

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2013

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 number: **0-31641**

**SCI ENGINEERED MATERIALS, INC.**

(Exact name of registrant as specified in its charter)

**Ohio**  
(State or other jurisdiction of  
incorporation or organization)

**31-1210318**  
(I.R.S. Employer  
Identification No.)

**2839 Charter Street, Columbus, Ohio 43228**  
(Address of principal executive offices) (Zip Code)

**(614) 486-0261**  
(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  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 (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

3,838,898 shares of Common Stock, without par value, were outstanding at July 31, 2013.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SCI ENGINEERED MATERIALS, INC.

BALANCE SHEETS

ASSETS

	<u>June 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
	<u>(UNAUDITED)</u>	
<b>Current Assets</b>		
Cash	\$ 342,911	\$ 630,819
Accounts receivable, less allowance for doubtful accounts of \$15,000 and \$45,000 respectively	506,332	453,302
Inventories	960,928	815,075
Prepaid expenses	102,791	209,422
Total current assets	<u>1,912,962</u>	<u>2,108,618</u>
<b>Property and Equipment, at cost</b>		
Machinery and equipment	7,123,206	7,015,504
Furniture and fixtures	137,911	137,911
Leasehold improvements	317,870	317,870
Construction in progress	-	12,195
	<u>7,578,987</u>	<u>7,483,480</u>
Less accumulated depreciation	<u>(4,545,948)</u>	<u>(4,254,302)</u>
	<u>3,033,039</u>	<u>3,229,178</u>
<b>Other Assets</b>		
Deposits	16,959	15,332
Deferred financing fees	33,823	38,543
Intangibles	11,974	12,889
Total other assets	<u>62,756</u>	<u>66,764</u>
<b>TOTAL ASSETS</b>	<u>\$ 5,008,757</u>	<u>\$ 5,404,560</u>

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

SCI ENGINEERED MATERIALS, INC.

BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY

	June 30, 2013	December 31, 2012
	<u>(UNAUDITED)</u>	
<b>Current Liabilities</b>		
Capital lease obligations, current portion	\$ 173,557	\$ 221,366
Notes payable, current portion	368,741	316,571
Accounts payable	273,235	260,531
Customer deposits	386,204	313,745
Accrued compensation	59,234	76,646
Accrued expenses and other	102,375	117,572
Total current liabilities	<u>1,363,346</u>	<u>1,306,431</u>
Capital lease obligations, net of current portion	182,094	163,331
Notes payable, net of current portion	<u>835,012</u>	<u>1,057,104</u>
Total liabilities	2,380,452	2,526,866
<b>Commitments and contingencies</b>		
<b>Shareholders' Equity</b>		
Convertible preferred stock, Series B, 10% cumulative, nonvoting, no par value, \$10 stated value, optional redemption at 103%; optional shareholder conversion 2 shares for 1; 24,152 shares issued and outstanding	429,906	417,830
Common stock, no par value, authorized 15,000,000 shares; 3,838,898 and 3,826,898 shares issued and outstanding, respectively	9,819,240	9,800,100
Additional paid-in capital	1,796,873	1,758,358
Accumulated deficit	<u>(9,417,714)</u>	<u>(9,098,594)</u>
	2,628,305	2,877,694
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 5,008,757</u>	<u>\$ 5,404,560</u>

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

SCI ENGINEERED MATERIALS, INC.

STATEMENTS OF OPERATIONS

THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2013 AND 2012

(UNAUDITED)

	THREE MONTHS ENDED JUNE 30, 2013	2012	SIX MONTHS ENDED JUNE 30, 2013	2012
Product revenue	\$ 1,766,337	\$ 2,647,217	\$ 3,136,207	\$ 4,461,759
Contract research revenue	26,438	56,511	90,170	125,001
	<u>1,792,775</u>	<u>2,703,728</u>	<u>3,226,377</u>	<u>4,586,760</u>
Cost of product revenue	1,372,455	2,134,110	2,577,939	3,648,000
Cost of contract research revenue	22,129	46,586	76,648	100,583
	<u>1,394,584</u>	<u>2,180,696</u>	<u>2,654,587</u>	<u>3,748,583</u>
Gross profit	398,191	523,032	571,790	838,177
General and administrative expense	239,623	290,556	534,833	571,469
Research and development expense	78,083	70,567	142,203	167,389
Marketing and sales expense	119,116	147,136	224,440	259,804
(Loss) income from operations	<u>(38,631)</u>	<u>14,773</u>	<u>(329,686)</u>	<u>(160,485)</u>
Other (expense) income				
Interest, net	(18,659)	(24,871)	(39,122)	(44,561)
(Loss) gain on disposal of equipment, net	(312)	-	49,688	-
	<u>(18,971)</u>	<u>(24,871)</u>	<u>10,566</u>	<u>(44,561)</u>
Loss before provision for income taxes	(57,602)	(10,098)	(319,120)	(205,046)
Income tax benefit	38	20,704	-	25,889
Net (loss) income	<u>(57,564)</u>	<u>10,606</u>	<u>(319,120)</u>	<u>(179,157)</u>
Dividends on preferred stock	(6,038)	(6,038)	(12,076)	(12,076)
<b>(LOSS) INCOME APPLICABLE TO COMMON SHARES</b>	<u>\$ (63,602)</u>	<u>\$ 4,568</u>	<u>\$ (331,196)</u>	<u>\$ (191,233)</u>
Earnings per share - basic and diluted (Note 6)				
(Loss) income per common share				
Basic	<u>\$ (0.02)</u>	<u>\$ 0.00</u>	<u>\$ (0.09)</u>	<u>\$ (0.05)</u>
Diluted	<u>\$ (0.02)</u>	<u>\$ 0.00</u>	<u>\$ (0.09)</u>	<u>\$ (0.05)</u>
Weighted average shares outstanding				
Basic	<u>3,835,997</u>	<u>3,811,997</u>	<u>3,832,964</u>	<u>3,808,964</u>
Diluted	<u>3,835,997</u>	<u>3,821,528</u>	<u>3,832,964</u>	<u>3,808,964</u>

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

SCI ENGINEERED MATERIALS, INC.

