

PERFORMANCE TECHNOLOGIES INC \DE\
Form 10-Q
May 06, 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 March 31, 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

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 11,116,397 as of April 30, 2013.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

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| | March 31, 2013 | December 31, 2012 |
|---|-------------------|-------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$9,004,000 | \$7,546,000 |
| Investments | 3,024,000 | 4,794,000 |
| Accounts receivable, net | 5,386,000 | 3,775,000 |
| Inventories, net | 3,246,000 | 3,615,000 |
| Prepaid expenses and other assets | 1,067,000 | 932,000 |
| Prepaid income taxes | 255,000 | 206,000 |
| Deferred income taxes | 444,000 | 445,000 |
| Total current assets | 22,426,000 | 21,313,000 |
| Investments | 453,000 | 1,969,000 |
| Property, equipment and improvements, net | 1,629,000 | 1,683,000 |
| Software development costs, net | 3,697,000 | 3,716,000 |
| Purchased intangible assets, net | 2,601,000 | 2,835,000 |
| Total assets | \$30,806,000 | \$31,516,000 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|--|-------------|-------------|
| Current liabilities: | | |
| Accounts payable | \$1,046,000 | \$1,134,000 |
| Accrued expenses | 1,481,000 | 1,664,000 |
| Deferred revenue | 3,367,000 | 3,002,000 |
| Fair value of foreign currency hedge contracts | 15,000 | |
| Total current liabilities | 5,909,000 | 5,800,000 |
| Deferred income taxes | 704,000 | 696,000 |
| Total liabilities | 6,613,000 | 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 | 17,648,000 | 17,591,000 |
| Retained earnings | 16,233,000 | 17,099,000 |
| Accumulated other comprehensive loss | (3,000) | 15,000 |
| Treasury stock - at cost; 2,188,199 shares | (9,818,000) | (9,818,000) |
| Total stockholders' equity | 24,193,000 | 25,020,000 |
| Total liabilities and stockholders' equity | \$30,806,000 | \$31,516,000 |

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

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-------------|
| | 2013 | 2012 |
| Sales | \$6,285,000 | \$8,356,000 |
| Cost of goods sold | 3,456,000 | 3,797,000 |
| Gross profit | 2,829,000 | 4,559,000 |
| Operating expenses: | | |
| Selling and marketing | 1,395,000 | 1,614,000 |
| Research and development | 1,181,000 | 1,697,000 |
| General and administrative | 849,000 | 950,000 |
| Restructuring charges | 243,000 | |
| Total operating expenses | 3,668,000 | 4,261,000 |
| (Loss) income from operations | (839,000) | 298,000 |
| Other (expense) income, net | (9,000) | (30,000) |
| (Loss) income before income taxes | (848,000) | 268,000 |
| Income tax provision (benefit) | 18,000 | (21,000) |
| Net (loss) income | \$(866,000) | \$289,000 |
| Basic (loss) income per share | \$(0.08) | \$0.03 |
| Diluted income per share | | \$0.03 |
| Weighted average number of common shares used in basic and diluted income (loss) per share | 11,116,397 | 11,116,397 |

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

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PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-------------|
| | 2013 | 2012 |
| Net (loss) income | \$(866,000) | \$289,000 |
| Other comprehensive income, net of tax: | | |
| Change in unrealized (loss) gain on foreign currency hedge | | |
| Contracts | (15,000) | 37,000 |
| Change in unrealized (loss) gain on available-for-sale | | |
| Investments | (3,000) | 79,000 |
| Other comprehensive income | (18,000) | 116,000 |
| Comprehensive (loss) income | \$(884,000) | \$405,000 |

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)**

| | Three Months Ended | |
|--|--------------------|-------------|
| | March 31, | |
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net (loss) income | \$(866,000) | \$289,000 |
| Non-cash adjustments: | | |
| Depreciation and amortization | 648,000 | 687,000 |
| Amortization of purchased intangible assets | 234,000 | 279,000 |
| Stock-based compensation expense | 57,000 | 67,000 |
| Deferred income taxes | 9,000 | 7,000 |
| Revenue from non-monetary exchange | | (257,000) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,611,000) | (623,000) |
| Inventories | 369,000 | 524,000 |
| Prepaid expenses and other assets | (135,000) | (22,000) |
| Accounts payable and accrued expenses | (271,000) | 83,000 |
| Deferred revenue | 365,000 | 374,000 |
| Income taxes payable and prepaid income taxes | (49,000) | (28,000) |
| Net cash provided (used) by operating activities | (1,250,000) | 1,380,000 |
| Cash flows from investing activities: | | |
| Purchase of equipment, inventory and intangible assets | | (1,000,000) |
| Purchases of property, equipment and improvements | (95,000) | (50,000) |
| Capitalized software development costs | (448,000) | (560,000) |
| Proceeds from sales of investments | 3,251,000 | |
| Purchases of investments | | (2,037,000) |
| Net cash used by investing activities | 2,708,000 | (3,647,000) |
| Net increase (decrease) in cash and cash equivalents | 1,458,000 | (2,267,000) |
| Cash and cash equivalents at beginning of period | 7,546,000 | 9,641,000 |
| Cash and cash equivalents at end of period | \$9,004,000 | \$7,374,000 |
| 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 first quarter 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:

