PULSE ELECTRONICS CORP
Form 10-Q
August 08, 2012

UNITED STATES
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

xThe Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 29, 2012, or

oTransition 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 (State or other jurisdiction of incorporation or organization)	23-1292472 (IRS Employer Identification Number)
12220 World Trade Drive San Diego, CA (Address of principal executive offices)	92128 (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 x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer

(as defined in Rule 12b-2 of the Act).

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

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

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of August 7, 2012: 42,285,395

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PART I. FINANCIAL INFORMATION

Item 1: Financial Statements

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

Assets	June 29, 2012	December 30, 2011
Current assets:		
Cash and cash equivalents	$ 19,767	$ 17,606
Accounts receivable, net	71,371	59,507
Inventory, net	32,597	36,968
Prepaid expenses and other current assets	22,432	19,842
Total current assets	146,167	133,923
Long-term assets:		
Property, plant and equipment	96,331	97,448
Less accumulated depreciation	65,656	68,843
Net property, plant and equipment	30,675	28,605
Deferred income taxes	3,310	3,223
Intangible assets, net	3,300	3,535
Other assets	3,387	4,151
	$ 186,839	$ 173,437
Liabilities and Shareholders' Deficit		
Current liabilities:		
Accounts payable	$ 66,663	$ 52,802
Accrued expenses and other current liabilities	41,397	42,855
Current portion of long-term debt	54,950	--
Total current liabilities	163,010	95,657
Long-term liabilities:		
Long-term debt	--	43,950
Convertible senior notes	50,000	50,000
Deferred income taxes	8,764	8,653
Other long-term liabilities	10,359	12,997
Shareholders' deficit:		
Pulse Electronics Corporation shareholders' deficit:		
Common stock and additional paid-in capital	221,974	218,795
Accumulated deficit	(296,549)	(286,046)
Accumulated other comprehensive income	22,121	21,977
Total Pulse Electronics Corporation shareholders' deficit	(52,454)	(45,274)
Non-controlling interest	7,160	7,454
Total shareholders' deficit	(45,294)	(37,820)

	$	186,839	$	173,437

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)
In thousands, except per share data

	Three Months Ended		Six Months Ended	
	June 29, 2012	July 1, 2011	June 29, 2012	July 1, 2011
Net sales	$ 100,383	$ 94,758	$ 194,518	$ 182,797
Cost of sales	81,179	72,385	156,916	142,000
Gross profit	19,204	22,373	37,602	40,797
Selling, general and administrative expenses	18,792	21,255	37,785	42,796
Severance, impairment and other associated costs	515	3,867	2,052	10,623
Cost related to unsolicited takeover attempt	--	1,486	--	1,916
Operating loss	(103)	(4,235)	(2,235)	(14,538)
Other (expense) income:				
Interest expense, net	(3,752)	(1,158)	(6,345)	(2,451)
Other (expense) income, net	(1,148)	167	(69)	1,709
Total other expense	(4,900)	(991)	(6,414)	(742)
Loss from continuing operations before income taxes	(5,003)	(5,226)	(8,649)	(15,280)
Income tax (expense) benefit	(1,491)	765	(2,148)	5,830
Net loss from continuing operations	(6,494)	(4,461)	(10,797)	(9,450)
Net earnings from discontinued operations	--	--	--	612
Net loss	(6,494)	(4,461)	(10,797)	(8,838)
Less: Net (loss) earnings attributable to non-controlling interest	(97)	44	(294)	92
Net loss attributable to Pulse Electronics Corporation	$ (6,397)	$ (4,505)	$ (10,503)	$ (8,930)
Amounts attributable to Pulse Electronics Corporation common shareholders:				
Net loss from continuing operations	$ (6,397)	$ (4,505)	$ (10,503)	$ (9,542)
Net earnings from discontinued operations	--	--	--	612
Net loss attributable to Pulse Electronics Corporation	$ (6,397)	$ (4,505)	$ (10,503)	$ (8,930)
Per share data:				
Basic (loss) earnings per share:				
Net loss from continuing operations	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.23)
Net earnings from discontinued operations	--	--	--	0.01
Net loss attributable to Pulse Electronics Corporation	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.22)

Diluted (loss) earnings per share:				
Net loss from continuing operations	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.23)
Net earnings from discontinued operations	--	--	--	0.01
Net loss attributable to Pulse Electronics Corporation	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.22)

