

PERFORMANCE TECHNOLOGIES INC \DE\  
Form 10-Q  
August 12, 2013

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 Quarter 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 0-27460**

PERFORMANCE TECHNOLOGIES,  
INCORPORATED  
(Exact name of registrant as specified in its charter)

**Delaware**

**16-1158413**

(State or other jurisdiction of incorporation) (I.R.S. Employer Identification No.)

**140 Canal View Blvd., Rochester, New York 14623**

(Address of principal executive offices) (Zip Code)

**Registrant's telephone number, including area code: (585) 256-0200**

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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 (§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, or a non-accelerated filer: 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

The number of shares outstanding of the registrant's common stock was 11,154,730 as of July 31, 2013.

**PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES**

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<sup>a</sup> – not applicable as PT qualifies as a Smaller Reporting Company

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PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (unaudited)

## ASSETS

	<b>June 30,</b>	<b>December 31, 2012</b>
	<b>2013</b>	
Current assets:		
Cash and cash equivalents	\$9,799,000	\$7,546,000
Investments	1,963,000	4,794,000
Accounts receivable, net	6,541,000	3,775,000
Inventories, net	2,741,000	3,615,000
Prepaid expenses and other assets	1,122,000	932,000
Prepaid income taxes	297,000	206,000
Deferred income taxes	409,000	445,000
Total current assets	22,872,000	21,313,000
Investments	510,000	1,969,000
Property, equipment and improvements, net	1,654,000	1,683,000
Software development costs, net	3,567,000	3,716,000
Purchased intangible assets, net	2,367,000	2,835,000
Total assets	\$30,970,000	\$31,516,000

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:		
Accounts payable	\$936,000	\$1,134,000
Accrued expenses	1,852,000	1,664,000
Deferred revenue	3,054,000	3,002,000
Fair value of foreign currency hedge contracts	64,000	
Total current liabilities	5,906,000	5,800,000
Deferred income taxes	671,000	696,000
Total liabilities	6,577,000	6,496,000
Stockholders' equity:		
Preferred stock - \$.01 par value: 1,000,000 shares authorized; none issued		
Common stock - \$.01 par value: 50,000,000 shares authorized; 13,304,596 shares issued; 11,116,397 shares outstanding	133,000	133,000
Additional paid-in capital	17,714,000	17,591,000

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Retained earnings	16,426,000	17,099,000	
Accumulated other comprehensive income (loss)	(62,000 )	15,000	
Treasury stock - at cost; 2,188,199 shares	(9,818,000 )	(9,818,000	)
Total stockholders' equity	24,393,000	25,020,000	
Total liabilities and stockholders' equity	\$30,970,000	\$31,516,000	

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

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PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Sales	\$7,107,000	\$5,018,000	\$13,392,000	\$13,374,000
Cost of goods sold	3,597,000	2,944,000	7,053,000	6,741,000
Impairment of software development costs	137,000		137,000	
Gross profit	3,373,000	2,074,000	6,202,000	6,633,000
Operating expenses:				
Selling and marketing	1,340,000	1,473,000	2,735,000	3,088,000
Research and development	1,028,000	1,574,000	2,209,000	3,273,000
General and administrative	804,000	857,000	1,653,000	1,804,000
Restructuring charges			243,000	
Total operating expenses	3,172,000	3,904,000	6,840,000	8,165,000
Income (loss) from operations	201,000	(1,830,000)	(638,000)	(1,532,000)
Other (expense) income, net	(10,000)	29,000	(19,000)	(1,000)
Income (loss) before income taxes	191,000	(1,801,000)	(657,000)	(1,533,000)
Income tax (benefit) provision	(2,000)	(47,000)	16,000	(68,000)
Net income (loss)	\$193,000	\$(1,754,000)	\$(673,000)	\$(1,465,000)
Basic income (loss) per share	\$.02	\$(.16)	\$(.06)	\$(.13)
Diluted income per share	\$.02			
Weighted average number of common shares used in basic and diluted income (loss) per share	11,116,397	11,116,397	11,116,397	11,116,397

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

Table of contents**PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	\$ 193,000	\$(1,754,000)	\$(673,000)	\$(1,465,000)
Other comprehensive income (loss), net of tax:				
Change in unrealized (loss) gain on foreign currency hedge contracts	(49,000 )	9,000	(64,000 )	46,000
Change in unrealized (loss) gain on available-for-sale investments	(10,000 )	(6,000 )	(13,000 )	73,000
Other comprehensive income (loss)	(59,000 )	3,000	(77,000 )	119,000
Comprehensive income (loss)	\$ 134,000	\$(1,751,000)	\$(750,000)	\$(1,346,000)

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





Table of contents**PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	Six Months Ended	
	June 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$(673,000 )	\$(1,465,000)
Non-cash adjustments:		
Depreciation and amortization	1,266,000	1,329,000
Amortization of purchased intangible assets	468,000	589,000
Stock-based compensation expense	123,000	125,000
Impairment of software development costs	137,000	
Deferred income taxes	11,000	6,000
Realized loss on disposal of property and equipment	5,000	
Realized gain on redemption of investment	(4,000 )	
Revenue from non-monetary exchange		(257,000 )
Non-cash interest expense		1,000
Changes in operating assets and liabilities:		
Accounts receivable	(2,766,000)	1,319,000
Inventories	885,000	456,000
Prepaid expenses and other assets	(190,000 )	139,000
Accounts payable and accrued expenses	(10,000 )	(91,000 )
Deferred revenue	52,000	676,000
Income taxes payable and prepaid income taxes	(91,000 )	(84,000 )
Net cash (used) provided by operating activities	(787,000 )	2,743,000
Cash flows from investing activities:		
Purchase of equipment, inventory and intangible assets		(1,000,000)
Purchases of property, equipment and improvements	(285,000 )	(279,000 )
Capitalized software development costs	(913,000 )	(1,170,000)
Proceeds from sales and maturities of investments	4,752,000	1,053,000
Purchases of investments	(514,000 )	(2,995,000)
Net cash provided (used) by investing activities	3,040,000	(4,391,000)
Net increase (decrease) in cash and cash equivalents	2,253,000	(1,648,000)
Cash and cash equivalents at beginning of period	7,546,000	9,641,000
Cash and cash equivalents at end of period	\$9,799,000	\$7,993,000
Supplemental Disclosure of Cash Flow Information:		
Software acquired in non-monetary exchange		\$257,000

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

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**PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**Note A – Basis of Presentation and Changes in Significant Accounting Policies**

The interim unaudited Consolidated Financial Statements of Performance Technologies, Incorporated and Subsidiaries (collectively “PT” or “the Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information (“GAAP”) and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (“SEC”). Accordingly, the Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The results for the interim periods are not necessarily indicative of the results to be expected for the full year. The accompanying Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of the Company as of December 31, 2012, as reported in its Annual Report on Form 10-K filed with the SEC.

Our preparation of the interim unaudited Consolidated Financial Statements of PT requires us to make estimates and assumptions that affect the amounts in those financial statements and accompanying notes. Actual results could differ from these estimates.

**Financial Statement Presentation**

Certain reclassifications have been made to the amounts presented for the three and six months ended June 30, 2012 in order to conform to the current year presentation. Due to the Company’s recent restructuring actions and realignment of its business, management has elected to change the account classification of certain items of compensation and related expense, previously reported in general and administrative expenses to selling and marketing expense and research and development expense.