| | March 31, 2013 | | December 31, 2012 | |
|---------------------------|-----------------------|---------------|--------------------------|---------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| Corporate bonds | \$2,964,000 | \$2,977,000 | \$5,247,000 | \$5,262,000 |
| Municipal bonds | 500,000 | 500,000 | 1,501,000 | 1,501,000 |
| Total investments | 3,464,000 | 3,477,000 | 6,748,000 | 6,763,000 |
| Less: current investments | (3,013,000) | (3,024,000) | (4,786,000) | (4,794,000) |
| Non-current investments | \$451,000 | \$453,000 | \$1,962,000 | \$1,969,000 |

The Company's bond investments have a cumulative par value of \$6,601,000 at March 31, 2013.

Note C – Inventories, net

Inventories consisted of the following:

| | March 31, 2013 | December 31, 2012 |
|--|---------------------------|----------------------------------|
| Purchased parts and components | \$1,110,000 | \$1,245,000 |
| Work in process and purchased assemblies | 1,496,000 | 1,631,000 |
| Finished goods | 640,000 | 739,000 |
| Net | \$3,246,000 | \$3,615,000 |

Note D – Software Development Costs

Software development costs consisted of the following:

| | March 31, 2013 | December 31, 2012 |
|--|---------------------------|------------------------------|
| Capitalized software development costs | \$24,898,000 | \$24,450,000 |
| Less: accumulated amortization | (21,201,000) | (20,734,000) |
| Net | \$3,697,000 | \$3,716,000 |

Amortization of software development costs included in cost of goods sold was \$467,000 and \$400,000 in the first quarter 2013 and 2012, respectively.

Note E – Purchased Intangible Assets

Purchased intangible assets consisted of the following:

| | March 31, 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 | (3,171,000) | (2,937,000) |
| Purchased intangible assets, net | \$2,601,000 | \$2,835,000 |

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Amortization of purchased intangible assets included in cost of goods sold was \$234,000 and \$279,000 in the first quarter 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 months ended March 31, 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 |

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 options considered in the first quarter 2012.

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 March 31, 2013, the Company had contracts in place to hedge approximately 65% of its estimated Canadian foreign currency risk for the remainder of 2013. At March 31, 2012, the Company had contracts in place to hedge approximately 60% of its estimated Canadian foreign currency risk for the second quarter 2012. The Company had no such contracts in place at December 31, 2012.

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 | |
|---|-------------------------------|---------------------------|------------------------------|
| | | March 31, 2013 | December 31, 2012 |
| Derivatives designated as hedging instruments | Current Liabilities | \$(15,000) | \$ — |

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

| | Location of gain (loss) recognized in operations | Amount of gain (loss) reclassified from accumulated other comprehensive income (loss) to the statement of operations Three Months Ended March 31, 2013 2012 |
|----------------------------|--|--|
| Derivatives fair value | | |
| hedging relationships | | |
| Foreign exchange contracts | Research and development expenses | \$(4,000) \$(12,000) |

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

| | Three Months Ended March 31, 2013 2012 | |
|---|---|------------|
| Accumulated other comprehensive income, January 1 | \$— | \$(46,000) |
| Amount of loss (gain) recognized in statement of operations, net of tax | 4,000 | 12,000 |
| Net change in fair value of derivative instruments | (19,000) | 25,000 |
| Accumulated other comprehensive income, March 31 | \$(15,000) | \$(9,000) |

Note I – Accumulated Other Comprehensive Loss

Accumulated other comprehensive income consists of the following:

| | March 31, 2013 | December 31, 2012 |
|---|-------------------------------|----------------------------------|
| Unrealized loss on foreign currency hedge contracts | \$(15,000) | \$— |
| Unrealized gain on available-for-sale investments | 12,000 | 15,000 |
| Net | \$(3,000) | \$ 15,000 |

An out-of-period charge amounting to \$63,000 was made to other (expense) income during the three months ended March 31, 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 quarter ended March 31, 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.