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries

Condensed Consolidated Statement of Comprehensive Loss
(Unaudited)
In thousands

	Three Months Ended June 29, 2012	Three Months Ended July 1, 2011	Six Months Ended June 29, 2012	Six Months Ended July 1, 2011
Comprehensive loss:				
Net loss	$ (6,494)	$ (4,461)	$ (10,797)	$ (8,838)
Other comprehensive income:				
Currency translation adjustment	546	90	144	833
Total comprehensive loss	(5,948)	(4,371)	(10,653)	(8,005)
Comprehensive (loss) income attributable to non-controlling interests	(97)	44	(294)	92
Comprehensive loss attributable to Pulse Electronics Corporation	$ (5,851)	$ (4,415)	$ (10,359)	$ (8,097)

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows
(Unaudited)
In thousands

	Six Months Ended	
	June 29, 2012	July 1, 2011
Cash flows from operating activities:		
Net loss	$(10,797)	$ (8,838)
Net earnings from discontinued operations	--	(612)
Adjustment to reconcile net loss to net cash used in activities:		
Depreciation and amortization	3,884	5,176
Amortization and write-off of deferred loan costs	2,113	505
Changes in assets and liabilities, net of the effect of divestitures:		
Accounts receivable	(11,820)	7,001
Inventory	4,292	(635)
Prepaid expenses and other current assets	(751)	(762)
Accounts payable and accrued expenses	7,779	(8,930)
Severance, impairment and other associated costs, net of cash payments	(2,139)	5,889
Other, net	1,105	(812)
Net cash used in operating activities	(6,334)	(2,018)
Cash flows from investing activities:		
Cash received from dispositions, net	--	1,072
Deposits received from pending divestitures, net	4,932	--
Capital expenditures	(6,284)	(4,669)
Proceeds from sale of property, plant and equipment	585	105
Foreign currency impact on intercompany lending	(83)	1,200
Net cash used in investing activities	(850)	(2,292)
Cash flows from financing activities:		
Credit facility borrowings	11,000	20,000
Principal payments on credit facility	--	(10,000)
Debt issuance costs	(1,584)	--
Purchases of shares in non-controlling interest	--	(4,134)
Proceeds from exercise of stock options	--	3
Dividends paid	--	(2,077)
Net cash provided by financing activities	9,416	3,792
Effect of exchange rate changes on cash	(71)	173
Net increase (decrease) in cash and cash equivalents	2,161	(345)
Cash and cash equivalents at beginning of period	17,606	35,905
Cash and cash equivalents at end of period	$19,767	$ 35,560
Other non-cash investing activity:		

Net change in non-cash capital expenditures	$(505)	$ --

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries
Condensed Consolidated Statement of Changes in Shareholders' Deficit
Six Months Ended June 29, 2012
(Unaudited)
In thousands

	Common stock and paid-in capital						
	Shares	Amount	Accumulated deficit	Accumulated other comprehensive income	Non-controlling interest	Total deficit
Balance at December 30, 2011	41,980	$ 218,795	$ (286,046)	$ 21,977	$ 7,454	$ (37,820)
Stock options, awards, and related compensation	306	1,166	--	--	--	1,166
Warrants issued in connection with credit facility	--	2,013	--	--	--	2,013
Net loss	--	--	(10,503)	--	(294)	(10,797)
Currency translation adjustments	--	--	--	144	--	144
Balance at June 29, 2012	42,286	$ 221,974	$ (296,549)	$ 22,121	$ 7,160	$ (45,294)

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

(1) General

Basis of presentation

The 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 accounting principles generally accepted 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 footnotes 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 30, 2011. Results for the six month period ended June 29, 2012 are not necessarily indicative of annual results.

Reclassifications

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

Recently adopted accounting pronouncements

Effective at the beginning of our fiscal year 2012, we retrospectively adopted changes issued by the Financial Accounting Standards Board to the presentation of comprehensive income. These changes eliminate the option to present components of other comprehensive income as part of the statement of changes in shareholders' deficit and requires that all changes in shareholders' deficit be presented either in a single statement of comprehensive income or in two separate but consecutive statements. The adoption of these changes affected our presentation of other comprehensive income in our condensed consolidated financial statements, but did not have any impact on our results of operations, financial position, or cash flows.