**Recent Accounting Pronouncements**

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income:

In February 2013, the FASB issued authoritative guidance on the reporting of amounts reclassified out of accumulated other comprehensive income (“AOCI”), which is effective for reporting periods beginning after December 15, 2012. This guidance requires companies to provide information about the amounts reclassified out of AOCI either in a single note or on the face of the financial statements. Significant amounts reclassified out of AOCI should be presented by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified in its entirety to net income in the same reporting period. For amounts not required to be reclassified in their entirety to net income, a cross-reference to other disclosures provided for in accordance with U.S. GAAP is required. The Company has adopted this authoritative guidance. To date, its adoption does not have a material impact on its consolidated financial statement disclosures.

Disclosures about Offsetting Assets and Liabilities:

In December 2011, the FASB issued authoritative guidance requiring enhanced disclosures about offsetting assets and liabilities, which is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The new rules require companies to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position, as well as instruments and transactions subject to a netting arrangement. In January 2013, the FASB issued a clarification of the guidance in order to address implementation issues surrounding the scope of the standard and to clarify the scope of the offsetting disclosures and address any unintended consequences. The Company has evaluated this updated authoritative guidance, and the adoption of this guidance does not have a material impact on its consolidated financial statement disclosures.

Table of contents**Note B – Investments**

Investments are stated at fair value and consisted of the following:

	June 30, 2013		December 31, 2012	
	Amortized cost	Fair value	Amortized cost	Fair value
Corporate bonds	\$2,471,000	\$2,473,000	\$5,247,000	\$5,262,000
Municipal bonds			1,501,000	1,501,000
Total investments	2,471,000	2,473,000	6,748,000	6,763,000
Less: current investments	(1,959,000)	(1,963,000)	(4,786,000)	(4,794,000)
Non-current investments	\$512,000	\$510,000	\$1,962,000	\$1,969,000

The Company's bond investments have a cumulative par value of \$2,450,000 at June 30, 2013.

**Note C – Inventories, net**

Inventories consisted of the following:

	June 30, 2013	December 31, 2012
Purchased parts and components	\$827,000	\$1,245,000
Work in process and purchased assemblies	1,381,000	1,631,000
Finished goods	533,000	739,000
Net	\$2,741,000	\$3,615,000

**Note D – Software Development Costs**

Software development costs consisted of the following:

	June 30, 2013	December 31, 2012
Capitalized software development costs	\$25,363,000	\$24,450,000
Less: accumulated amortization	(21,796,000)	(20,734,000)
Net	\$3,567,000	\$3,716,000

Amortization of software development costs included in cost of goods sold was \$595,000 and \$437,000 in the second quarter 2013 and 2012, respectively. The second quarter 2013 amount includes a charge amounting to \$137,000 for the impairment of certain capitalized software projects. Amortization of software development costs included in cost of goods sold was \$1,062,000 and \$837,000 for the six months ended June 30, 2013 and 2012, respectively, including the impairment charge in 2013.

Table of contents**Note E – Purchased Intangible Assets**

Purchased intangible assets consisted of the following:

	June 30, 2013	December 31, 2012
Purchased developed technologies	\$5,352,000	\$5,352,000
Support contracts	420,000	420,000
Total	5,772,000	5,772,000
Less: accumulated amortization	(3,405,000)	(2,937,000)
Purchased intangible assets, net	\$2,367,000	\$2,835,000

Amortization of purchased intangible assets included in cost of goods sold totaled \$234,000 and \$310,000 in the second quarter 2013 and 2012, respectively. Amortization of purchased intangible assets included in cost of goods sold totaled \$468,000 and \$589,000 in the six months ended June 30, 2013 and 2012, respectively.

**Note F – Warranty Obligations**

Warranty obligations are incurred in connection with the sale of certain products. The warranty period for PT's products is generally one year. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. Future warranty costs are estimated based on product-based historical performance rates and related costs to repair. Changes in accrued warranty obligations for the three and six months ended June 30, 2013 and 2012 were as follows:

	2013	2012
Accrued warranty obligations, January 1	\$68,000	\$92,000
Actual warranty experience	(9,000 )	(14,000)
Warranty provisions	9,000	14,000
Accrued warranty obligations, March 31	68,000	92,000
Actual warranty experience	(11,000)	(20,000)
Warranty provisions	7,000	15,000
Accrued warranty obligations, June 30	\$64,000	\$87,000

**Note G – Earnings (Loss) Per Share**

Basic earnings (loss) per share is computed by dividing net income or loss by the weighted average number of common shares outstanding for the period. Diluted earnings per share calculations reflect the assumed exercise and conversion of dilutive stock options, if any, using the treasury stock method. There were no dilutive stock options for the second quarter 2013. Due to the net losses incurred in the second quarter 2012 and the six months ended June 30, 2013 and 2012, dilutive options were not considered for those periods. The weighted average number of excluded options totaled approximately 2,289,000 shares and 1,869,000 shares for the second quarter 2013 and 2012, respectively, and 2,218,000 shares and 1,888,000 shares for the six months ended June 30, 2013 and 2012, respectively.

**Note H – Derivative Instruments – Foreign Currency Hedge Contracts**

The Company is exposed to the impact of fluctuations in foreign currency exchange rates on the expenses incurred in its Canadian and United Kingdom operations. PT's risk management program is designed to reduce the exposure and volatility arising from this risk. At June 30, 2013, the Company had contracts in place to hedge approximately 60% of its estimated Canadian foreign currency risk for the remainder of 2013. At June 30, 2012 and December 31, 2012, the Company had no such contracts in place.



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PT's derivative instruments are designated and qualify as cash flow hedges. Such contracts are stated at estimated fair value and any gains or losses resulting from changes in the fair value of these contracts are recorded in other comprehensive income or loss. The Company will receive, or be required to disburse, cash payments upon the expiration of each contract depending on fluctuations in the underlying exchange rates. Such payments will be recorded as reductions to or increases in expense as they are determined.

The fair value of the Company's derivative instruments consisted of the following:

	Balance sheet location	Fair value at	
		June 30, 2013	December 31, 2012
Derivatives designated as hedging instruments	Current liabilities	\$(64,000)	\$ —

The Company's derivative instruments had the following effect on the statements of operations:

	Location of gain (loss) recognized in operations	Amount of (loss) reclassified from accumulated other comprehensive income (loss) to the statement of operations	
		Three Months Ended	
		June 30, 2013	2012
Derivatives fair value			
hedging relationships			
Foreign exchange contracts	Operating expenses	\$(8,000)	\$(15,000)

		Six Months Ended	
		June 30,	
		2013	2012
Foreign exchange contracts	Operating expenses	\$(12,000)	\$(27,000)

The Company's derivative instruments had the following effect on accumulated other comprehensive income (loss):

	Three Months Ended	Six Months Ended
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	June 30, 2013	2012	June 30, 2013	2012
Accumulated other comprehensive (loss) income – derivative instruments, beginning	\$(15,000)	\$(9,000 )	\$—	\$(46,000)
Amount of loss recognized in statement of operations, net of tax	8,000	15,000	12,000	27,000
Net change in fair value of derivative instruments	(57,000)	(6,000 )	(76,000)	19,000
Accumulated other comprehensive income – derivative instruments, ending	\$(64,000)	\$—	\$(64,000)	\$—

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Table of contents**Note I – Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) consists of the following:

	June 30, 2013	December 31, 2012
Unrealized loss on foreign currency hedge contracts	\$(64,000)	\$—
Unrealized gain on available-for-sale investments	2,000	15,000
Net	\$(62,000)	\$ 15,000

An out-of-period charge amounting to \$63,000 was made to other (expense) income during the six months ended June 30, 2012 to adjust the recorded balance of unrealized gain (loss) on available-for-sale securities. This adjustment did not have a material impact on our consolidated financial statements for the six months ended June 30, 2012.