STATEMENTS OF CASH FLOWS

SIX MONTHS ENDED JUNE 30, 2013 AND 2012

(UNAUDITED)

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (319,120)	\$ (179,157)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and accretion	301,777	287,975
Amortization	915	1,545
Stock based compensation	69,731	70,878
Net gain on disposal of equipment	(49,688)	-
Inventory reserve	11,652	9,095
Credit for doubtful accounts	(30,223)	-
Changes in operating assets and liabilities:		
Accounts receivable	(22,807)	(52,072)
Inventories	(157,505)	(211,556)
Prepaid expenses	106,631	(44,949)
Other assets	3,093	11,651
Accounts payable	12,704	207,598
Accrued expenses and customer deposits	35,529	(25,896)
Net cash (used in) provided by operating activities	<u>(37,311)</u>	<u>75,112</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds on sale of equipment	50,000	-
Purchases of property and equipment	(15,241)	(549,403)
Net cash provided by (used in) investing activities	<u>34,759</u>	<u>(549,403)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from notes payable	-	911,546
Principal payments on capital lease obligations and notes payable	(285,356)	(706,275)
Net cash (used in) provided by financing activities	<u>(285,356)</u>	<u>205,271</u>
<b>NET DECREASE IN CASH</b>	<b>(287,908)</b>	<b>(269,020)</b>
CASH - Beginning of period	<u>630,819</u>	<u>798,069</u>
CASH - End of period	<u>\$ 342,911</u>	<u>\$ 529,049</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the period for:		
Interest	\$ 39,493	\$ 40,464
Income taxes	-	605
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH FINANCING ACTIVITIES</b>		
Property and equipment purchased by capital lease	86,389	-
Increase in asset retirement obligation	4,320	4,320

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

**SCI ENGINEERED MATERIALS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 1. Business Organization and Purpose**

SCI Engineered Materials, Inc. (“SCI”, or the “Company”), formerly Superconductive Components, Inc., an Ohio corporation, was incorporated in 1987. The Company is a global supplier and manufacturer of advanced materials for Physical Vapor Deposition Thin Film Applications. Through partnerships with end users and Original Equipment Manufacturers the Company develops innovative customized solutions enabling commercial success.

**Note 2. Summary of Significant Accounting Policies**

The accompanying unaudited financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and with 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. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for fair presentation of the results of operations for the periods presented have been included. The financial statements should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2012. Interim results are not necessarily indicative of results for the full year.

The preparation of financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Note 3. Common Stock and Stock Options**

Stock Based Compensation - Compensation cost for all stock-based awards is based on the grant date fair value and recognized over the required service (vesting) period. Non cash stock based compensation expense was \$34,296 and \$ 35,782 for the three months ended June 30, 2013 and 2012, respectively. Non cash stock based compensation expense was \$69,731 and \$70,878 for the six months ended June 30, 2013 and 2012, respectively. Unrecognized compensation expense was \$455,317 as of June 30, 2013 and will be recognized through 2017. There was no tax benefit recorded for this compensation cost as the expense primarily relates to incentive stock options that do not qualify for a tax deduction until, and only if, a qualifying disposition occurs.

The four non-employee board members each received compensation of 3,000 shares of common stock of the Company during the six months ended June 30, 2013 and June 30, 2012. The stock had an aggregate value of \$19,140 and \$17,940 for the six months ended June 30, 2013 and 2012, respectively, and was recorded in general and administrative expense as non cash stock compensation expense in the financial statements.

**SCI ENGINEERED MATERIALS, INC.  
NOTES TO FINANCIAL STATEMENTS**

**Note 3. Common Stock and Stock Options (continued)**

The cumulative status of options granted and outstanding at June 30, 2013 , and December 31, 2012, as well as options which became exercisable in connection with the Company's stock option plans is summarized as follows:

**Employee Stock Options**

	<u>Stock Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at January 1, 2012	736,750	\$ 4.52
Expired	(144,500)	1.59
Outstanding at December 31, 2012	592,250	\$ 5.23
Expired	(250)	1.00
Outstanding at June 30, 2013	592,000	\$ 5.23
Options exercisable at December 31, 2012	322,250	\$ 4.59
Options exercisable at June 30, 2013	367,000	\$ 4.76

**Non-Employee Director Stock Options**

	<u>Stock Options</u>	<u>Average Exercise Price</u>
Outstanding at January 1, 2012	250,000	\$ 3.87
Outstanding at December 31, 2012	250,000	3.87
Expired	(30,000)	1.00
Outstanding at June 30, 2013	220,000	\$ 4.26
Options exercisable at December 31, 2012	250,000	\$ 3.87
Options exercisable at June 30, 2013	220,000	\$ 4.26

Exercise prices for options ranged from \$2.40 to \$6.00 at June 30, 2013. The weighted average option price for all options outstanding was \$4.97 with a weighted average remaining contractual life of 3.7 years.



**SCI ENGINEERED MATERIALS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 4. Preferred Stock**

The Board of Directors voted not to authorize the payment of a cash dividend on convertible preferred stock, Series B, to shareholders of record as of December 31, 2012. Dividends on the Series B preferred stock accrue at 10% annually on the outstanding shares. Accrued dividends on the Series B preferred stock were \$6,038 for the three months ended June 30, 2013 and 2012 and \$12,076 for the six months ended June 30, 2013 and 2012. The Company had accrued dividends on Series B preferred stock of \$ 181,140 at June 30, 2013, and \$169,064 at December 31, 2012. These amounts are included in Convertible preferred stock, Series B on the balance sheet at June 30, 2013 and December 31, 2012.