(2) Assets held for sale

During the fourth quarter of 2011, we reclassified two manufacturing plants and related equipment in China and equipment related to our encapsulated transformer line as held for sale within other current assets in the Condensed Consolidated Balance Sheets. On February 22, 2012, we entered into definitive agreements for the sales of these assets to an acquirer, subject to closing conditions. We completed the sale of the encapsulated transformer assets in the first quarter of 2012 and recognized a gain of $0.4 million on the sale. During the first quarter of 2012, we also received $5.1 million in cash deposits in connection with the pending sales of the remaining assets included under these definitive agreements. As of June 29, 2012, these remaining assets have a net carrying value of approximately $5.8 million and are classified as held for sale, pending completion of the asset sales. We expect to complete these sales in the third quarter of 2012.

During the fourth quarter of 2011, we reclassified the land and building located in our former operations in Tunisia as held for sale within other current assets in the Condensed Consolidated Balance Sheets. These assets remain

classified as held for sale at June 29, 2012 and have a net carrying value of approximately $2.2 million.

During the second quarter of 2012, we reclassified certain assets related to one of our manufacturing plants in China as held for sale within other current assets in the Condensed Consolidated Balance Sheets. At June 29, 2012, these assets have a net carrying value of approximately $0.3 million. We expect to complete the sale of these assets in 2012.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(3) Inventory

Inventory as of June 29, 2012 and December 30, 2011 consisted of the following (in thousands):

	June 29, 2012	December 30, 2011
Finished goods	$ 15,819	$ 18,768
Work in process	5,462	5,650
Raw materials and supplies	11,316	12,550
	$ 32,597	$ 36,968

(4) Accrued expenses and other current liabilities

Accrued expenses and other current liabilities as of June 29, 2012 and December 30, 2011 consisted of the following (in thousands):

	June 29, 2012	December 30, 2011
Accrued compensation	$ 10,729	$ 10,553
Income taxes payable	2,636	4,967
Accrued restructuring costs	1,583	4,157
Deposit on pending divestitures (Note 2)	5,100	--
Other accrued expenses	21,349	23,178
	$ 41,397	$ 42,855

(5) Intangible assets, net

The net carrying amounts of intangible assets as of June 29, 2012 and December 30, 2011 are as follows (in thousands):

	June 29, 2012	December 30, 2011
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	(2,600)	(2,365)
Technology	(2,000)	(2,000)
Total	(4,600)	(4,365)
Net intangible assets subject to amortization	700	935
Intangible assets not subject to amortization (indefinite lives):		
Tradename	2,600	2,600
Intangible assets, net	$ 3,300	$ 3,535

As of June 29, 2012, the weighted average useful life of intangible assets with finite lives was approximately 1.5 years. Amortization expense for intangible assets was $0.2 million and $0.7 million for the six months ended June 29, 2012 and July 1, 2011, respectively.

Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(6) Income taxes

The income tax (expense) benefit for the six months ended June 29, 2012 and July 1, 2011 was as follows (in thousands):

	June 29, 2012	July 1, 2011
Income tax (expense) benefit	$ (2,148)	$ 5,830
Effective tax rate	(24.8)%	38.2%

The Company's effective tax rate is a blended rate for different jurisdictions in which the Company operates. We continue to provide a full valuation allowance against losses in the majority of jurisdictions in which the Company operates. The Company will continue to evaluate the realizability of its 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 and expect to release the valuation allowance when it has 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 in the first six months of 2012 versus the first six months of 2011 was primarily due to the occurrence of losses in individual jurisdictions, which we are unable to use as a tax benefit. Additionally, there was a release of tax reserves of approximately $4.4 million during the first six months of 2012 due to the settlement of an audit in Hong Kong, of which $0.6 million impacted the effective tax rate.

We recognize interest and penalties, if any, related to income tax matters as income tax expense. As of June 29, 2012, we have approximately $0.2 million accrued for interest and/or penalties related to uncertain income tax positions. The amount accrued for interest and/or penalties increased by less than $0.1 million from the year ended December 30, 2011 to the six months ended June 29, 2012.

At June 29, 2012, we had approximately $12.9 million of unrecognized tax benefits, which represents a reduction of $4.4 million for the year ended December 30, 2011. The reduction of $4.4 million was due to settlement of an audit in Hong Kong during the six months ended June 29, 2012. Of the $12.9 million of unrecognized tax benefits, it is reasonably possible that up to $7.3 million could be resolved within the next twelve months. The reduction is not expected to have any impact on the tax rate due to valuation allowances in the related jurisdictions.

(7) Defined benefit plans

We maintain defined benefit pension plans for certain U.S. and non-U.S. employees. However, 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 benefit income was approximately $0.4 million and less than $0.1 million for the six months ended June 29, 2012 and July 1, 2011, respectively. In the six months ended June 29, 2012, we contributed less than $0.1 million to our defined benefit plans.