**Note J – Fair Value Measurements**

GAAP defines fair value, establishes a framework for measuring fair value and requires certain disclosures about fair value measurements. In addition, GAAP establishes a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted prices included in Level 1 that are directly or indirectly observable for the asset or liability. Such inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs derived principally from or corroborated by observable market data by correlation or other means. Level 3 inputs are unobservable inputs for the asset or liability. Such inputs are used to measure fair value when observable inputs are not available.

The Company's assets and liabilities measured at fair value on a recurring basis at June 30, 2013, were as follows:

Level 1	Level 2	Level 3
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Assets:

Investments – corporate bonds	\$2,473,000	\$—	\$ —
Total assets measured at fair value	\$2,473,000	\$—	\$ —

Liabilities:

Foreign currency hedge contracts	\$—	\$64,000	\$ —
Total liabilities measured at fair value	\$—	\$64,000	\$ —

The Company’s assets measured at fair value on a recurring basis at December 31, 2012, were as follows:

	Level 1	Level 2	Level 3
Assets:			
Investments – corporate bonds	\$5,262,000	\$—	\$ —
Investments – municipal bonds	—	1,501,000	—
Total assets measured at fair value	\$5,262,000	\$ 1,501,000	\$ —

There were no transfers into or out of Level 1, Level 2 or Level 3.

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Foreign currency forward contracts are measured at fair value using models based on observable market inputs such as foreign currency exchange rates; therefore, they are classified within Level 2 of the valuation hierarchy. The fair value of the Company's investments in municipal bonds and bank guaranteed investment contracts is measured using Level 2 inputs. For these investments, fair value is not materially different than amortized cost.

**Note K – Stock-Based Compensation**

PT has stock options outstanding from two stock-based employee compensation plans: the 2003 Omnibus Incentive Plan and the 2012 Omnibus Incentive Plan. Each plan provides for equity-based incentive awards to selected employees, directors and consultants, with a maximum of 1,500,000 shares that may be awarded under each plan.

PT recognizes compensation expense in the financial statements for stock option awards based on the grant date fair value of those awards, estimated using the Black-Scholes-Merton option pricing model. The table below summarizes the impact of outstanding stock options on the results of operations for the three and six month periods ended June 30, 2013 and 2012.

	Three Months ended June 30,		Six Months ended June 30,	
	2013	2012	2013	2012
Stock-based compensation expense – stock options	\$65,000	\$58,000	\$123,000	\$125,000
Income tax benefit	—	—	—	—
Net increase in net loss	\$65,000	\$58,000	\$123,000	\$125,000
Per share increase in basic net loss:	\$.01	\$.01	\$.01	\$.01

The following table summarizes stock option activity for the six months ended June 30, 2013:

	Number of shares	Weighted Average Exercise Price
Outstanding at January 1, 2013	1,654,600	\$ 3.08
Granted	732,000	.93
Exercised	—	—

Expired	(156,250 )	4.50
Outstanding at June 30, 2013	2,230,350	2.26
Exercisable at June 30, 2013	1,152,017	\$ 3.16

The weighted average fair value of option grants was estimated using the Black-Scholes-Merton option pricing method. At June 30, 2013, PT had approximately \$327,000 of unrecognized stock compensation expense which will be recognized over a weighted average period of approximately 1.9 years.

**Note L – Income Taxes**

PT's effective income tax rate is a combination of federal, state and foreign tax rates and differs from the U.S. statutory rate due to taxes on and credits against foreign income, permanent differences including tax-exempt interest, and the resolution of tax uncertainties, offset by a valuation allowance against U.S. deferred income tax assets.

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PT's estimated effective annual tax rate was -2% for the six months ended June 30, 2013 and does not include any material discrete items. The estimated effective annual tax rate used for the six months ended June 30, 2012 was 4% and did not include any material discrete items. The change in the effective annual tax rate is due to expected refundable Canadian provincial tax credits which are presented in 2013 as a reduction of research and development expenses.

The Company had no balance in unrecognized tax benefits at either June 30, 2013 or December 31, 2012.

At June 30, 2013, the Company had gross deferred income tax assets totaling approximately \$17,600,000, against substantially all of which the Company has recorded a valuation allowance. At December 31, 2012, the Company had gross deferred income tax assets totaling approximately \$17,217,000 and has recorded a valuation allowance against substantially all of this amount.

The Company files U.S. federal, U.S. state, and foreign tax returns. For federal tax returns, the Company is generally no longer subject to tax examinations for years prior to 2009. For state and foreign tax returns, the Company is generally no longer subject to tax examinations for years prior to 2008. It is reasonably possible that the Company may need to establish a liability associated with the Company's unrecognized tax benefits within the next twelve months. Based upon the closing of the tax years in these various jurisdictions, the Company may adjust its liability for unrecognized tax benefits. These changes may be the result of new examinations by taxing authorities or the expiration of statutes of limitations.

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

Matters discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q include 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, and are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those discussed in the forward-looking statements.

*Critical Accounting Estimates and Assumptions*

In preparing the financial statements in accordance with the accounting principles generally accepted in the United States (GAAP), estimates and assumptions are required to be made that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information disclosures, including information about contingencies, risk and financial condition. These estimates and assumptions are made during the closing process for the quarter, after the quarter end has passed. The Company believes that given the current facts and circumstances, these estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates, and estimates may vary as new facts and circumstances arise. Management's judgments in making these estimates and relying on these assumptions may materially impact amounts reported for any period.



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The critical accounting policies, judgments and estimates that we believe have the most significant effect on our financial statements are set forth below:

.	Revenue Recognition
.	Software Development Costs
.	Valuation of Inventories
.	Income Taxes
.	Product Warranty
.	Stock-Based Compensation
.	Restructuring Costs
.	Carrying Value of Long-Lived Assets

*Revenue Recognition:* Revenue is recognized from product sales in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Product sales represent the majority of our revenue and include both hardware products and hardware products with embedded software. Revenue is recognized from these product sales when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectibility is reasonably assured. Additionally, products are sold on terms which transfer title and risk of loss at a specified location, typically the shipping point. Accordingly, revenue recognition from product sales occurs when all factors are met, including transfer of title and risk of loss, which typically occurs upon shipment. If these conditions are not met, revenue recognition is deferred until such time as these conditions have been satisfied.