**Note 5. Inventories**

Inventories consisted of the following:	<u>June 30, 2013</u>	<u>December 31, 2012</u>
	(unaudited)	
Raw materials	\$ 358,187	\$ 346,613
Work-in-process	567,026	408,491
Finished goods	147,367	159,971
Inventory reserve	(111,652)	(100,000)
	<u>\$ 960,928</u>	<u>\$ 815,075</u>

**Note 6. Earnings Per Share**

Basic income (loss) per share is calculated as income available to (loss applicable to) common stockholders divided by the weighted average of common shares outstanding. Diluted earnings per share is calculated as diluted income available to common stockholders divided by the diluted weighted average number of common shares. Diluted weighted average number of common shares gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and convertible preferred stock using the if-converted method. Diluted earnings per share exclude all diluted potential shares if their effect is anti-dilutive. For the three months ended June 30, 2013, and the six months ended June 30, 2013 and 2012, all convertible preferred stock and common stock options listed in Note 3 were excluded from diluted earnings per share due to being out-of-the-money or anti-dilutive. The following is provided to reconcile the earnings per share calculations:

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	2013	2012	2013	2012
(Loss) income applicable to common shares	\$ (63,602)	\$ 4,568	\$ (331,196)	\$ (191,233)
Weighted average common shares outstanding - basic	3,835,997	3,811,997	3,832,964	3,808,964
Effect of dilution	-	9,531	-	-
Weighted average shares outstanding - diluted	3,835,997	3,821,528	3,832,964	3,808,964

**SCI ENGINEERED MATERIALS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 7. Notes Payable**

On October 16, 2012, the Company issued a Promissory Note (the "Note") in the amount of \$213,000 to The Huntington National Bank, as Lender, with a maturity date of February 28, 2014. This Note replaced an existing promissory note to the Huntington National Bank which had a balance of \$213,000 and an original maturity date of December 31, 2012.

The Note is collateralized by the Company's inventories, equipment and accounts receivable. Among other items, the Note provides for the following:

- Interest subject to change from time to time based on changes in LIBOR. The interest rate applied to the unpaid principal balance is at a rate of 4.0 percentage points over LIBOR. Under no circumstance will the interest rate be less than 5.00% per annum or more than the maximum rate allowed by applicable law.
- Interest only payments through December 31, 2012, with a \$25,000 principal payment due December 31, 2012 and another \$25,000 due January 31, 2013. Monthly payments of approximately \$5,600, including interest, beginning in January 2013 with remaining principal due at maturity in February 2014.

As of June 30, 2013 there was an outstanding balance of \$133,220 on this Note. The Note requires the Company to comply with various restrictive covenants, including a tangible net worth covenant. On May 10, 2013, the Company entered into a modification to the Note with Huntington, whereby Huntington waived the requirement to comply with this covenant for the period ending June 30, 2013. The Company would have been in compliance with this covenant at June 30, 2013. The Company will be required and expects to comply with this covenant beginning September 30, 2013 and through the maturity of the Note in February 2014.

The Company's revolving line of credit arrangement with its senior lender expired on April 13, 2012. There was no balance outstanding under this arrangement at maturity.

During 2010, the Company applied and was approved for a 166 Direct Loan to borrow up to \$744,250 with the Ohio Department of Development (ODOD). This loan was finalized in February 2011. The term of the loan is 84 months at a fixed interest rate of 3%. There is also a 0.25% annual servicing fee charged monthly on the outstanding principal balance. Payments of approximately \$10,500, including interest, are payable monthly through November 2018. The loan is collateralized by the related project equipment. As of June 30, 2013 there was an outstanding balance of \$620,321 on this loan.

During 2010, the Company also applied and was approved for a 166 Direct Loan through the Advanced Energy Program with the Ohio Air Quality Development Authority (OAQDA) to borrow up to approximately \$1.4 million (this maximum commitment by the OAQDA was subsequently reduced to \$368,906 on March 20, 2012). The interest rate was 3% at December 31, 2011 and increased to 10% effective with the first amendment dated March 20, 2012. A second amendment dated June 12, 2012 returned the interest rate to 3% effective April 10, 2012. There is also an annual servicing fee of \$1,600 charged quarterly. The loan is being amortized over 84 months through March 2018. Payments were interest only through March 2012. Thereafter, payments of approximately \$17,300, including interest and servicing fee, are payable quarterly. The loan is collateralized by the related project equipment. As of June 30, 2013 there was an outstanding balance of \$297,409 on this loan.

**SCI ENGINEERED MATERIALS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 7. Notes Payable (continued)**

An Intercreditor Agreement exists as part of the above mentioned loans with agencies of the State of Ohio. The OAQDA and ODOD agree to shared lien and security interest through mutual covenants. These covenants include, but are not limited to, the creation of an agreed upon number of jobs, filing of quarterly and annual reports and various financial covenants. The Company expects to maintain compliance with all covenants through June 30, 2014.

During 2006, the Company was approved for a 166 Direct Loan from the Ohio Department of Development in the amount of \$400,000. These funds were received in July of 2008 and were used for the purchase of production equipment and to reduce the Company's capital lease obligations on certain equipment. The term of the loan is 84 months at a fixed interest rate of 3%. There is also a 0.25% annual servicing fee to be charged monthly on the outstanding principal balance. The Company is making monthly servicing fee, interest and principal payments of approximately \$6,100. The loan principal balance will be fully amortized at the end of the term in August 2015. The loan is collateralized by the related project equipment. As of June 30, 2013 the loan had a balance of \$152,803. This loan is also subject to certain covenants, including job creation and retention. On March 5, 2013, the Company signed a First Amendment to the Loan Agreement, which changed the number of jobs to be created. The Company expects to maintain compliance with all covenants through June 30, 2014.

