drive systems. SL-MTI designs and manufactures high power density precision motors that are used in numerous applications, including military and commercial aerospace, oil and gas, and medical and industrial products. RFL designs and manufactures communication and power protection products/systems that are used to protect electric utility transmission lines and apparatus by isolating faulty transmission lines from a transmission grid. The Unallocated Corporate Expenses segment includes corporate related items, financing activities and other costs not allocated to reportable segments, which includes but is not limited to certain treasury, risk management, legal, litigation and public reporting charges and certain legacy costs. The accounting policies for the business units are the same as those described in the summary of significant accounting policies. For additional information, see Note 1 of the Notes to the Consolidated Financial Statements included in Part IV of the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

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

The unaudited comparative results for the three and nine month periods ended September 30, 2013 September 30, 2012 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Net sales				
SLPE	$ 22,370	$ 21,194	$ 58,350	$ 58,361
High Power Group	16,396	15,620	51,096	47,091
SL-MTI	9,414	9,490	27,568	28,166
RFL	4,819	4,582	14,866	15,507
Net sales	$ 52,999	$ 50,886	$ 151,880	$ 149,125

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Income from operations				
SLPE	$ 2,115	$ 1,144	$ 4,296	$ 1,412
High Power Group	1,444	1,499	5,596	4,449
SL-MTI	1,880	1,875	4,762	5,019
RFL	770	153	2,099	1,789
Unallocated Corporate Expenses	(1,504)	(1,138)	(4,431)	(4,419)
Income from operations	$ 4,705	$ 3,533	$ 12,322	$ 8,250

Total assets as of September 30, 2013 and December 31, 2012 are as follows:

	September 30, 2013	December 31, 2012
	(in thousands)	
Total assets		
SLPE	$ 39,195	$ 36,419
High Power Group	34,383	31,296
SL-MTI	14,374	12,012
RFL	13,756	13,744
Unallocated Corporate Assets	15,485	13,666
Total assets	$ 117,193	$ 107,137

Goodwill and other intangible assets, net, as of September 30, 2013 and December 31, 2012 are as follows:

	September 30, 2013	December 31, 2012
	(in thousands)	
Goodwill and other intangible assets, net		
SLPE	$ 4,530	$ 4,563
High Power Group	15,102	15,343
SL-MTI	115	140
RFL	5,318	5,359
Goodwill and other intangible assets, net	$ 25,065	$ 25,405

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15. Retirement Plans And Deferred Compensation

During the nine months ended September 30, 2013 and September 30, 2012, the Company maintained a defined contribution pension plan covering all full-time, U.S. employees of SLPE, the High Power Group, including TEAL and MTE, SL-MTI, RFL, and the corporate office. The Company s contributions to this plan are based on a percentage of employee contributions and/or plan year gross wages, as defined. Costs incurred under these plans amounted to $179,000 and $576,000 during the three month and nine month periods ended September 30, 2013 compared to $181,000 and $614,000 during the three month and nine month periods ended September 30, 2012.

The Company has agreements with certain retired directors, officers and key employees providing for supplemental retirement benefits. The liability for supplemental retirement benefits is based on the most recent mortality tables available and discount rates ranging from 6% to 12%. The amount charged to expense in connection with these agreements amounted to $91,000 and $223,000 for the three month and nine month periods ended September 30, 2013 compared to $64,000 and $265,000 for the three month and nine month periods ended September 30, 2012.

16. Discontinued Operations

For the three and nine months ended September 30, 2013, total loss from discontinued operations before income taxes was $463,000 and $1,211,000 ($282,000 and $737,000, net of tax). For the three and nine months ended September 30, 2012, total loss from discontinued operations before income taxes was $764,000 and $1,478,000 ($464,000 and $902,000, net of tax), respectively. The loss from discontinued operations during 2013 and 2012 relates to environmental remediation costs, consulting fees, and legal expenses associated with the past operations of the Company s five environmental sites (See Note 13 Commitments and Contingencies for further information concerning the environmental sites).

17. Fair Value Measurement and Financial Instruments

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

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, FASB ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

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

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

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

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2013, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

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

During the third quarter of 2013, the Company purchased publicly traded equity securities which are classified as available-for-sale securities. Fair values for these investments are based on closing stock prices from active markets for identical assets and therefore are classified within Level 1 of the fair value hierarchy. The fair value of available-for-sale securities is included in other current assets in the Company s Consolidated Balance Sheets.