(8) 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 during the same reporting period 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. 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 claims that we infringe certain U.S. patents related to an electronic surface mount package, and is seeking injunctive relief and damages. Discovery has ended, and on September 6, 2011, the Court ruled on numerous pending motions for summary judgment. The Court denied the plaintiff’s motion for summary judgment of infringement by our products with the exception of one claim relating to one representative product. The Court partially granted one of our summary judgment motions, in effect, excluding any liability for direct infringement for products sold outside of North America on all of the plaintiff’s claims.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(8) Commitments and contingencies, continued

A trial date has been scheduled for November 6, 2012. The plaintiff has previously produced expert reports asserting infringement and liability in the amount of $34.3 million for sales through July 2010, plus requests for trebling and attorneys fees. However, these reports do not take into account the Court's September 2011 ruling, which excluded foreign sales from direct infringement and therefore may reduce our potential exposure to significantly less than the amount claimed by the plaintiff.

In light of the Court's summary judgment order and its ruling that we are not liable with respect to direct infringement for products sold outside North America, we recorded a charge of approximately $0.2 million as selling, general and administrative expense during the year ended December 30, 2011. We intend to continue presenting a vigorous defense against the remaining claims in the case, to maintain our counterclaim that Pulse owes no liability whatsoever to Halo, to contest the amount of damages asserted by Halo and its expert, and to consider our rights of appeal with respect to any adverse rulings. However, management is currently unable to determine whether any additional loss will occur or to estimate the range of such loss. During the six months ended June 29, 2012 and July 1, 2011, we incurred approximately $0.4 million and $0.7 million of legal expenses, respectively, related to this matter.

(9) Debt

On December 22, 2009, we issued $50.0 million in convertible senior notes, which will mature on December 15, 2014. The notes bear a coupon rate of 7.0% per annum that is payable semi annually in arrears on June 15 and December 15 of each year.

We have a credit facility that provides for borrowings not to exceed $55.0 million including letters of credit in an aggregate amount not to exceed $3.0 million. Our credit facility was amended on March 9, 2012 and the revised terms reduced the borrowings permitted under the credit facility from $60.8 million to $55.0 million, increased the interest rate on the outstanding borrowings, reduced our permitted capital expenditures and reduced the available cash we are required to maintain to $1.0 million. In addition, under the amended facility, net proceeds that we receive from any dispositions of assets or equity interests in our wholly-owned subsidiaries, issuance of equity and incurrence of additional indebtedness (as permitted) must be used to repay our outstanding borrowings under the credit facility. Outstanding borrowings that are repaid or prepaid may not be reborrowed. The amendment also eliminated the requirement that we comply with the following financial covenants for the remainder of the facility term: (i) total debt (excluding our convertible senior notes) as compared to our rolling four-quarter EBITDA; (ii) fixed charges as compared to our rolling four-quarter EBITDA; and (iii) a minimum rolling six-month EBITDA.

The maturity date of the facility continues to be February 28, 2013. The amendment was accounted for as a modification to the existing credit facility. We have $55.0 million of outstanding borrowings under the credit facility at June 29, 2012, which have been classified as a current liability in our Condensed Consolidated Balance Sheets.

While we cannot provide assurance that we will have sufficient liquidity to repay our indebtedness, we are committed to a strategic plan to significantly delever our balance sheet and reduce our outstanding borrowings under our credit facility. We remain engaged in negotiations for the sale of certain non-strategic assets and are exploring all financing and strategic alternatives available to us in the event that the potential asset sale proceeds are not sufficient to completely extinguish the outstanding borrowings under our credit facility.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(9) Debt, continued

In connection with the March 2012 amendment, we issued in a private placement warrants to the lender group to purchase approximately 2.6 million shares of our common stock at an exercise price of $0.01 per share. The warrants vest and become exercisable as follows: on June 28, 2012, warrants to purchase 0.8 million shares of our common stock will vest unless we have repaid the outstanding borrowings under the credit facility by such date; on September 28, 2012, warrants to purchase an additional 0.4 million shares of our common stock will vest unless we have repaid the outstanding borrowings under the credit facility by such date; and on December 31, 2012, warrants to purchase an additional 1.4 million shares of our common stock will vest unless we have repaid the outstanding borrowings under the credit facility by such date. We did not repay the outstanding borrowings under the credit facility by the first warrant vesting date of June 28, 2012. Consequently, the warrants to purchase approximately 0.8 million shares of common stock became vested. On September 28, 2012 and December 31, 2012, warrants to purchase approximately 0.4 million additional shares of common stock and 1.4 million additional shares of common stock, respectively, will vest unless the Company has repaid the outstanding borrowings under the credit facility by such dates.