**Note 8. Income Taxes**

Following is the income tax benefit for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Federal - deferred	\$ -	\$ -	\$ -	\$ -
State and local	38	20,704	-	25,889
	<u>\$ 38</u>	<u>\$ 20,704</u>	<u>\$ -</u>	<u>\$ 25,889</u>

The tax benefit for the three and six months ended June 30, 2012 was due to the reversal of an accrual. Deferred tax assets and liabilities result from temporary differences in the recognition of income and expense for tax and financial reporting purposes. A full valuation allowance has been recorded against the realizability of the net deferred tax assets at June 30, 2013 and December 31, 2012. The Company has net operating loss carryforwards available for federal and state tax purposes of approximately \$4,000,000 which expire in varying amounts through 2031.

**SCI ENGINEERED MATERIALS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 9. Liquidity**

Management has forecasted the Company's revenues and related costs as well as its investing plans and financing needs to determine its liquidity to meet cash flow requirements and believes it will have sufficient liquidity at least through June 30, 2014. This forecast was based on current cash levels and debt obligations, and management's best estimates of revenues primarily from existing customers and gave consideration to the continued and possible increased levels of uncertainty in demand in the markets in which the Company operates. The Company's ability to maintain current operations is dependent upon its ability to achieve these forecasted results, which management believes will occur.

The Company does not currently have any available sources of additional external funding. The Company's revolving line of credit arrangement with its senior lender expired on April 13, 2012. There was no balance outstanding under this arrangement at maturity. The Company did not have the need to draw on the revolving line of credit since the original commitment date of January 13, 2009. The Company does not anticipate the need for a similar credit facility in 2013; although management may pursue revolving credit arrangements as working capital requirements increase. The Company's ability to obtain a new line of credit, if deemed necessary, is not certain.

During the second quarter of 2013 the Company enacted various cost cutting measures which included officer wage reductions and reduced work hours where feasible. Should projected sales levels fall below the minimum levels expected to be achievable by management, additional cost reduction actions could be instituted which might facilitate the continued operation of the Company. The achievement of such reductions and the timing of their impact are not readily predictable.

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

The following discussion should be read in conjunction with the Financial Statements and Notes contained herein and with those in our Form 10-K for the year ended December 31, 2012.

Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q include certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. Those statements include, but may not be limited to, all statements regarding our intent, belief, and expectations, such as statements concerning our future profitability and operating and growth strategy. Words such as “believe,” “anticipate,” “expect,” “will,” “may,” “should,” “intend,” “plan,” “estimate,” “predict,” “potential,” “continue,” “likely” and similar expressions are intended to identify forward-looking statements. Investors are cautioned that all forward-looking statements contained in this Quarterly Report on Form 10-Q and in other statements we make involve risks and uncertainties including, without limitation, the factors set forth under the caption “Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2012, and other factors detailed from time to time in our other filings with the Securities and Exchange Commission. One or more of these factors have affected, and in the future could affect our business and financial condition and could cause actual results to differ materially from plans and projections. Although we believe the assumptions underlying the forward-looking statements contained herein are reasonable, there can be no assurance that any of the forward-looking statements included in this Quarterly Report on Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statements are made or reflect the occurrence of unanticipated events, unless necessary to prevent such statements from becoming misleading. New factors emerge from time to time and it is not possible for us to predict all factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

### **Overview**

SCI Engineered Materials, Inc. (“SCI”, “we” or the “Company”), formerly Superconductive Components, Inc., an Ohio corporation, was incorporated in 1987. The Company is a global supplier and manufacturer of advanced materials for Physical Vapor Deposition Thin Film Applications. Through partnerships with end users and Original Equipment Manufacturers the Company develops innovative customized solutions enabling commercial success. Photonics currently represents the largest market for our targets. We have made considerable resource investment in the solar industry and we expect adoption of our products by current and new customers. Thin Film Battery is a developing market where manufacturers of batteries use our products to produce very small power supplies with small quantities of stored energy.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### Executive Summary

Total revenue was \$1,792,775 for the three months ended June 30, 2013, which is \$359,173 higher than the first quarter of 2013 and \$910,953 less than the same period in 2012. The sequential increase from the first quarter of 2013 to the second quarter of 2013 was principally due to the resumption of product shipments to a large customer following completion of their periodic inventory adjustment. This customer represented 12% of our revenue in the first quarter of 2013 compared to 32% during the second quarter of 2013. Second quarter 2013 revenue was impacted by lower cost of a high priced raw material and lower volume compared to the second quarter of 2012.

Gross profit was \$398,191 for the three months ended June 30, 2013 compared to \$173,599 for the first quarter of 2013 and \$523,032 for the second quarter of 2012. The sequential increase from the first quarter of 2013 to the second quarter of 2013 is attributable to improved product mix and cost controls, while the year-over-year decline was primarily due to the lower product volume noted above. Gross profit as a percentage of revenue was 22.2% for the second quarter of 2013 compared to 12.1% for the first quarter of 2013 and 19.3% for the second quarter of 2012.

Specific cost reductions were implemented during the second quarter of 2013 in response to customer order patterns during the first quarter of this year. Operating expenses of \$436,822 for the second quarter of 2013 were below the \$464,654 for the first quarter of 2013 and \$508,259 for the second quarter of 2012. We continue to invest in developing new products for the solar and glass industries including transparent conductive oxide systems and transparent electronics which have led to new customers for these products. These efforts include accelerating time to market.