For arrangements with multiple deliverables, the arrangement consideration is allocated at the inception of an arrangement to all deliverables using the relative selling price method. A selling price hierarchy is employed for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence ("VSOE") if available; (2) third-party evidence ("TPE") if vendor-specific objective evidence is not available; and (3) best estimated selling price ("BESP") if neither vendor-specific nor third-party evidence is available. For PT's multiple deliverable arrangements, our products and services qualify as separate units of accounting. The Company's multiple deliverable arrangements generally include a combination of telecommunications hardware and software products, services including installation and training, and support services. These arrangements typically have both software and non-software components that function together to deliver the product's essential functionality. These arrangements generally do not include any provisions for cancellation, termination, or refunds that would significantly impact recognized revenue. Because the Company rarely sells its proprietary hardware and software products on a stand-alone basis or without support, PT is not able to establish VSOE for these products. Additionally, PT generally expects that it will not be able to establish TPE due to the proprietary nature of PT's products and the markets in which we compete. Accordingly, PT expects the selling price of its products to be based on its BESP. PT has established VSOE for its support and services and, therefore, it utilizes VSOE for these elements.

Since the adoption of this guidance on January 1, 2011, we have primarily used the same information used to set pricing strategy to determine BESP. The Company has corroborated the BESP with our historical sales prices, the anticipated margin on the deliverable, the selling price and profit margin for similar deliverables and the characteristics of the geographical markets in which the deliverables are sold. PT plans to analyze the selling prices used in our allocation of arrangement consideration at least semi-annually. Selling prices will be analyzed more

frequently if a significant change in our business necessitates a more timely analysis.

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For substantially all multiple deliverable arrangements, PT defers support and services revenue, and recognizes revenue for delivered products in an arrangement when persuasive evidence of an arrangement exists and delivery of the last product has occurred, provided the fee is fixed or determinable, and collection is deemed probable. In instances where final acceptance of the product is based on customer specific criteria, revenue is deferred until the earlier of the receipt of customer acceptance or the expiration of acceptance period. Support revenue is recognized ratably over the term of the support period. Services revenue is typically recognized upon completion of the services for fixed-fee service arrangements, as these services are relatively short-term in nature (typically several weeks, or in limited cases, several months). For service arrangements that are billed on a time and material basis, we recognize revenue as the services are performed.

For multiple deliverable arrangements entered into prior to January 1, 2011 and not materially modified after that date, PT recognized revenue based on the then-existing software revenue recognition guidance, which required the entire fee from the arrangement to be allocated to each respective element based on its relative selling price using VSOE. For such arrangements, when the Company was unable to establish VSOE for the delivered telecommunications products, PT utilized the residual method to allocate revenue to each of the elements of an arrangement. Under this method, PT allocated the total fee in an arrangement first to the undelivered elements (typically support and services) based on VSOE of those elements, and the remaining, or “residual” portion of the fee to the delivered elements (typically the product or products).

Revenue from software requiring significant production, modification, or customization is recognized using the percentage of completion method of accounting. Anticipated losses on contracts, if any, are charged to operations as soon as such losses are determined. If all conditions of revenue recognition are not met, the Company defers revenue recognition and will recognize revenue when the Company has fulfilled its obligations under the arrangement. Revenue from software maintenance contracts is recognized ratably over the contractual period.

Revenue from consulting and other services is recognized at the time the services are rendered. The Company also sells certain products through distributors who are granted limited rights of return. Potential returns are accounted for at the time of sale.

The accounting estimate related to revenue recognition is considered a “critical accounting estimate” because terms of sale can vary, and judgment is exercised in determining whether to defer revenue recognition. Such judgments may materially affect net sales for any period. Judgment is exercised within the parameters of GAAP in determining when contractual obligations are met, title and risk of loss are transferred, sales price is fixed or determinable and collectibility is reasonably assured.

*Software Development Costs:* All software development costs incurred in establishing the technological feasibility of computer software products to be sold are charged to expense as research and development costs. Software development costs incurred subsequent to the establishment of technological feasibility of a computer software product to be sold, and prior to general release of that product, are capitalized. Amounts capitalized are amortized

commencing after general release of that product over the estimated remaining economic life of that product, generally three years, using the straight-line method or using the ratio of current revenues to current and anticipated revenues from such product, whichever provides greater amortization. If the technological feasibility for a particular project is judged not to have been met or recoverability of amounts capitalized is in doubt, project costs are expensed as research and development or charged to cost of goods sold, as applicable. The accounting estimate related to software development costs is considered a “critical accounting estimate” because judgment is exercised in determining whether project costs are expensed as research and development or capitalized as an asset. Such judgments may materially affect expense amounts for any period. Judgment is exercised within the parameters of GAAP in determining when technological feasibility has been met and recoverability of software development costs is reasonably assured.

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*Valuation of Inventories:* Inventories are stated at the lower of cost or market, using the first-in, first-out method. Inventory includes purchased parts and components, work in process and finished goods. Provisions for excess, obsolete or slow moving inventory are recorded after periodic evaluation of historical sales, current economic trends, forecasted sales, estimated product life cycles and estimated inventory levels. Purchasing practices, electronic component obsolescence, accuracy of sales and production forecasts, introduction of new products, product life cycles, product support and foreign regulations governing hazardous materials are the factors that contribute to inventory valuation risks. Exposure to inventory valuation risks is managed by maintaining safety stocks, minimum purchase lots, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing certain inventory minimization strategies such as vendor-managed inventories. The accounting estimate related to valuation of inventories is considered a “critical accounting estimate” because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors, including purchasing, sales, production, and after-sale support. If actual demand, market conditions or product life cycles differ from estimates, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs and a decrease to gross margins.

*Income Taxes:* PT provides deferred income tax assets and liabilities based on the estimated future tax effects of differences between the financial and tax bases of assets and liabilities based on currently enacted tax laws. A valuation allowance is established for deferred tax assets in amounts for which realization is not considered more likely than not to occur. The accounting estimate related to income taxes is considered a “critical accounting estimate” because judgment is exercised in estimating future taxable income, including prudent and feasible tax planning strategies, and in assessing the need for any valuation allowance. If it should be determined that all or part of a net deferred tax asset is not able to be realized in the future, an adjustment to the valuation allowance would be charged to income in the period such determination was made. Likewise, in the event that it should be determined that all or part of a deferred tax asset in the future is in excess of the net recorded amount, an adjustment to the valuation allowance would increase income to be recognized in the period such determination was made.

PT operates within multiple taxing jurisdictions worldwide and is subject to audit in these jurisdictions. These audits can involve complex issues, which may require an extended period of time for resolution. Although management believes that adequate provision has been made for such issues, there is the possibility that the ultimate resolution of such issues could have an adverse effect on the earnings of PT. Conversely, if these issues are resolved favorably in the future, the related provisions would be reduced, thus having a positive impact on earnings.

In addition, the calculation of PT’s tax liabilities involves dealing with uncertainties in the application of complex tax regulations. PT recognizes liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires PT to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires PT to determine the probability of various possible outcomes. PT re-evaluates these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period. At June 30, 2013, there are no tax uncertainties that PT has determined are required to be recognized.

Finally, the value of PT's deferred tax assets is dependent upon PT's ability to generate future taxable income in the jurisdictions in which PT operates. These assets consist of research credit carry-forwards, capital and net operating loss carry-forwards, and the future tax effect of temporary differences between balances recorded for financial statement purposes and for tax return purposes. It will require future pre-tax earnings in excess of \$30 million in order to fully realize the value of the Company's deferred tax assets. Due to the uncertainty of PT's ability to realize its deferred tax assets, a valuation allowance has been recorded against substantially the full value of its deferred tax assets.