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The following table presents the Company s assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, aggregated by the level in the fair value hierarchy within which those measurements fall:

	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2013
		(in thousands)		
Assets				
Available-for-sale securities	$ 2,688	$	$	$ 2,688
Liabilities				
Derivative financial instruments	$	$ 105	$	$ 105

	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2012
		(in thousands)		
Assets				
Derivative financial instruments	$	$ 243	$	$ 243

The Company does not have any fair value measurements using significant unobservable inputs (Level 3) as of September 30, 2013 and December 31, 2012.

Credit Risk Contingent Features

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

18. Derivative Instruments and Hedging Activities

ASC Topic 815, as amended and interpreted, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by ASC Topic 815, the Company records all derivatives on the balance sheet at fair value. The accounting for

changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to variability in expected future cash flows related to forecasted foreign exchange-based risk are considered economic hedges of the Company s forecasted cash flows.

Risk Management Objective of Using Derivatives

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

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During 2012 and 2013, the Company entered into a series of foreign currency forward contracts to hedge its exposure to foreign exchange rate movements in its forecasted expenses in China and Mexico. The foreign currency forwards are not speculative and are being used to manage the Company s exposure to foreign exchange rate movements. Foreign currency forward contracts involve fixing the USD-MXN and USD-CNH exchange rates for delivery of a specified amount of foreign currency on a specified date. The Company has elected not to apply hedge accounting to these derivatives and they are marked to market through earnings. Therefore, gains and losses resulting from changes in the fair value of these contracts are recognized at the end of each reporting period directly in earnings. The gains and losses associated with the foreign currency forward contracts are included in other gain (loss), net on the Consolidated Statements of Income. As of September 30, 2013, the fair value of the foreign currency forward contracts was recorded as a $105,000 liability in other current liabilities on the Consolidated Balance Sheets. As of December 31, 2012, the fair value of the foreign currency forward contracts was recorded as a $243,000 asset in other current assets on the Consolidated Balance Sheets.

Non-designated Hedges of Foreign Exchange Risk

The notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency losses. The following table summarizes the notional values of the Company s derivative financial instruments as of September 30, 2013.

Product	Number of Instruments	Notional (in thousands)
Mexican Peso (MXN) Forward Contracts	18	MXN 72,392
Chinese Yuan (CNH) Forward Contracts	17	CNH 89,843

The following table details the location in the financial statements of the gain or loss recognized on foreign currency forward contracts that are marked to market for the three and nine months ended September 30, 2013 and September 30, 2012:

	Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative (in thousands)	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative (in thousands)
Foreign Exchange Contracts	Other gain (loss), net	$ (21)	Other gain (loss), net	$ 312

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Nine Months Ended September 30, 2013 Amount of Gain (Loss) Recognized in Income on Derivative (in thousands)	Location of Gain (Loss) Recognized in Income on Derivative	Nine Months Ended September 30, 2012 Amount of Gain (Loss) Recognized in Income on Derivative (in thousands)
Foreign Exchange Contracts	Other gain (loss), net	$ (348)	Other gain (loss), net	$ 142

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19. Foreign Operations

As a result of a work stoppage at the Company s Xianghe manufacturing facilities from March 7, 2013 through March 20, 2013, revenues for the quarter ended March 31, 2013 were adversely impacted by approximately $900,000. The Company realized those sales during the second quarter of 2013. Additionally, certain incremental costs were incurred during the nine months ended September 30, 2013 related to the work stoppage, including employee, travel, consulting and legal costs of $662,000.

20. Shareholders Equity

On November 16, 2010, the Board of Directors authorized a plan that allows for the repurchase up to an aggregate of 470,000 shares of the Company s outstanding common stock (the 2010 Repurchase Plan). Any repurchases pursuant to the 2010 Repurchase Plan would be made in the open market or in negotiated transactions. During the first nine months of 2013, the Company purchased approximately 76,000 shares of Company stock at an average price of $23.90 a share. As a result, as of September 30, 2013, approximately 254,000 shares remained available for purchase under the 2010 Repurchase Plan.

21. Related Party Transactions

On May 1, 2013, the Company entered into a Management Services Agreement (Management Services Agreement) with SP Corporate Services LLC (SP Corporate). SP Corporate is an affiliate of SPH Group Holdings LLC (SPHG). A member of the Company s Board of Directors, Warren G. Lichtenstein, is affiliated with SPHG. Also, the Company s Chairman of the Board, Glen M. Kassan is affiliated with SPHG. Pursuant to the Management Services Agreement, SP Corporate agreed to provide, at the direction of the Company s Chief Executive Officer, non-exclusive services to support the Company s growth strategy, business development, planning, execution assistance and related support services. The monthly fee for these services is $10,400 paid in advance. The Management Services Agreement has a term of one year and has been approved by the Audit Committee of the Board of Directors and a majority of the disinterested directors of the Company.