For the three months ended June 30, 2013, we had a loss from operations of \$38,631 compared to a loss from operations of \$291,055 for the first three months of 2013 and income from operations of \$14,773 for the three months ended June 30, 2012. We had a loss applicable to common shares of \$63,602 for the three months ended June 30, 2013, compared to a loss applicable to common shares of \$267,594 for the first quarter of 2013 and income applicable to common shares of \$4,568 for the second quarter of 2012.

We invested approximately \$102,000 in new equipment during the first six months of 2013 and approximately \$590,000 during the full-year 2012. Investment in equipment is expected to be less for 2013 versus last year. Given identified market opportunities, we continue to invest in internally financed research and development, marketing, and sales for all of our markets.

Previous investments have resulted in ongoing production orders with periodic releases and intermittent repeat orders from several customers, as well as trial and qualification orders that were shipped to customers in the solar and glass industries during the last two years. We continue to work closely with all of our customers and are positioned to meet their near term product requirements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**RESULTS OF OPERATIONS**

**Three and six months ended June 30, 2013 (unaudited) compared to three and six months ended June 30, 2012 (unaudited):**

*Revenue*

For the three months ended June 30, 2013, we had total revenue of \$1,792,775. This was a decrease of \$910,953, or 33.7%, compared to the three months ended June 30, 2012. Product revenue decreased \$880,880, or 33.3% for the three months ended June 30, 2013 from the same period in 2012. Product revenue decreased primarily due to the lower cost of a high priced raw material and lower volume. Contract revenue was lower by approximately \$30,000 in the second quarter of 2013 compared to the same time period in 2012 as the final grant drew to a close during the second quarter of 2013.

For the six months ended June 30, 2013, we had total revenue of \$3,226,377. This was a decrease of \$1,360,383, or 29.7%, compared to the six months ended June 30, 2012. Product revenue decreased \$1,325,552, or 29.7%, primarily due to a periodic inventory adjustment by one of our large customers. This customer represented 23% of our revenue in the first six months of 2013 compared to 58% during the first six months of 2012. We resumed shipping product to this customer late in the first quarter of 2013. In addition, during August 2012, another customer announced it was reorganizing its manufacturing operations which impacted our shipments. We had no shipments to this customer during the first six months of 2013 compared to approximately \$250,000 during the first six months of 2012. Shipments to this customer are expected to resume during the second half of 2013. The reduction in these shipments was partially offset by increased shipments to existing customers and new customers.

Revenue from product sales is recognized upon shipment to customers. Provisions for discounts and rework costs for returns are established when products are shipped based on historical experience. Customer deposits represent cash received in advance of revenue earned.

Revenue from contract research provided for third parties is recognized on the percentage of completion method. Contract research revenue is recognized during the period qualifying expenses are incurred for the research that is performed as set forth under the terms of the grant award agreements.

*Gross Profit*

Gross profit was \$398,191 for the three months ended June 30, 2013 compared to \$523,032 for the same three months in 2012. This was a decrease of \$124,841, or 23.9%. The decrease in gross profit can be attributed to lower sales volume. Gross profit as a percentage of revenue was 22.2% for the second quarter of 2013 compared to 19.3% for the same period in 2012. This increase can be attributed to cost cutting measures implemented during the second quarter of 2013, and product mix which included the lower cost of the high priced raw material previously mentioned.

Gross profit was \$571,790 for the six months ended June 30, 2013 compared to \$838,177 for the same six months in 2012. This was a decrease of \$266,387 or 31.8%. The decrease in gross profit was attributed primarily to lower volume mentioned earlier which included the customer that experienced an inventory adjustment during the first quarter of 2013 and the customer that temporarily halted operations in 2012 through the second quarter of 2013.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Gross profit as a percentage of revenue was 17.7% for the first six months of 2013 compared to 18.3% for the same period in 2012. The decrease can be attributed to the lower gross profit and product mix.

### *General and Administrative Expense*

General and administrative expense for the three months ended June 30, 2013 decreased to \$239,623 from \$290,556 for the three months ended June 30, 2012, or 17.5%. The second quarter of 2013 included lower professional accounting fees of approximately \$24,000 compared to the second quarter of 2012 and a reduction of the allowance for doubtful accounts which adjusted bad debt expense by approximately \$27,000.

General and administrative expense for the six months ended June 30, 2013 decreased to \$534,833 from \$571,469 for the six months ended June 30, 2012, or 6.4%. The first six months of 2013 included lower professional fees of approximately \$20,000 compared to the first six months of 2012 and the reduction of the allowance for doubtful accounts which adjusted bad debt expense by approximately \$27,000.

### *Professional Fees*

Included in general and administrative expense was \$43,621 and \$71,697 for professional fees for the three months ended June 30, 2013 and 2012, respectively and \$110,983 and \$130,723 for professional fees for the six months ended June 30, 2013 and 2012, respectively. The decrease was due primarily to lower accounting fees. These continued expenses are related to SEC compliance costs for legal, accounting and stockholder relations fees.

### *Research and Development Expense*

Research and development expense for the three months ended June 30, 2013 was \$78,083 compared to \$70,567 for the same period in 2012, an increase of 10.7%. The increase was primarily due to the final contract drawing to a close during the second quarter of 2012 and thus some costs moving from cost of goods sold to internal R&D expense.

Research and development expense for the six months ended June 30, 2013 was \$142,203 compared to \$167,389 for the same period in 2012, a decrease of 15.0%. This decrease can be related to improved efficiencies throughout our research area. The first half of 2012 included higher costs related to developing innovative transparent conductive oxide systems to further align our activities with customer needs. These expenses declined by approximately \$58,000 in the first six months of 2013 compared to the same time period in 2012. These research and development endeavors have moved us beyond the scope of our current federal and state grants and awards. We expect internal R&D expense to increase as all research grant work has ceased.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### *Marketing and Sales Expense*

Marketing and sales expense for the three months ended June 30, 2013 decreased 19.0% to \$119,116 from \$147,136 for the same period in 2012. Compensation was lower by approximately \$11,000 during the second quarter of 2013. In addition, commissions to our outside manufacturing sales representatives and travel expense were each lower by approximately \$7,000.