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*Product Warranty:* Warranty obligations are generally incurred in connection with the sale of PT's products. The warranty period for these products is generally one year. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. Future warranty costs are estimated based on historical performance rates and related costs to repair given products. The accounting estimate related to product warranty is considered a "critical accounting estimate" because judgment is exercised in determining future estimated warranty costs. Should actual performance rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required.

*Stock-Based Compensation:* PT's board of directors approves grants of stock options to employees to purchase our common stock. Stock compensation expense is recorded based upon the estimated fair value of the stock option at the date of grant. The accounting estimate related to stock-based compensation is considered a "critical accounting estimate" because estimates are made in calculating compensation expense including expected option lives, forfeiture rates and expected volatility. Expected option lives are estimated using vesting terms and contractual lives. Expected forfeiture rates and volatility are calculated using historical information. Actual option lives and forfeiture rates may be different from estimates and may result in potential future adjustments which would impact the amount of stock-based compensation expense recorded in a particular period.

*Restructuring Costs:* Restructuring costs generally consist of employee-related severance costs, lease termination costs and other facility-related closing expenses. Employee-related severance benefits are recorded either at the time an employee is notified or, if there are extended service periods, is estimated and recorded pro-rata over the period of each planned restructuring activity. Lease termination costs are calculated based upon fair value considering the remaining lease obligation amounts and estimates for sublease receipts. The accounting estimate related to restructuring costs is considered a "critical accounting estimate" because estimates are made in calculating the amount of employee-related severance benefits that will ultimately be paid and the amount of sublease receipts that will ultimately be received in future periods. Actual amounts paid for employee-related severance benefits can vary from these estimates depending upon the number of employees actually receiving severance payments. Actual sublease receipts received may also vary from estimates.

*Carrying Value of Long-Lived Assets:* PT periodically reviews the carrying values of its long-lived assets, other than capitalized software development costs and purchased intangible assets with indefinite useful lives, for impairment whenever events or changes in circumstances indicate that the carrying values may not be recoverable. PT assesses the recoverability of the carrying values of long-lived assets by first grouping its long-lived assets with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities (the asset group) and, secondly, by estimating the undiscounted future cash flows that are directly associated with and that are expected to arise from the use of and eventual disposition of such asset group. PT estimates the undiscounted cash flows over the remaining useful life of the primary asset within the asset group. If the carrying value of the asset group exceeds the estimated undiscounted cash flows, PT records an impairment charge to the extent the carrying value of the long-lived asset exceeds its fair value. PT determines fair value through quoted market prices in active markets or, if quoted market prices are unavailable, through the performance of internal analyses of discounted cash flows. The accounting estimate related to impairment of long-lived assets is considered a "critical accounting estimate" because PT's impairment tests include estimates of future cash flows that are dependent upon subjective assumptions regarding future operating results including revenue growth rates, expense levels, discount rates, capital requirements and other factors that impact estimated future cash flows and the estimated fair

value of long-lived assets.

#### Business Overview

PT, a Delaware corporation founded in 1981, is a global supplier of advanced, high availability network communications solutions.

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PT's product portfolio includes its SEGway® Diameter and SS7 Signaling Systems, which provide tightly integrated signaling and advanced routing capabilities and applications that uniquely span the mission critical demands of both existing and next-generation 4G/Long-Term Evolution ("LTE") and IMS telecommunications networks. The Company's IPnexus® Multi-Protocol Gateways and Servers enable a broad range of IP-interworking in data acquisition, sensor, radar, and control applications for aviation, weather and other infrastructure networks.

PT is headquartered in Rochester, New York and maintains direct sales and marketing offices in the U.S. in Raleigh, North Carolina and Chicago, Illinois and international offices in London, England and Shanghai, China, and has centers of engineering excellence in San Diego, California, and Kanata, Ontario, Canada, in addition to Rochester, New York.

## **Strategy**

The Company's strategy is to focus on its high value-add network communications solutions – leveraging its core competencies. In the telecommunications space, PT is building upon its seventeen years of signaling systems experience and its installed customer base for its SEGway SS7 Signaling Systems. The mobile telecommunications industry is in the early stages of building out much higher bandwidth 4G/LTE-based network architectures. As part of this network evolution, service providers' signaling infrastructure is migrating from SS7 signaling to Diameter signaling. During 2012, PT introduced its own SEGway Universal Diameter Router ("UDR"), a premier Diameter Signaling solution set for next-generation 4G/LTE networks, and the Company recognized its first related revenue during the first quarter 2013. The Company's SEGway Diameter signaling product line gained traction and momentum by adding additional customers during the second quarter. The Company expects to be a key player in this growth market by providing high value proposition "best-of-breed" solutions and by taking those solutions to the global market through a combination of strong channel partners and focused direct sales activities.

Sales of our IPnexus Multi-Protocol IP-interworking solutions are typically to prime contractors and system integrators and generally reflect investment levels by various government agencies and defense branches in specific programs and projects requiring radar and sensor communications services over IP networks. These solutions enable extremely reliable and highly available radar and sensor communications – gathering and delivering vital data such as weather, flight tracking, and ground surveillance over IP networks. We continue to work with numerous prime contractors to incorporate these products into specific programs and projects requiring enhanced communications capabilities. Looking ahead, the Company expects to expand its IPnexus Multi-Protocol Gateways and Servers into new aerospace/defense applications as well as potentially enter new emerging markets such as Energy and Smart-Grid.

As part of its strategic realignment, which was initiated during the fourth quarter 2012, PT is transitioning out of the general OEM platform business, through a last-time buy and build program which will run through 2014 for major customers. PT will continue to utilize its own open standards platforms as key elements of its network communications solutions and maintain a certain number of strategic OEM platform customers.

During the first half of 2013, the Company has increased its sales and marketing investments for our SEGway Diameter signaling product line to accelerate our penetration in this growing market.

In summary, given our concentrated product focus, the substantial steps we have taken to reduce our operating expense levels and our strong and unleveraged balance sheet, management believes PT is well positioned for a positive future trajectory as economic conditions improve.

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There are identifiable risks associated with PT's strategy in the current economic climate. While management believes that its network communications market focus offers opportunities for growth in the long term, network infrastructure investments by carriers have continued to be sluggish; the total available market for traditional SS7-based signaling products is declining and the market for next-generation 4G network products is currently in an early-stage of growth. Despite the present economic climate, which may involve new risks not currently identified, management believes the outlook for the Company's profitability is improving because expenses have been aligned with projected revenues and we have strong channel partners actively engaged in selling our products.