If we repay the outstanding borrowings under the credit facility by such dates, any unvested warrants will revert to us and will effectively be canceled. If the repayment occurs as of September 28, 2012 or as of December 31, 2012 then 1.8 million or 1.4 million of the warrants will revert to us and be canceled, respectively. If the outstanding borrowings are not repaid by December 31, 2012, none of the warrants will revert to us. The warrants are exercisable on a cashless basis from the vesting date through March 9, 2015.

We recorded the fair value of the equity-classified warrants of $2.0 million as debt issuance costs, which have been capitalized and are being amortized using the effective interest method. The value of the warrants was determined on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 0.46%, volatility of 80.0%, a three-year term, and no dividend yield. The valuation also takes into account the probability that warrants will vest and become exercisable at June 28, 2012, September 28, 2012, and December 31, 2012. These vesting probabilities were based on management's estimates regarding the probability of success and timing related to the possible sale of certain non-strategic assets and additional financing opportunities that would enable us to repay the outstanding borrowings under the credit facility by these dates.

We incurred additional debt issuance costs in connection with the March 2012 amendment of $1.3 million. These costs have been capitalized and are being amortized using the effective interest method through the maturity date of the debt. In addition, we recorded a charge of approximately $0.3 million to write off previously capitalized fees and costs that related to the credit facility and its amendments. We incurred additional fees of 0.5% of outstanding borrowings on June 29, 2012, or $0.3 million, and may incur additional fees on September 28, 2012 and December 31, 2012, if outstanding borrowings under the credit facility remain outstanding at those dates.

(10) Per share amounts

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

	Three Months Ended		Six Months Ended	
	June 29, 2012	July 1, 2011	June 29, 2012	July 1, 2011
Net loss from continuing operations	$ (6,494)	$ (4,461)	$ (10,797)	$ (9,450)
Net earnings from discontinued operations	--	--	--	612

Less: Net (loss) earnings attributable to non-controlling interest		(97)		44		(294)		92
Net loss attributable to Pulse Electronics Corporation	$	(6,397)	$	(4,505)	$	(10,503)	$	(8,930)
Basic (loss) earnings per share:								
Shares		41,686		41,153		41,554		41,186
Continuing operations	$	(0.15)	$	(0.11)	$	(0.25)	$	(0.23)
Discontinued operations		--		--		--		0.01
Per share amount	$	(0.15)	$	(0.11)	$	(0.25)	$	(0.22)

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(10) Per share amounts, continued

	Three Months Ended		Six Months Ended	
	June 29, 2012	July 1, 2011	June 29, 2012	July 1, 2011
Diluted (loss) earnings per share:				
Shares	41,686	41,153	41,554	41,186
Continuing operations	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.23)
Discontinued operations	--	--	--	0.01
Per share amount	$ (0.15)	$ (0.11)	$ (0.25)	$ (0.22)

As we had net losses in the three and six months ended June 29, 2012 and July 1, 2011, we did not include any common stock equivalents related to stock options and restricted shares in our calculation of diluted loss per share. There were approximately 1.2 million and 1.0 million stock options outstanding as of June 29, 2012 and July 1, 2011, respectively, and unvested restricted shares outstanding of approximately 0.5 million and 0.4 million as of June 29, 2012 and July 1, 2011, respectively. We also did not include any common stock equivalents related to the 1.8 million of unvested warrants to purchase our common stock for $0.01 per share in our basic or diluted loss per share since these warrants are unvested as of June 29, 2012. In addition, for the three and six months ended June 29, 2012 and July 1, 2011, the effect of the convertible notes was anti-dilutive and excluded from our diluted loss per share calculation.

(11) Severance, impairment and other associated costs

The changes in the restructuring reserve during the six months ended June 29, 2012 were as follows (in millions):

Balance accrued at December 30, 2011	$ 4.2
Net expense	2.1
Cash payments	(4.2)
Non-cash charges	(0.5)
Balance accrued at June 29, 2012	$ 1.6

During the first six months of 2012, the $2.1 million of charges included $1.1 million for severance, lease termination and other costs associated with our restructuring program initiated in the fourth quarter of 2010 to reduce and reorganize the capacity of our manufacturing plants in China as we shift manufacturing to lower cost facilities; $0.8 million related to workforce reductions, primarily in Europe; and $0.2 million of additional costs associated with our withdrawal from Wireless' audio components business, which we initiated and substantially completed in 2011.