Marketing and sales expense for the six months ended June 30, 2013 decreased 13.6% to \$224,440 from \$259,804 for the same period in 2012. This decrease was related to less compensation and travel expense and lower commissions to our outside manufacturing sales representatives.

### *Stock Compensation Expense*

Included in operating expenses were non cash stock based compensation costs of \$34,296 and \$35,526 for the three months ended June 30, 2013 and 2012, respectively, and \$69,731 and \$69,855 for the six months ended June 30, 2013 and 2012, respectively. Compensation cost for all stock-based awards is based on the grant date fair value and recognized over the required service (vesting) period. Unrecognized non cash stock based compensation expense related to operating expense was \$455,317 as of June 30, 2013 and will be recognized through 2017.

### *Interest, net*

Interest, net was \$18,659 and \$24,871 for the three months ended June 30, 2013 and 2012, respectively and \$39,122 and \$44,561 for the six months ended June 30, 2013 and 2012, respectively. The decrease was due to continued payments reducing principal balances. The second quarter of 2012 included a higher interest rate on one of the loans from an agency of the State of Ohio which was subsequently reduced.

### *Income Tax Benefit*

Income tax benefit for the three and six months ended June 30, 2012 was \$20,704 and \$25,889, respectively. This income tax benefit was due to the reversal of an accrual.

### *Loss/Income Applicable to Common Shares*

Loss applicable to common shares was \$63,602 for the three months ended June 30, 2013 compared to income applicable to common shares of \$4,568 for the three months ended June 30, 2012, due to lower sales volume and gross profit partially offset by lower operating expenses. Loss applicable to common shares was \$331,196 for the six months ended June 30, 2013 compared to \$191,233 for the six months ended June 30, 2012. The lower gross profit in 2013 primarily contributed to the loss applicable to common shares.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### Common Shares

The following schedule represents our outstanding common stock during the period of 2013 through 2019 assuming all outstanding stock options are exercised during the year of expiration. Based on outstanding shares at June 30, 2013, if each shareholder exercises his or her options, it would increase our common shares by 812,000 to 4,650,898 by December 31, 2019. Assuming all such options are exercised in the year of expiration, the effect on shares outstanding is illustrated as follows:

	Options due to expire	Potential shares outstanding	Weighted average exercise price
2013	-	3,838,898	-
2014	180,000	4,018,898	\$ 4.36
2015	140,000	4,158,898	\$ 2.97
2016	36,000	4,194,898	\$ 3.25
2017	-	4,194,898	-
2018	6,000	4,200,898	\$ 3.10
2019	450,000	4,650,898	\$ 6.00

### Liquidity and Capital Resources

#### *Cash*

As of June 30, 2013 cash on hand was \$342,911. Cash on-hand was \$630,819 at December 31, 2012. We believe, based on forecasted sales and expenses that cash flow from operations will be adequate to sustain operations at least through June 30, 2014.

#### *Working Capital*

At June 30, 2013 working capital was \$549,616 compared to \$802,187 at December 31, 2012, a decrease of \$252,571 or 31.5%. As discussed below cash decreased approximately \$288,000 during the six months ended June 30, 2013. Accounts receivable increased approximately \$53,000. Inventories increased approximately \$146,000 due to increased orders received during the first half of 2013. Prepaid expenses decreased approximately \$107,000 as inventory prepaid in 2012 was received early in 2013. Customer deposits increased approximately \$73,000 due to orders received for third quarter shipments. Current capital lease obligations decreased by approximately \$48,000 while current notes payable increased by approximately \$52,000 due to the Huntington National Bank promissory note maturing on February 28, 2014.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### *Cash from Operations*

Net cash used by operating activities was approximately \$37,000 for the six months ended June 30, 2013. Net cash provided by operating activities was approximately \$75,000 for the six months ended June 30, 2012. In addition to the changes in various current assets and liabilities mentioned above, non cash expenses for depreciation, accretion and amortization increased to approximately \$303,000 during the first six months of 2013 from \$290,000 during the first six months of 2012, an increase of 4.5%. This increase was related to the purchase of additional machinery and equipment. Included in expenses were non cash stock based compensation costs of approximately \$70,000 and \$71,000 for the six months ended June 30, 2013 and 2012, respectively. There was a net gain on disposal of equipment during the first six months of 2013 of approximately \$50,000. Accounts receivable increased by approximately \$53,000, partially due to a decrease in allowance for doubtful accounts of approximately \$30,000.

### *Cash from Investing Activities*

Cash of approximately \$35,000 was provided by investing activities during the six months ended June 30, 2013. Cash of approximately \$549,000 was used for investing activities during the six months ended June 30, 2012. The amounts invested were used to purchase safety equipment and machinery for increased production capacity and new product lines. Proceeds on sale of equipment were \$50,000 for the six months ended June 30, 2013.

### *Cash from Financing Activities*

Cash of approximately \$285,000 was used in financing activities for principal payments to third parties for capital lease obligations and notes payable during the six months ended June 30, 2013. We incurred a new capital lease obligation of approximately \$86,000 for new production equipment during the first six months of 2013.

During the six months ended June 30, 2012 cash of approximately \$205,000 was provided by financing activities. Principal payments to third parties for capital lease obligations and notes payable approximated \$706,000. Proceeds from notes payable were approximately \$912,000 of which \$462,000 was received from the Ohio Department of Development and used to pay towards the Promissory Note from The Huntington National Bank.