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

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

Forward-Looking Statements

In addition to other information in this Quarterly Report on Form 10-Q, this Management s Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations and the current economic environment. These statements are not guarantees of future performance. They involve a number of risks and uncertainties that are difficult to predict, including, but not limited to, the Company s ability to implement its business plan, retain key management, anticipate industry and competitive conditions, realize operating efficiencies, secure necessary capital facilities and obtain favorable determinations in various legal and regulatory matters. Actual results could differ materially from those expressed or implied in the forward-looking statements. Some important assumptions and other critical factors that could cause actual results to differ materially from those in the forward-looking statements are specified in the Company s filings with the Securities and Exchange Commission (the SEC), including the Company s Annual Report on Form 10-K for the year ended December 31, 2012, and Current Reports on Form 8-K.

Overview

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

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

In the sections that follow, statements with respect to the quarter ended 2013 or nine months ended 2013 refer to the three month and nine month periods ended September 30, 2013. Statements with respect to the quarter ended 2012 or nine months ended 2012 refer to the three month and nine month periods ended September 30, 2012. Also, statements with respect to operating costs refer to engineering and product development costs, selling, general and administrative costs and depreciation and amortization (operating costs).

Significant Transactions and Financial Trends

As a result of a work stoppage at the Company s Xianghe manufacturing facilities from March 7, 2013 through March 20, 2013, revenues for the quarter ended March 31, 2013 were adversely impacted by approximately $900,000. The Company realized those sales during the second quarter of 2013. Additionally, certain incremental costs were incurred during the nine months ended September 30, 2013 related to the work stoppage, including employee, travel, consulting and legal costs of $662,000.

On March 11, 2013, the Company entered into a First Amendment (the First Amendment) to the senior revolving credit facility (the 2012 Credit Facility) with PNC Bank, National Association (PNC Bank). The First Amendment, among other things, (a) amends the Letter of Credit (LC) sublimit amount to the lesser of (i) an amount equal to $5,000,000 plus the aggregate amount of Designated Usage LC issued and outstanding under the Designated Usage LC sublimit or (ii) $25,000,000 and (b) allows the Company to enter into foreign currency exchange services with Loan Parties on an unsecured basis and that such obligations shall not exceed at any time an aggregate amount equal to $3,500,000 (See Note 10 Debt for terms and conditions of the 2012 Credit Facility).

On May 9, 2013, the Company s shareholders voted to approve a proposal to change the state of incorporation of SL Industries from the State of New Jersey to the State of Delaware by merging SL Industries, Inc., a New Jersey corporation (SL-NJ) with and into SL Industries, Inc., a Delaware corporation (SL-DE) (the Reincorporation). On June 20, 2013 (the Effective Date), the Reincorporation was effected by merging SL-NJ with and into SL-DE pursuant to an Agreement and Plan of Merger, dated June 3, 2012, between SL-NJ and SL-DE. SL-DE survived the merger and SL-NJ ceased to exist. The principal reason for the Reincorporation was to give the Company a greater measure of flexibility and simplicity in corporate governance and provide greater clarity and predictability with respect to the Company s corporate legal affairs. The Reincorporation did not result in any change in the name, business, management, fiscal year, accounting, location of the principal executive officers, assets or liabilities or net worth (other than the costs of reincorporation which were immaterial) of the Company.

On June 20, 2013, the Company entered into a Second Amendment and Joinder to Credit Agreement and to Security Agreement (the Second Amendment), which amends the 2012 Credit Facility in order to reflect the Reincorporation of the Company. The Second Amendment, among other things, joins the Company as a Borrower under the Credit Agreement and a Debtor under the Security Agreement entered into by SL-NJ in connection with the 2012 Credit Facility.

Business Trends

Demand for the Company s products and services increased during 2013 compared to 2012. Sales for the nine months ended September 30, 2013, increased by $2,755,000, or 2%, and income from operations increased by $4,072,000, or 49%.

Sales increased during the nine months ended September 30, 2013 due to an increase at the High Power Group, which was partially offset by decreases at RFL Electronics Inc. (RFL) and Montevideo Technology, Inc. (SL-MTI). SL Power Electronics Corp. (SLPE) remained relatively flat during 2013. The increase in sales at the High Power Group was due to an increase at MTE Corporation (MTE), which was partially offset by a decrease at Teal Electronics Corp. (TEAL).

Income from operations increased during the nine months ended September 30, 2013 due to increases at SLPE, the High Power Group, and RFL, which was partially offset by a decrease at SL-MTI. Unallocated Corporate Expenses remained flat during 2013 compared to 2012. The increase in income from operations at the High Power Group was due to an increase at MTE, which was partially offset by a decrease at TEAL.

