

PULSE ELECTRONICS CORP  
Form 10-Q  
August 05, 2014

---

UNITED STATES  
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

---

FORM 10-Q

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

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

Commission File No. 1-5375

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

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

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

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

---

---

PART I FINANCIAL INFORMATION	PAGE
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets (Unaudited)</u>	2
<u>Condensed Consolidated Statements of Operations (Unaudited)</u>	3
<u>Condensed Consolidated Statements of Comprehensive Loss (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 4. <u>Controls and Procedures</u>	21
PART II OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	22
Item 1a. <u>Risk Factors</u>	22
Item 6. <u>Exhibits</u>	22
<u>Exhibit Index</u>	23
<u>Signatures</u>	24

Table of Contents

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

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

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

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

2

---

Table of ContentsPulse Electronics Corporation and Subsidiaries  
Condensed Consolidated Statements of Operations  
(Unaudited)

In thousands, except per share data

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

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

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

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

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

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

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

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.





Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

(1) General

Basis of presentation

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

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

Reclassifications

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

New accounting pronouncements

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

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

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

(2) Inventory

Inventory consisted of the following (in thousands):

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

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

(3) Intangible assets, net

Intangible assets consisted of the following (in thousands):

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

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

(4) Accrued expenses and other current liabilities

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

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

(5) Income taxes

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

June 27, 2014	June 28, 2013

Edgar Filing: PULSE ELECTRONICS CORP - Form 10-Q

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

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

7

---

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

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

(6) Defined benefit plans

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

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

(7) Commitments and contingencies

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

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

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

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

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

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

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

8

---

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

(8) Debt

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

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

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

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

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

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

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



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

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

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

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

9

---

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

Debt Issuance and Extinguishment Costs

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

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

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

(9) Preferred stock

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

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

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

(10) Per share amounts

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

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

Edgar Filing: PULSE ELECTRONICS CORP - Form 10-Q

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

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

10

---

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

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

(11) Severance, impairment and other associated costs

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

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

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

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

(12) Fair Value Measurements

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

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

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

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

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

Fair Value Measurements at  
June 27, 2014

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

Table of Contents

Pulse Electronics Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements, continued

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

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

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

(13) Business segment information

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

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

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

Edgar Filing: PULSE ELECTRONICS CORP - Form 10-Q

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

(14) Subsequent events

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

Table of Contents

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

Introduction

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

Critical Accounting Policies

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

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

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

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

Overview

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

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



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

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

13

---

Table of Contents

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

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

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

Table of Contents

## Results of Operations

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

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

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

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

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

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

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

Edgar Filing: PULSE ELECTRONICS CORP - Form 10-Q

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

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

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

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

15

---

Table of Contents

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

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

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

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

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

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

Table of Contents

## Results of Operations

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

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

	Six Months Ended				Results as % of net sales	
	June 27, 2014	June 28, 2013	Change \$	Change %	2014	2013
Net sales	\$175,219	\$173,064	\$2,155	1.2	% 100.0%	100.0%
Cost of sales	137,956	132,133	(5,823)	(4.4)	) (78.7)	(76.3)
Gross profit	37,263	40,931	(3,668)	(9.0)	) 21.3	23.7
Selling, general and administrative expenses	34,948	38,182	3,234	8.5	(19.9)	(22.1)
Severance, impairment and other associated costs	1,937	112	(1,825)	(1,629.5)	(1.1)	(0.1)
Legal reserve	22	75	53	70.7	(0.0)	(0.0)
Operating profit	356	2,562	(2,206)	86.1	0.2	1.5