During the first six months of 2011, the $10.6 million of charges included $10.4 million of severance and related costs and a $0.2 million write-down of a manufacturing facility to its fair value. Of the $10.4 million of severance costs, approximately $2.6 million related to the transition and reorganization of our corporate headquarters in North America, which was initiated during the first quarter of 2011 and completed in 2011, and $5.0 million of costs primarily related to two plant closures in China and reductions in staff at other facilities in China as we shift manufacturing to lower cost facilities.

As of June 29, 2012, we had $1.6 million accrued for costs associated with our ongoing restructuring actions, of which a majority will be paid within one year.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(12) Fair Value Measurements

During the six months ended June 29, 2012, 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 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 majority of our financial instruments and financial assets approximate fair value, as presented on our Condensed Consolidated Balance Sheets. As of June 29, 2012, the estimated fair value of the outstanding borrowings under our senior revolving credit facility was approximately $55.0 million and the estimated fair value of our convertible senior notes was approximately $41.7 million, as determined through use of Level 2 fair value inputs as defined in the fair value hierarchy of ASC Topic 820 – Fair Value Measurements and Disclosures. These liabilities are not measured at their fair value in our Condensed Consolidated Balance Sheets for any period presented.

During the six months ended June 29, 2012, we did not have any non-financial assets or non-financial liabilities that were required to be measured at fair value on a recurring basis. Management believes that there is no material risk of loss from changes in inherent market rates or prices in our financial instruments due to the materiality of our financial instruments in relation to our Condensed Consolidated Balance Sheets.

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Pulse Electronics Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements, continued

(13) Business segment information

Our segments' net sales and operating profit (loss) excluding severance, impairment and other associated costs, and costs related to an unsolicited takeover attempt for the three and six months ended June 29, 2012 and July 1, 2011 were as follows (in thousands):

	Three months ended		Six months ended	
	June 29, 2012	July 1, 2011	June 29, 2012	July 1, 2011
Net sales:				
Network	$41,699	$43,391	$80,453	$85,935
Power	32,121	38,668	63,811	70,567
Wireless	26,563	12,699	50,254	26,295
Total net sales	$100,383	$94,758	$194,518	$182,797
Operating profit (loss) from continuing operations before severance, impairment and other associated costs, and costs related to unsolicited takeover attempt:				
Network	$767	$1,278	$(106)	$1,687
Power	2,045	3,399	4,377	3,927
Wireless	(2,400)	(3,559)	(4,454)	(7,613)
Operating profit (loss) excluding severance, impairment and other associated costs, and costs related to unsolicited takeover attempt	412	1,118	(183)	(1,999)
Severance, impairment and other associated costs	515	3,867	2,052	10,623
Costs related to unsolicited takeover attempt	--	––––1,486	--	1,916
Operating loss	(103)	(4,235)	(2,235)	(14,538)
Interest expense, net	(3,752)	(1,158)	(6,345)	(2,451)
Other (expense) income, net	(1,148)	167	(69)	1,709
Loss from continuing operations before income taxes	$(5,003)	$(5,226)	$(8,649)	$(15,280)

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

Introduction

This discussion and analysis of our financial condition and results of operations as well as other sections of this report contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and involve a number of risks and uncertainties. Actual results may differ materially from those anticipated in these forward-looking statements for many reasons, including the risks we face described in the "Risk Factors" section of this report on page 25. 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 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 30, 2011 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 30, 2011 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;
- 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 30, 2011.

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.

General. We define net sales as gross sales less returns and allowances. We sometimes refer to net sales as revenue.

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

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We believe our focus on technology and other strategic investments, both internal and external, provides us opportunities for future growth in net sales and operating profit in all our segments. However, unfavorable economic and market conditions, as well as customer preferences, may result in a reduction in demand for our products, thus negatively impacting our financial performance. Also, we may divest portions of our business, close certain locations or complete other cost reduction programs to enable our management to focus on our core businesses and to improve our overall long-term financial performance.

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. Also, 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 expand our capacity of advanced three dimensional antenna equipment which is used to produce our Wireless products. We have also committed capital to automate certain manual manufacturing processes and to implement an enterprise resource planning ("ERP") system to enhance visibility, reduce cost, and enhance customer service. In the future, similar investments in property, plant and equipment or research, development and engineering may be funded through internally generated cash flows or through other external resources.

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, asset impairments 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 to lower-cost locations, specifically 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 and changes in operating strategies.