**Market Overview**

PT's business addresses one industry segment – Communications. The telecommunications market, historically our largest vertical market, is fundamentally driven by investments in network infrastructure by carriers and service providers. Industry analysts are forecasting the market for SS7 signaling products will continue for the next seven to ten years, albeit on a declining scale. While the worldwide market for these products is declining, the number of vendors selling into this market has dropped much more rapidly and now stands at four, including PT. Management believes this is an opportunity to grow its share of the SS7 signaling market. In addition, the mobile telecommunications industry is in the early stages of building out much higher bandwidth 4G/LTE-based network architectures. The extraordinary increase in the projected number of wireless subscribers and related mobile data and application demands is driving tremendous growth in signaling traffic, which was the basis for defining a new signaling infrastructure based upon the Diameter protocol. The Diameter signaling market is at an early stage of growth and only a few of the world's wireless carriers have implemented or are currently implementing 4G/LTE. This market is projected by industry analysts to result in an aggregate spend of over \$2 billion in the next five years.

To complement its SEGway SS7 Signaling solutions for present generation telecommunications networks, during 2012 PT introduced the SEGway Universal Diameter Router – its premier Diameter Signaling solution set for next-generation 4G/LTE networks. The Company is marketing its SEGway Diameter and SS7 Signaling solutions to the global market through a combination of strong channel partners and focused direct sales activities.

Sales of our IPnexus Multi-Protocol IP-interworking solutions are typically to prime contractors and system integrators and generally reflect investment levels by various government agencies and defense branches in specific programs and projects requiring radar and sensor communications services over IP networks. Our IPnexus Multi-Protocol Gateways and Servers enable the gathering and delivering of vital data such as weather, flight tracking, and ground surveillance over IP networks for these applications. Beginning in the second half of 2012, aerospace and defense budgets for radar and sensor communications projects were dramatically reduced and PT's prime contractor partners were unclear about future project deployment schedules. This trend continued during the first half 2013 as customer spending for radar and sensor communications projects declined from the previous year's levels.

## Financial Overview

### Revenue:

Revenue in the second quarter 2013 amounted to \$7.1 million, compared to \$5.0 million in the second quarter 2012. Revenue was \$13.4 million for the six months ended June 30 of both 2013 and 2012. The increase in revenue during the second quarter 2013 over the comparable prior year period reflects increased Diameter and SS7 signaling systems revenue and an increase in shipments of our platform products under the Company's last-time buy and build program. Revenue was essentially unchanged for the six months ended June 30, 2013 as compared to the prior year, as increased sales to Diameter and SS7 signaling systems customers and last-time buy and build platform sales essentially offset a decrease in sales to the Company's largest customer from 2007 through 2011. Shipments to customers outside of the United States represented 39% and 41% in the second quarter of 2013 and 2012, respectively, and 43% and 49% in the six months ended June 30, 2013 and 2012, respectively.

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Net income (loss):

Net income in the second quarter 2013 amounted to \$.2 million, or \$.02 per diluted share, including a charge for impairment of software development costs of \$.01 per share, amortization of purchased intangible assets of \$.02 per share, and stock-based compensation expense of \$.01 per share, based on 11.1 million shares outstanding. The Company incurred a net loss in the second quarter 2012 in the amount of (\$1.8 million), or (\$.16) per basic share, including amortization of purchased intangible assets of \$.03 per share and stock-based compensation expense of \$.01 per share, based on 11.1 million shares outstanding.

PT incurred a net loss for the six months ended June 30, 2013 amounting to (\$.7 million), or (\$.06) per basic share, including a restructuring charge of \$.02 per share, a charge for impairment of software development costs of \$.01 per share, amortization of purchased intangible assets of \$.04 per share, and stock-based compensation of \$.01 per share, based on 11.1 million shares outstanding. The Company incurred a net loss for the six months ended June 30, 2012 amounting to (\$1.5 million), or (\$.13) per basic share, including amortization of purchased intangible assets of \$.05 per share and stock-based compensation of \$.01 per share, based on 11.1 million shares outstanding.

Liquidity:

Cash, cash equivalents and investments amounted to \$12.3 million and \$14.3 million at June 30, 2013 and December 31, 2012, respectively. The Company had no long-term debt at either date. Accounts receivable at June 30, 2013 amounted to \$6.5 million, compared to \$3.8 million at the end of 2012. The higher level of accounts receivable is primarily related to significantly higher sales in June 2013 than in December 2012.

Cash used by operating activities amounted to (\$.8 million) in the six months ended June 30, 2013, as compared to cash provided by operating activities of \$2.7 million in the six months ended June 30, 2012. The large swing in cash (used) provided by operating activities was primarily due to a \$2.8 million net increase in accounts receivable in 2013, as compared with a net decrease in accounts receivable of \$1.3 million in the prior year, and a \$.1 million increase in deferred revenue in 2013, as compared with a \$.7 million increase in the comparable 2012 period, partially offset by substantially improved earnings in 2013 (a loss of \$.7 million in the six months ended 2013 as compared to a loss of \$1.5 million in the same period in 2012) and a \$.9 million decrease in inventories in 2013, as compared with a \$.5 million decrease in 2012. The increase in accounts receivable was due to the higher sales level in June 2013, as compared with the level in December 2012. The decrease in inventory is primarily attributable to the Company's ongoing efforts to manage inventory levels and the lower increase in deferred revenue is primarily due to the recognition in revenue of amounts previously deferred relating to the Company's signaling systems sales in Africa.

Key Performance Indicator:

PT believes that a key indicator for its business is the trend for the volume of orders received from customers. PT's decision in the fourth quarter 2012 to transition out of the general OEM platform business is impacting revenues derived from that product line, which amounted to approximately \$5.8 million in 2012.

Total revenue for the first half 2013 amounted to \$13.4 million, on a par with the corresponding period in 2012. Total revenue for the second quarter 2013 amounted to \$7.1 million, an increase of \$.8 million, or 13%, over the first quarter 2013, and an increase of \$2.1 million, or 42%, over the second quarter 2012. The increase in revenue was primarily attributable to an increase in sales to SEGway signaling systems customers and an increase in shipments of platform products as part of the last-time buy and build program in the quarter, as compared to both the first quarter 2013 and second quarter 2012.

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More in-depth discussions of PT's strategy can be found in PT's Annual Report on Form 10-K and other filings with the Securities and Exchange Commission.

**Results of Operations****Three and Six Months Ended June 30, 2013, Compared with the****Three and Six Months Ended June 30, 2012**

The following table presents the percentage of sales represented by each item in PT's consolidated statements of operations for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	50.6	58.7	52.7	50.4
Impairment of software development costs	2.0		1.0	
Gross profit	47.4	41.3	46.3	49.6
Operating expenses:				
Selling and marketing	18.9	29.3	20.4	23.1
Research and development	14.4	31.4	16.5	24.5
General and administrative	11.3	17.1	12.4	13.5
Restructuring charges			1.8	
Total operating expenses	44.6	77.8	51.1	61.1
Income (loss) from operations	2.8	(36.5)	(4.8)	(11.5)
Other (expense) income, net	(.1)	.6	(.1)	
Income (loss) before income taxes	2.7	(35.9)	(4.9)	(11.5)
Income tax (benefit) provision	—	(.9)	.1	(.5)
Net income (loss)	2.7 %	(35.0)%	(5.0)%	(11.0)%

*Sales.* Total revenue for the second quarter 2013 amounted to \$7.1 million, compared to \$5.0 million for the corresponding quarter in 2012. The increase in revenue in the second quarter 2013 over the comparable prior year period was due primarily to increased sales to SEGway signaling systems customers. In the second quarter 2013, PT's four largest customers represented 52% of sales, compared to 28% of sales in the second quarter 2012. The Company's four largest customers comprised 41% and 37% of sales in the six months ended June 30, 2013 and 2012, respectively.