### *Debt Outstanding*

Total debt outstanding decreased during the first six months of 2013 from approximately \$1,758,000 to approximately \$1,559,000, or 11.3%. We paid cash of approximately \$285,000 towards principal amounts of capital lease obligations and notes payable during the first six months of 2013.

### *Liquidity*

We have forecasted revenues and related costs as well as investing plans and financing needs to determine liquidity to meet cash flow requirements and believe we will have sufficient liquidity at least through June 30, 2014. This forecast was based on current cash levels and debt obligations, and our best estimates of revenues primarily from existing customers and gave consideration to the continued and possible increased levels of uncertainty in demand in the markets in which we

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

operate. Our ability to maintain current operations is dependent upon its ability to achieve these forecasted results, which we believe will occur.

We do not currently have any available sources of additional external funding. Our revolving line of credit arrangement with our senior lender expired on April 13, 2012. There was no balance outstanding under this arrangement at maturity. We did not have the need to draw on the revolving line of credit since the original commitment date of January 13, 2009. We do not anticipate the need for a similar credit facility in 2013; although we may pursue revolving credit arrangements as working capital requirements increase. Our ability to obtain a new line of credit, if deemed necessary, is not certain.

During the second quarter of 2013 we enacted various cost cutting measures which included officer wage reductions and reduced work hours where feasible. Should projected sales levels fall below the minimum levels expected to be achievable, additional cost reduction actions could be instituted, which might facilitate the continued operation of the Company. The achievement of such reductions and the timing of their impact are not readily predictable.

### **Government Grants and Contracts**

During the fourth quarter of 2009 we were notified we had been awarded a grant in the amount of \$775,400 by the Ohio Department of Development's Third Frontier Photovoltaic Program (TFPVP) to commercialize advanced technology for high power density rotatable ceramic sputtering targets. These targets are used in the manufacture of thin film photovoltaics. This technology will enable manufacturers to operate rotatable sputtering targets at higher power densities than current technology. The approval of the grant was received during January 2010 and the work on the contract commenced in the first quarter of 2010. Revenue totaled \$26,438 during the three months ended June 30, 2013 compared to \$56,511 during the same period in 2012. Revenue totaled \$90,170 during the first six months of 2013 compared to \$125,001 during the first six months of 2012. Total expenditures for the project through June 30, 2013 were \$775,400. The work on the contract concluded during the second quarter of 2013.

We anticipate that contract research revenue will be zero during the last six months of 2013 due to the TFPVP program drawing to a close during the second quarter of 2013. We do not rely on contract revenue as a main part of our business and do not believe that this reduction will have an adverse effect on our business.

### **Off Balance Sheet Arrangements**

We have no off balance sheet arrangements including special purpose entities.

### **Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make judgments, assumptions and estimates that affect the amounts reported in the Financial Statements and accompanying notes. Note 2 to the Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012 describes the significant accounting policies and methods used in the preparation of the Financial Statements. Estimates are used for, but not limited to, accounting for the allowance for doubtful accounts, inventory allowances, property and equipment depreciable lives, patents and licenses useful lives, revenue recognition, tax valuation, stock based compensation and

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

assessing changes in which impairment of certain long-lived assets may occur. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Financial Statements. The allowance for doubtful accounts is based on our assessment of the collectability of specific customer accounts and the aging of the accounts receivable. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, our estimates of the recoverability of amounts due us could be adversely affected. Inventory purchases and commitments are based upon future demand forecasts. If there is a sudden and significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology and customer requirements, we may be required to increase our inventory allowances and our gross margin could be adversely affected. Depreciable and useful lives estimated for property and equipment, licenses and patents are based on initial expectations of the period of time these assets and intangibles will benefit us. Changes in circumstances related to a change in our business, change in technology or other factors could result in these assets becoming impaired, which could adversely affect the value of these assets.

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Due to a segregation of duties material weakness described below, and based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2013, the Company's disclosure controls and procedures were not effective, at the reasonable assurance level, in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act and in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussions regarding required disclosure. Until we are able to hire additional employees, we will continue to report to the Audit Committee and the Board of Directors at least monthly (and more often as necessary). We believe this will continue to mitigate this weakness. This reporting includes balance sheets, statements of operations, statements of cash flows, and other detail supporting these statements. Accordingly, we believe that the financial statements included in this report fairly present, in all material respects, our financial condition, results of operation, changes in shareholder's equity and cash flows for all periods presented.

#### **Item 4. Controls and Procedures (continued)**

##### **Inherent Limitations over Internal Controls**

Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on the financial statements.

Management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods is subject to the risk that those internal controls may become inadequate because of changes in business conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management previously disclosed a material weakness in internal control over financial reporting in its annual report on Form 10-K, filed on March 19, 2013 for the year ended December 31, 2012, relating to insufficient segregation of duties consistent with control objectives. Management is aware of the risks associated with the lack of segregation of duties due to the small number of employees currently working with general administrative and financial matters. Due to our size and nature, segregation of all conflicting duties may not always be possible and may not be economically feasible. However, to the extent possible, the initiation of transactions, the custody of assets and the recording of transactions shall be performed by separate individuals. In order to remediate this weakness, we will need to hire additional employees. Although we will periodically reevaluate this situation, at this point we consider that the risks associated with such lack of segregation of duties and the potential benefits of adding employees to segregate such duties are not cost justified. Until we are able to hire additional employees, we will continue to report to the Audit Committee and the Board of Directors at least monthly (and more often as necessary). We believe this will continue to mitigate this weakness. This reporting includes balance sheets, statements of operations, statements of cash flows, and other detail supporting these statements.