Divestitures. We have historically completed divestitures to streamline our operations, to focus on our core businesses, to reduce our external debt and to strengthen our financial position.

Management Focus. Our executives focus on a number of metrics to evaluate our consolidated financial condition and operating performance. For example, we use consolidated revenue growth, gross margin, operating margin and return on research, development and engineering as performance measures. Operating leverage, or incremental operating profit as a percentage of incremental sales, is also reviewed, which reflects the benefit of absorbing fixed overhead and operating expenses. In evaluating consolidated working capital, liquidity and cash flow, our executives also use performance measures such as days sales outstanding, days payables outstanding, inventory turnover, debt-to-EBITDA leverage, cash conversion efficiency and free cash flow. We define free cash flow as cash flow from operations less capital spending. Additionally, as the continued success of our business is largely dependent on meeting and exceeding our customers' expectations, non-financial performance measures relating to product

development, product quality and on-time delivery assists in monitoring customer satisfaction on an on-going basis.

Income Taxes. We have generally not provided for U.S. and foreign withholding taxes on our non-U.S. subsidiaries' undistributed earnings. We expect to reinvest this cash and earnings outside of the United States, because we anticipate that a significant portion of our opportunities for future growth will be abroad. In addition, we expect to use a significant portion of the cash to service debt outside the United States. In 2010, we concluded that there was $8.5 million of earnings that would not be permanently reinvested, and provided a deferred tax liability for this amount. This amount has not yet been repatriated. Thus, with the exception of earnings in the amount of $8.5 million as of June 29, 2012, our non-U.S. subsidiaries' undistributed earnings are intended to be reinvested outside of the U.S. indefinitely. Our effective income tax rate is affected by the proportion of our income earned in higher tax jurisdictions, such as those in Europe and the United States, versus the amount of our 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, the deductibility or non-deductibility of severance and impairment costs and other similar costs, as well as by changes in our valuation allowance against our net deferred tax assets. Changes in operations, tax legislation, estimates, judgments and forecasts may also affect our tax rate from period to period.

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Results of Operations

Three months ended June 29, 2012 compared to the three months ended July 1, 2011

The table below presents our results of operations and the change in those results from period to period in percentage and dollars (in thousands):

	Three Months Ended June 29, 2012	Three Months Ended July 1, 2011	Change $	Change %	Results as % of net sales 2012	Results as % of net sales 2011
Net sales	$ 100,383	$ 94,758	$ 5,625	5.9 %	100.0 %	100.0 %
Cost of sales	81,179	72,385	8,794	12.1	80.9	76.4
Gross profit	19,204	22,373	(3,169)	(14.2)	19.1	23.6
Selling, general and administrative expenses	18,792	21,255	(2,463)	(11.6)	18.7	22.4
Severance, impairment and other associated costs	515	3,867	(3,352)	(86.7)	0.5	4.1
Costs related to unsolicited takeover attempt	--	1,486	(1,486)	(100.0)	--	1.6
Operating loss	(103)	(4,235)	4,132	97.6	(0.1)	(4.5)
Interest expense, net	(3,752)	(1,158)	(2,594)	(224.0)	(3.7)	(1.2)
Other (expense) income, net	(1,148)	167	(1,315)	(787.4)	(1.1)	0.2
Loss from continuing operations before income taxes	(5,003)	(5,226)	223	4.3	(4.9)	(5.5)
Income tax (expense) benefit	(1,491)	765	(2,256)	(294.9)	(1.5)	0.8
Net loss	$ (6,494)	$ (4,461)	$ (2,033)	(45.6)%	(6.5)%	(4.7)%

Net sales. Our consolidated net sales increased by 5.9% in the three months ended June 29, 2012 compared to the prior year period primarily as a result of higher sales in Wireless as sales to new customers continue to increase, partially offset by ongoing industry weaknesses which constrained demand for Network and Power products.

Net sales for our three segments for the three months ended June 29, 2012 and July 1, 2011 were as follows (in thousands):

	June 29, 2012	July 1, 2011
Network	$ 41,699	$ 43,391
Power	32,121	38,668
Wireless	26,563	12,699

Net sales	$	100,383	$	94,758

Gross profit. Our consolidated gross margin was 19.1% for the three months ended June 29, 2012 as compared to 23.6% for the three months ended July 1, 2011. The lower gross profit compared to the prior year reflects higher labor costs, lower pricing and volumes for Network and Power products, the unfavorable mix effect of the growth of lower-margin Wireless products, and ramp-up costs and inefficiencies associated with the growth in our Wireless business.