Total revenue for the six months ended June 30, 2013 amounted to \$13.4 million, equal to the comparable period in 2012, as increase in signaling systems sales and a last-time buy for one customer offset the decline in sales to the Company's largest customer from 2007 through 2011.

Shipments to customers outside of the United States represented 39% and 41% of PT's sales during the second quarter of 2013 and 2012, respectively. Shipments to customers outside of the United States represented 43% and 49% of the Company's sales for the six months ended June 30, 2013 and 2012, respectively.

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Looking at revenue categories:

Revenue from telecommunications customers amounted to \$5.5 million and \$3.7 million in the second quarter 2013 and 2012, respectively, and \$10.3 million and \$10.8 million in the six months ended June 30, 2013 and 2012, respectively. The quarter-over-quarter increase of \$1.8 million, or 49%, is largely due to a \$1.6 million increase in shipments to SEGway signaling systems customers. The decrease of \$.5 million from the first half 2012 to the comparable 2013 period is due primarily to a decrease in sales to the Company's largest customer from 2007 through 2011 (sales to which essentially ceased after the first quarter 2012), partially offset by an increase in shipments to SEGway signaling systems customers.

Revenues from our IPnexus Multi-Protocol IP-interworking solutions decreased by \$.8 million, from \$1.4 million in the second quarter 2012 to \$.6 million in the second quarter 2013. Revenues from this product line were \$1.8 million and \$2.5 million in the first half of 2013 and 2012, respectively. The period-over-period decreases are due to sharp cutbacks in the quarter in spending by government prime contractors.

Revenues from our OEM platform product line amounted to \$1.3 million and \$1.2 million in the second quarter 2013 and 2012, respectively, and \$2.6 million and \$3.8 million in the six months ended June 30, 2013 and 2012, respectively. The decrease in the first six months 2013 over the comparable period in 2012 is primarily attributable to declines in sales to the Company's largest customer from 2007 through 2011.

*Gross profit.* Gross profit consists of sales, less cost of goods sold including material costs, manufacturing expenses, depreciation, amortization of software development costs, amortization of purchased intangible assets, and expenses associated with engineering contracts and the technical support function. Gross profit and gross margin percentage amounted to \$3.4 million and 47.4% of sales in the second quarter 2013, compared to \$2.1 million and 41.3% of sales for the second quarter 2012. The improvement in gross margin percentage was primarily attributable to substantial workforce reductions in manufacturing in late 2012 and early 2013, the effect of relatively fixed manufacturing expenses measured against substantially higher sales in 2013, and lower amortization costs in 2013. Also contributing to the improvement in margin was the sale of products and components previously reserved for as excess or obsolete, totaling \$.2 million in the quarter. Partially offsetting these improvements, the Company recorded a second quarter 2013 charge in the amount of \$.1 million to impair costs associated with certain capitalized software development projects.

Gross margin and gross margin percentage amounted to \$6.2 million and 46.3% of sales in the six months ended June 30, 2013, compared to \$6.6 million and 49.6% for the six months ended June 30, 2012. The decline in gross margin and gross margin percentage was primarily attributable to the impairment charge discussed above and generally less favorable sales mix, offset partially by the effect of lower manufacturing expenses and amortization expenses in 2013 as compared to the prior year period.

*Total Operating Expenses.* Total operating expenses amounted to \$3.2 million in the second quarter 2013, as compared to \$3.9 million in the second quarter 2012. Total operating expenses amounted to \$6.8 million in the six months ended June 30, 2013, as compared to \$8.2 million in the comparable 2012 period.

Selling and marketing expenses were \$1.3 million and \$1.5 million for the second quarter 2013 and 2012, respectively. For the six months ended June 30, 2013 and 2012, selling and marketing expenses were \$2.7 million and \$3.1 million, respectively. The decrease in 2013 over the comparable 2012 periods is primarily the result of a reduction in sales and marketing headcount and a lower bad debt expense in 2013 than in 2012.

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Research and development expenses were \$1.0 million and \$1.6 million in the second quarter 2013 and 2012, respectively. The Company capitalizes certain software development costs, which reduces the amount of software development charged to operating expenses. Amounts capitalized were \$.5 million and \$.6 million during the second quarter 2013 and 2012, respectively. Research and development expenses were \$2.2 million and \$3.3 million for the six months ended June 30, 2013 and 2012, respectively. Six month amounts capitalized to software development costs amounted to \$.9 million and \$1.2 million in 2013 and 2012, respectively. The period over period decreases in research and development expenses are due primarily to the Company's staff reductions in the fourth quarter 2012 and first quarter 2013, and staff attrition.

General and administrative expenses were \$.8 million and \$.9 million in the second quarter 2013 and 2012, respectively. General and administrative expenses were \$1.6 million and \$1.8 million in the six months ended June 30, 2013 and 2012, respectively. The period over period decreases are primarily due to attrition and the Company's staff reductions in the fourth quarter 2012 and first quarter 2013.

Restructuring expenses were \$.2 million in the six months ended June 30, 2013. The Company reduced its personnel by ten employees, or 8% of its workforce, in a restructuring action commenced and completed during the first quarter 2013. All of the expense associated with this action resulted in cash expenditures.

*Other (expense) income, net.* Other income consists primarily of interest income. PT's funds continue to be invested in high-quality corporate and government bonds, and guaranteed investment contracts and money market funds. Other income is presented net of other expense, which consists primarily of foreign currency translation adjustments relating to the Company's foreign subsidiary financial statements. Other income (expense) for the six months ended June 30, 2012 also included a \$.06 million out-of-period charge to adjust the recorded balance of accumulated other comprehensive income.

*Income taxes.* The Company's effective income tax rates differ from the statutory rates primarily due to a full valuation allowance provided against its U.S. deferred tax assets, income taxes on foreign income and refundable income tax credits that differ from the U.S. income tax rate, and permanent income tax differences including Canadian research activities.

PT's annual estimated effective income tax rate for 2013 is -2%, as compared to an estimated effective income tax rate of 4% for 2012. The expected annual effective income tax rate for 2013 is different than in the corresponding period in 2012 due to a change in the classification of refundable Canadian provincial tax credits the Company expects to receive for 2013. These credits are reported as a reduction of research and development expense in 2013, while they were reported as a component of tax provision (benefit) in 2012.

## **Liquidity and Capital Resources**

The Company had working capital of \$17.0 million and \$15.5 million at June 30, 2013 and December 31, 2012, respectively. This increase is primarily a result of a \$2.8 million increase in accounts receivable from December 31, 2012 to June 30, 2013. PT's primary sources of liquidity are cash, cash equivalents and long-term investments, which totaled \$12.3 million at June 30, 2013 and \$14.3 million at December 31, 2012.