During the nine months ended September 30, 2013, the Company s backlog increased to $66,909,000, from $64,608,000 for the same period in the prior year, for a change of 4% on a comparative basis. The increase in backlog in 2013 was primarily attributable to SL-MTI, who recorded a 20% increase in backlog. The increase in backlog at SL-MTI was partially offset by decreases at RFL, SLPE and the High Power Group of 26%, 7%, and 3%, respectively. The Company s net new orders for the nine months ended September 30, 2013 increased by 4%, compared to the nine months ended September 30, 2012.

The Company s management is taking numerous actions to improve sales through the deployment of numerous growth tools aimed at identifying attractive market segments and penetrating those markets through aggressive new product introduction. The Company is also identifying and penetrating selected geographic opportunities. The Company is continuing to emphasize lean initiatives at all of its facilities in manufacturing as well as in the transactional and reporting processes. The Company also continues to pursue strategic alternatives to maximize shareholder value. Some of these alternatives have included, and could continue to include, selective acquisitions, divestitures and the sale of certain assets.

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

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Critical Accounting Policies

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

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

The Company s significant accounting policies are described in Note 1 in the Notes to Consolidated Financial Statements included in Part IV of the Company s Annual Report on Form 10-K for the year ended December 31, 2012. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies are deemed to be critical within the SEC definition. The Company s senior management has reviewed these critical accounting policies and estimates and the related Management s Discussion and Analysis of Financial Condition and Results of Operations with the Audit Committee of the Board of Directors.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the purchase price is fixed or determinable and collectability is reasonably assured. Revenue is recorded in accordance with Staff Accounting Bulletin (SAB) No. 104 and in certain circumstances in accordance with the guidance provided by ASC 605-25 Revenue Recognition Multiple-Element Arrangements. The major portion of the Company s revenue is derived from equipment sales. The Company recognizes equipment revenue upon shipment or delivery, depending upon the terms of the order, and transfer of title. Generally, the revenue recognition criteria is met at the time the product is shipped. Provisions are established for product warranties, principally based on historical experience. At times the Company establishes reserves for specific warranty issues known by management. Customer service and installation revenue is recognized when completed. RFL has customer service revenue, which accounted for less than one percent of consolidated net revenue for the nine months ended 2013 and 2012.

SLPE has two sales programs with distributors, pursuant to which credits are issued to distributors: (1) a re-stocking program and (2) a competitive discount program. The distributor re-stocking program allows distributors to rotate up to a pre-determined percentage of their purchases over the previous nine month period. SLPE provides for this allowance as a decrease to revenue based upon the amount of sales to each distributor and other historical factors. The competitive discount program allows a distributor to sell a product out of its inventory at a negotiated price in order to meet certain competitive situations. SLPE records this discount as a reduction to revenue based on the distributor s eligible inventory. The eligible distributor inventory is reviewed at least quarterly. No cash is paid under either distributor program. These programs affected consolidated gross revenue for each of the nine month periods ended 2013 and 2012 by approximately 0.5% and 0.7%, respectively.

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

Allowance For Doubtful Accounts

The Company s estimate for the allowance for doubtful accounts related to trade receivables is based on two methods. The amounts calculated from each of these methods are combined to determine the total amount reserved. First, the Company evaluates specific accounts where it has information that the customer may have an inability to meet its financial obligations (e.g., bankruptcy or insolvency). In these cases, the Company uses its judgment, based on the best available facts and circumstances, and records a specific reserve for that customer against amounts due to reduce the receivable to the amount that is expected to be collected. These specific reserves are reevaluated and adjusted as additional information is received that impacts the amount reserved. Second, a general reserve is established for all customers based on several factors, including historical write-offs as a percentage of sales. If circumstances change (e.g., higher than expected defaults or an unexpected material adverse change in a major customer s ability to meet its financial obligation), the Company s estimates of the recoverability of amounts due could be reduced by a material amount. Receivables are charged off against the reserve when they are deemed uncollectible. The Company s allowance for doubtful accounts equaled 1.9% and 2.0% of gross trade receivables as of September 30, 2013 and December 31, 2012.

Inventories

The Company values inventory at the lower of cost or market, and continually reviews the book value of discontinued product lines to determine if these items are properly valued. The Company identifies these items and assesses the ability to dispose of them at a price greater than cost. If it is determined that cost is less than market value, then cost is used for inventory valuation. If market value is less than cost, then related inventory is adjusted to market value.

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

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Investments

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