Selling, general and administrative expenses. Total selling, general and administrative expenses decreased 11.6% in the three months ended June 29, 2012 compared to the prior year quarter. The decrease was primarily attributable to expense reduction actions and sustained scrutiny over all discretionary spending.

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Research, development and engineering expenses ("RD&E") are included in selling, general and administrative expenses. For the three months ended June 29, 2012 and July 1, 2011, respectively, RD&E was as follows (in thousands):

	2012	2011
RD&E	$ 6,287	$ 6,935
Percentage of sales	6.3 %	7.3 %

Our RD&E spending as a percentage of sales in the quarter ended June 29, 2012 decreased primarily due to reduction in force actions taken in the prior year, partially offset by higher legal expenses incurred in connection with the patent lawsuit filed by Halo Electronics. During the three months ended June 29, 2012 and July 1, 2011, we incurred approximately $0.3 million and $0.1 million of legal expenses, respectively, related to this matter. Refer to further discussion in Note 8, Commitments and contingencies.

Severance, impairment and other associated costs. During the three months ended June 29, 2012, we incurred approximately $0.5 million of costs, primarily related to severance and other costs associated with our initiative to reorganize the capacity of our manufacturing plants in China. During the three months ended July 1, 2011, we incurred $3.9 million of charges, which included $3.4 million of severance and other costs associated with our initiative to reorganize the capacity of our manufacturing plants in China; $2.5 million of severance and other costs related to the transition and reorganization of our corporate headquarters in North America initiated and completed in fiscal year 2011; and $0.2 million write-down of a manufacturing facility to its fair value.

Costs related to unsolicited takeover attempt. During the three months ended July 1, 2011, we incurred $1.5 million of legal and professional fees and other costs related to an unsolicited takeover attempt and proxy contest. The majority of these costs represent fees of our financial and legal advisors. No similar costs related to this matter were incurred for the three months ended June 29, 2012.

Interest. Net interest expense increased by $2.6 million primarily due to higher interest on our senior credit facility. Under the March 2012 amendment, the interest rate increased to a variable rate plus 10.0%. Our interest expense also increased during the three months ended June 29, 2012 due to $0.3 million of additional fees incurred since the outstanding borrowings under the credit facility were not repaid as of June 28, 2012 and a $0.9 million increase in debt fee amortization, which includes approximately $0.5 million related to the warrants issued in connection with the amendment.

Other. Net other (expense) income for the three months ended June 29, 2012 is primarily attributable to our foreign currency exchange activity related to changes in the varying currencies of our intercompany lending program. During the three months ended June 29, 2012, we incurred $1.3 million in foreign currency losses as compared to a $0.1 million loss for the three months ended July 1, 2011. The increase in foreign currency losses were primarily due to the effects of the overall strengthening of the U.S. dollar to euro and related losses as a result of remeasuring intercompany advances and loans into their respective functional currencies.

Income taxes. The income tax (expense) benefit for the three months ended June 29, 2012 and July 1, 2011 was as follows (in thousands):

	June 29, 2012	July 1, 2011
Income tax (expense) benefit	$ (1,491)	$ 765
Effective tax rate	(29.8)%	14.6%

The Company's effective tax rate is a blended rate for different jurisdictions in which the Company operates. We continue to provide a full valuation allowance against losses in the majority of jurisdictions in which the Company operates. The Company will continue to evaluate the realizability of its 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 and expects to release the valuation allowance when it has 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 in the second quarter of 2012 versus the second quarter of 2011 was primarily due to the occurrence of losses in individual jurisdictions, which we are unable to use as a tax benefit.

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Results of Operations

Six months ended June 29, 2012 compared to the six months ended July 1, 2011

The table below presents our results of operations and the change in those results from period to period in percentage and dollars (in thousands):

	Six Months Ended					
	June 29, 2012	July 1, 2011	Change $	Change %	Results as % of net sales 2012	Results as % of net sales 2011
Net sales	$194,518	$182,797	$11,721	6.4 %	100.0 %	100.0 %
Cost of sales	156,916	142,000	14,916	10.5	80.7	77.7
Gross profit	37,602	40,797	(3,195)	(7.8)	19.3	22.3
Selling, general and administrative expenses	37,785	42,796	(5,011)	(11.7)	19.4	23.4
Severance, impairment and other associated costs	2,052	10,623	(8,571)	(80.7)	1.1	5.8
Costs related to unsolicited takeover attempt	--	1,916	(1,916)			