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For the six months ended June 30, 2013, cash used by operating activities amounted to \$.8 million. This amount reflects the net loss of (\$.7 million), non-cash items such as depreciation and amortization charges of \$1.7 million, stock-based compensation expense of \$.1 million, and an impairment charge against capitalized software development costs of \$.1 million. Cash used by operations due to changes in operating assets and liabilities included a decrease in cash associated with a \$2.8 million increase in accounts receivable, and a \$.2 million increase in prepaid expenses and other assets, offset partially by a \$.9 million decrease in inventories, and a \$.1 million increase in deferred revenue. The increase in accounts receivable was primarily attributable to the higher level of sales in the second quarter 2013, as compared with the fourth quarter 2012. The decrease in inventory was primarily attributable to the Company's efforts to manage inventory levels relative to shipments during the quarter and anticipated product demand.

Cash provided by investing activities during the six months ended June 30, 2013 totaled \$3.0 million. Proceeds from the maturity of investments amounted to \$4.8 million, offset partially by a purchase of investments of \$.5 million, capital expenditures of \$.3 million, and capitalized software development costs which amounted to \$.9 million.

*Off-Balance Sheet Arrangements:*

In July 2013, the Company renewed its lease for its San Diego engineering center through November 2016 on the same terms as its current lease.

*Current Position:*

Management believes that PT's current cash, cash equivalents and investments, together with cash generated from operations will be sufficient to meet our anticipated cash requirements, including working capital and capital expenditure requirements, for at least the next twelve months.

**Recent Accounting Pronouncements**

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income:

In February 2013, the FASB issued authoritative guidance on the reporting of amounts reclassified out of accumulated other comprehensive income ("AOCI"), which is effective for reporting periods beginning after December 15, 2012. This guidance requires companies to provide information about the amounts reclassified out of AOCI either in a single

note or on the face of the financial statements. Significant amounts reclassified out of AOCI should be presented by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified in its entirety to net income in the same reporting period. For amounts not required to be reclassified in their entirety to net income, a cross-reference to other disclosures provided for in accordance with U.S. GAAP is required. The Company has adopted this authoritative guidance. To date, its adoption does not have a material impact on its consolidated financial statement disclosures.

Disclosures about Offsetting Assets and Liabilities:

In December 2011, the FASB issued authoritative guidance requiring enhanced disclosures about offsetting assets and liabilities, which is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The new rules require companies to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position, as well as instruments and transactions subject to a netting arrangement. In January 2013, the FASB issued a clarification of the guidance in order to address implementation issues surrounding the scope of the standard and to clarify the scope of the offsetting disclosures and address any unintended consequences. The Company has evaluated this updated authoritative guidance, and the adoption of this guidance does not have a material impact on its consolidated financial statement disclosures.

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Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

This report and, in particular, the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report, contain forward-looking statements.

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a "safe harbor" for forward-looking statements. Certain written and oral statements made by PT's management include forward-looking statements intended to qualify for the safe harbor from liability established by the Reform Act. These forward-looking statements generally can be identified by words such as "believes," "expects," "anticipates," "projects," "foresees," "forecasts," "estimates," "other words or phrases of similar import. Words such as the "Company," "PT," "management," "we," "us," or "our," mean Performance Technologies, Incorporated and its subsidiaries. All statements herein that describe PT's business strategy, outlook, objectives, plans, intentions, goals or similar projections are also forward-looking statements within the meaning of the Reform Act. Forward-looking statements should be read in conjunction with the audited Consolidated Financial Statements, the Notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company as contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, and other documents filed with the Securities and Exchange Commission.

All such forward-looking statements are subject to certain risks and uncertainties and should be evaluated in light of important risk factors. These risk factors include, but are not limited to, the following as well as those that are described in "Risk Factors" under Item 1A and elsewhere in the Annual Report on Form 10-K: business and economic conditions, rapid technological changes accompanied by frequent new product introductions, competitive pressures, dependence on key customers, inability to gauge order flows from customers, fluctuations in quarterly and annual results, the reliance on a limited number of third party suppliers, limitations of the Company's manufacturing capacity and arrangements, the protection of the Company's proprietary technology, errors or defects in our products, the effects of pending or threatened litigation, the dependence on key personnel, changes in critical accounting estimates, potential impairments related to investments, foreign regulations, possible loss or significant curtailment of significant government contracts or subcontracts, possible effects related to compliance with new conflict-free mineral regulations, and potential material weaknesses in internal control over financial reporting,. In addition, during weak or uncertain economic periods, customers' visibility deteriorates causing delays in the placement of their orders. These factors often result in a substantial portion of the Company's revenue being derived from orders placed within a quarter and shipped in the final month of the same quarter.

Any of these factors could cause PT's actual results to differ materially from its anticipated results. For a more detailed discussion of these factors, see the "Risk Factors" discussion in Item 1A in the Annual Report on Form 10-K. The Company cautions readers to carefully consider such factors. Many of these factors are beyond the Company's control. Except as required by law, we undertake no obligation to publicly update these forward-looking statements, whether as a result of new information, future events or otherwise.

**ITEM 3.** Not applicable – Smaller Reporting Company

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**ITEM 4. CONTROLS AND PROCEDURES**

**A. Evaluation of Disclosure Controls and Procedures**

PT's Chief Executive Officer (our principal executive officer) and its Chief Financial Officer (our principal financial officer) have evaluated PT's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that PT's disclosure controls and procedures were effective as of such date.

**B. Changes in Internal Control Over Financial Reporting**

There has been no change in PT's internal control over financial reporting that occurred during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, PT's internal controls over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS**

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Section 1350 Certification

101.INS\* XBRL Instance Document

101.SCH\* XBRL Taxonomy Extension Schema Document

101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document

101.LAB\* XBRL Taxonomy Extension Label Linkbase Document

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

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\* XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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## **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.

### **PERFORMANCE TECHNOLOGIES, INCORPORATED**

August 12, 2013 By: /s/ John M. Slusser  
John M. Slusser  
President and Chief Executive Officer (principal executive officer)

August 12, 2013 By: /s/ Dorrance W. Lamb  
Dorrance W. Lamb  
Senior Vice President and Chief Financial Officer (principal financial officer)

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Exhibit 31.1

**Certification of Chief Executive Officer**

I, John M. Slusser, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Performance Technologies, Incorporated; 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;
2. 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;
3. The registrant's other certifying officer 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
4. The registrant's other certifying officer 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.
- 5.

Date: August 12, 2013 By: /s/ John M. Slusser

John M. Slusser

Chief Executive Officer



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Exhibit 31.2

**Certification of Chief Financial Officer**

I, Dorrance W. Lamb, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Performance Technologies, Incorporated; 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; 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; The registrant's other certifying officer 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 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 12, 2013 By: /s/ Dorrance W. Lamb  
Dorrance W. Lamb

Chief Financial Officer

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Exhibit 32.1

**Section 1350 Certification**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (“Section 906”), John M. Slusser and Dorrance W. Lamb, the Chief Executive Officer and Chief Financial Officer, respectively, of Performance Technologies, Incorporated, certify that (i) the quarterly report on Form 10-Q for the quarter ended June 30, 2013 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Performance Technologies, Incorporated.

A signed original of this written statement required by Section 906 has been provided to Performance Technologies, Incorporated and will be retained by Performance Technologies, Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.

Date: August 12, 2013 By: /s/ John M. Slusser  
John M. Slusser  
President and Chief Executive Officer (principal executive officer)

Date: August 12, 2013 By: /s/ Dorrance W. Lamb  
Dorrance W. Lamb  
Senior Vice President and Chief Financial Officer (principal financial officer)

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