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The Company's assets measured at fair value on a recurring basis at March 31, 2013, were as follows:

| | Level 1 | Level 2 | Level 3 |
|--|-------------|-----------|------------|
| Assets: | | | |
| Investments | \$2,977,000 | \$500,000 | \$ — |
| Total assets measured at fair value | \$2,977,000 | \$500,000 | \$ — |
| Liabilities: | | | |
| Foreign currency hedge contracts | \$— | \$15,000 | \$ — |
| Total liabilities measured at fair value | \$— | \$15,000 | \$ — |

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 | \$5,262,000 | \$1,501,000 | \$ — |
| Total assets measured at fair value | \$5,262,000 | \$1,501,000 | \$ — |

There were no liabilities measured at fair value on a recurring basis at December 31, 2012.

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

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 month periods ended March 31, 2013 and 2012.

| | Three Months Ended March 31, 2013 2012 | |
|---|--|----------|
| Stock-based compensation expense | \$57,000 | \$67,000 |
| Income tax benefit | — | — |
| Decrease in net income / increase in net loss | \$57,000 | \$67,000 |
| Per share | \$0.01 | \$0.01 |

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The following table summarizes stock option activity for the first quarter 2013:

| | Number of shares | Weighted Average Exercise Price |
|--------------------------------|---------------------|--|
| Outstanding at January 1, 2013 | 1,654,600 | \$ 3.08 |
| Granted | 692,000 | .90 |
| Exercised | — | — |
| Expired | (22,250) | 4.23 |
| Outstanding at March 31, 2013 | 2,324,350 | 2.43 |
| Exercisable at March 31, 2013 | 1,071,750 | \$ 3.62 |

The weighted average fair value of option grants was estimated using the Black-Scholes-Merton option pricing method. At March 31, 2013, PT had approximately \$373,000 of unrecognized stock compensation expense which will be recognized over a weighted average period of approximately 2.2 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.

PT's estimated effective annual tax rate was -2% for the three months ended March 31, 2013 and does not include any material discrete items. The estimated effective annual tax rate used for the three months ended March 31, 2012 was -8% 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 as a reduction of research and development expenses.

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

At March 31, 2013, the Company had gross deferred income tax assets totaling approximately \$17,100,000, 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.

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NOTE M – Restructuring

On January 10, 2013, the Company announced a program to sharpen its strategic business focus, which included a reduction of its workforce to better align its expense structure with its projected revenue levels. The program included the reduction of ten employees, or 8% of the Company's workforce, for which the Company recorded a first quarter charge for severance costs in the amount of approximately \$243,000. Substantially all of this charge resulted in an outlay of cash in the first quarter 2013.

The Company currently estimates that the full annualized cost savings resulting from this restructuring program will be approximately \$700,000 on an annualized basis.

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.

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.

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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 isn’t 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.

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.

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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.

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.

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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 March 31, 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 \$28 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 the full value of its net deferred tax assets.

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.

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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.

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 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.

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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 quarter 2013, the Company reduced its personnel by ten employees, or 8% of its workforce. This action reduced operating expenses by approximately \$.7 million per year. When combined with the savings from the restructuring PT completed in the fourth quarter 2012, the Company has reduced its break-even expense level by more than \$2 million a year. During the first half of 2013, the Company is increasing its sales and marketing investments for our 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.

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 been very 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.

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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. During the first quarter 2013, customer spending for radar and sensor communications projects improved.

Financial Overview

Revenue:

Revenue in the first quarter 2013 amounted to \$6.3 million, compared to \$8.4 million in the first quarter 2012. The decrease in revenue in the first quarter 2013 was primarily the result of a decrease in sales to the Company's OEM platform customers, most notably a decrease in sales of \$1.3 million to the Company's former largest customer. Shipments to customers outside of the United States represented 46% and 53% of sales in the first quarter 2013 and 2012, respectively.

Net (loss) income:

PT incurred a net loss in the first quarter 2013 in the amount of (\$.9 million), or (\$.08) per basic share, including a restructuring charge of \$.2 million, or \$.02 per share, amortization of purchased intangible assets of \$.2 million, or \$.02 per share, and stock-based compensation expense of \$.1 million, or \$.01 per share, based on 11.1 million shares outstanding. Net income in the first quarter 2012 amounted to \$.3 million, or \$.03 per diluted share, including stock-based compensation expense of \$.1 million, or \$.01 per share and amortization of purchased intangible assets of \$.3 million, or \$.03 per share, based on 11.1 million shares outstanding.

Liquidity:

Cash, cash equivalents and long-term investments amounted to \$12.5 million and \$14.3 million at March 31, 2013 and December 31, 2012, respectively. The Company had no long-term debt at either date.

Accounts receivable at March 31, 2013 amounted to \$5.4 million, compared to \$3.8 million at the end of 2012. The higher level of accounts receivable is primarily related to the higher level of sales in the first quarter 2013 as compared to the fourth quarter 2012, as well as the timing of shipments within those quarters.

Inventories decreased by \$.3 million, to \$3.3 million at March 31, 2013, from December 31, 2012. The decrease in inventory is primarily attributable to the decline in forecasted OEM platform shipments resulting from the change in strategy for this product line.