##### **Changes in Internal Controls over Financial Reporting**

There were no changes in our internal controls over financial reporting for the three months ended June 30, 2013 that materially affected or were reasonably likely to materially affect our disclosure controls and procedures. Additionally, there were no changes in our internal controls that could materially affect our disclosure controls and procedures subsequent to the date of their evaluation.

## Part II. Other Information

### Item 6. Exhibits

- 3.1 Certificate of Second Amended and Restated Articles of Incorporation of Superconductive Components, Inc. (Incorporated by reference to Exhibit 3(a) to the Company's initial Form 10-SB, filed on September 28, 2000)
- 3.2 Restated Code of Regulations of Superconductive Components, Inc. (Incorporated by reference to Exhibit 3(b) to the Company's initial Form 10-SB, filed on September 28, 2000)
- 3.3 Amendment to Articles of Incorporation recording the change of the corporate name to SCI Engineered Materials, Inc. (Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-QSB filed November 7, 2007).
- 4.1 SCI Engineered Materials, Inc. 2011 Stock Incentive Plan (Incorporated by reference to the Company's Definitive Proxy Statement for the 2011 Annual Meeting of Shareholders held on June 10, 2011, filed April 28, 2011).
- 4.2 Superconductive Components, Inc. 2006 Stock Incentive Plan (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement for the 2006 Annual Meeting of Shareholders held on June 9, 2006, filed May 1, 2006).
- 4.3 Description of the Material Terms of the Stock Option Grant and Cash Bonus Plan for Executive Officers (Incorporated by reference to the Company's Current Report on Form 8-K, dated June 19, 2006, filed June 23, 2006)
- 4.4 Form of Incentive Stock Option Agreement under the Superconductive Components, Inc. 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 19, 2006, filed June 23, 2006).
- 4.5 Form of Non-Statutory Stock Option Agreement under the Superconductive Components, Inc. 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated June 19, 2006, filed June 23, 2006).
- 4.6 Description of the Material Terms of the Stock Option Grant for Executive Officers and Board of Directors (Incorporated by reference to the Company's Current Report on Form 8-K dated January 2, 2009, filed January 6, 2009).
- 4.7 Fourth Amended and Restated 1995 Stock Option Plan (Incorporated by reference to Exhibit 4(a) to the Company's Registration Statement on Form S-8 (Registration No. 333-97583), filed on August 2, 2002)
- 4.8 Form of Non-Statutory Stock Option Agreement Under the Superconductive Components, Inc. Fourth Amended and Restated 1995 Stock Option Plan (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on December 22, 2005)

**Item 6. Exhibits (continued)**

- 10.1 Description of amendment to the Loan Agreement between the Company and The Ohio Air Quality Development Authority (Incorporated by reference to the Company's Current Report on Form 8-K, filed March 26, 2012).
- 10.2 Description of amendment to the Loan Agreement between the Company and the Ohio Department of Development (Incorporated by reference to the Company's Current Report on Form 8-K, filed April 9, 2012).
- 10.3 Description of amendment to the Loan Agreement between the Company and The Ohio Air Quality Development Authority (Incorporated by reference to the Company's Current Report on Form 8-K, filed July 10, 2012).
- 10.4 Description of amendment to the Loan Agreement between the Company and The Ohio Air Quality Development Authority (Incorporated by reference to the Company's Current Report on Form 8-K, filed October 19, 2012).
- 10.5 Description of Business Loan Agreement between the Company and The Huntington National Bank dated as of October 15, 2012 (Incorporated by reference to the Company's Current Report on Form 8-K, filed October 19, 2012).
- 10.6 Description of amendment to the Loan Agreement between the Company and the Ohio Development Services Agency, formerly known as the Ohio Department of Development (Incorporated by reference to the Company's Current Report on Form 8-K, dated March 19, 2013).
- 22.1 Description of matters submitted to vote of security holders (Incorporated by reference to the Company's Current Report on Form 8-K, dated June 17, 2013).
- 31.1 Rule 13a-14(a) Certification of Principal Executive Officer.\*
- 31.2 Rule 13a-14(a) Certification of Principal Financial Officer.\*
- 32.1 Section 1350 Certification of Principal Executive Officer and Certification of Principal Financial Officer.\*
- 99.1 Press Release dated August 7, 2013, entitled "SCI Engineered Materials, Inc. Reports Second Quarter 2013 Results."
- 101 The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at June 30, 2013 and December 31, 2012 (ii) Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012, (iii) Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012, (iv) Notes to Financial Statements.

\* Filed with this report



**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 7, 2013

**SCI ENGINEERED MATERIALS, INC.**

/s/ Daniel Rooney

Daniel Rooney, Chairman of the Board of Directors, President and Chief Executive Officer  
(Principal Executive Officer)

/s/ Gerald S. Blaskie

Gerald S. Blaskie, Vice President and Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Daniel Rooney, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SCI Engineered Materials, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2013

/s/ Daniel Rooney  
Daniel Rooney  
Chairman of the Board of Directors,  
President and Chief Executive Officer  
(Principal Executive Officer)

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Gerald S. Blaskie, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SCI Engineered Materials, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2013

/s/ Gerald S. Blaskie  
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Gerald S. Blaskie  
Vice President and Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SCI Engineered Materials, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Daniel Rooney, Chairman of the Board of Directors, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Daniel Rooney

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Daniel Rooney  
Chairman of the Board of Directors,  
President and Chief Executive Officer of  
SCI Engineered Materials, Inc.  
(Principal Executive Officer)  
August 7, 2013

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SCI Engineered Materials, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gerald S. Blaskie, Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Gerald S. Blaskie

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Gerald S. Blaskie  
Vice President and Chief Financial Officer of  
SCI Engineered Materials, Inc. (Principal Financial Officer and Principal  
Accounting Officer)  
August 7, 2013

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