Cash used by operating activities amounted to \$1.3 million in the three months ended March 31, 2013, as compared to cash provided by operating activities of \$1.4 million in the three months ended March 31, 2012. The large swing in cash (used) provided by operating activities was due to the net loss in 2013 as compared to net income in the first quarter 2012, a significantly larger increase in accounts receivable in the first quarter 2013 as compared with the first quarter 2012, and a \$.1 million increase in accounts payable, accrued expenses and deferred revenue in the first quarter 2013, as compared to a \$.4 million decrease in the corresponding accounts in first quarter 2012.

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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 expected to impact revenues derived from that product line, which amounted to \$5.8 million in 2012.

Total revenue for the first quarter 2013 amounted to \$6.3 million, compared to \$8.4 million for the corresponding quarter in 2012. The decrease in revenue in the first quarter 2013 was primarily the result of a decrease in sales to the Company's OEM platform customers, most notably a decrease in sales of \$1.3 million to the Company's former largest customer. In addition, the Company experienced a \$.4 million period-over-period decline in sales to its signaling systems channel partners.

The economy appears to be recovering unevenly around the world and current business conditions continue to remain quite challenging in the telecommunications equipment market. Forward-looking visibility on customer orders continues to be at low levels.

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 Months Ended March 31, 2013, compared with the

Three Months Ended March 31, 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 March 31, 2013 | | 2012 |
|-----------------------|--|---------|-------------|
| Sales | 100.0 % | 100.0 % | |
| Cost of goods sold | 55.0 % | 45.4 % | |
| Gross profit | 45.0 % | 54.6 % | |
| Operating expenses: | | | |
| Selling and marketing | 22.2 % | 19.3 % | |

| | | |
|-----------------------------------|---------|--------|
| Research and development | 18.8 % | 20.3 % |
| General and administrative | 13.5 % | 11.4 % |
| Restructuring | 3.9 % | |
| Total operating expenses | 58.4 % | 51.0 % |
| (Loss) income from operations | (13.4)% | 3.6 % |
| Other income (expense), net | (.1)% | (.4)% |
| (Loss) income before income taxes | (13.5)% | 3.2 % |
| Income tax provision (benefit) | .3 % | (.3)% |
| Net (loss) income | (13.8)% | 3.5 % |

Sales. Total revenue for the first quarter 2013 amounted to \$6.3 million, compared to \$8.4 million for the corresponding quarter in 2012. In the first quarter 2013, PT's four largest customers represented 31% of sales, compared to 48% of sales in the first quarter 2012. Shipments to customers outside of the United States represented 46% and 53% of PT's sales during the first quarter of 2013 and 2012, respectively.

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Revenue from telecommunications customers amounted to \$4.8 million and \$7.1 million in the first quarter 2013 and 2012, respectively. This decrease of \$2.3 million, or 32%, was largely due to a \$1.3 million decrease in shipments to the Company's former largest customer, and a \$.4 million decrease in sales to the Company's signaling channel partners.

Revenues from our IPnexus Multi-Protocol IP-interworking solutions increased by \$.1 million to \$1.2 million in the first quarter 2013, compared to the first quarter 2012. This increase in revenue reflects a recovery in shipments compared to each quarter in the second half of 2012 and was also attributable to shipments amounting to \$.3 million to a new U.K.-based prime contractor.

Revenues from our OEM platform product line amounted to \$1.5 million in the first quarter 2013, compared to \$2.6 million in the first quarter of 2012.

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 \$2.8 million and 45.0% of sales in the first quarter 2013, compared to \$4.6 million and 54.6% of sales for the first quarter 2012. The decline in gross margin percentage was primarily attributable to a less favorable sales mix and the effect of fixed manufacturing costs absorbed by a lower level of sales, offset partially by lower manufacturing costs and a decreased level of amortization expenses associated with purchased intangible assets.

Total Operating Expenses. Total operating expenses amounted to \$3.7 million in the first quarter 2013, as compared to \$4.3 million in the first quarter 2012.

Selling and marketing expenses were \$1.4 million and \$1.6 million for the first quarter 2013 and 2012, respectively. The decrease of \$.2 million, or 13%, primarily relates to a reduction in sales and marketing headcount and lower sales commissions.

Research and development expenses were \$1.2 million and \$1.7 million in the first quarter 2013 and 2012, respectively. PT capitalizes certain software development costs, which reduces the amount of software development charged to operating expenses. Amounts capitalized were \$.4 million and \$.6 million in the first quarter of 2013 and 2012, respectively. Gross expenditures amounted to \$1.5 million and \$2.2 million in the first quarter 2013 and 2012, respectively. The significant decrease in research and development expenses is due primarily to the elimination of engineering positions in the Company's fourth quarter 2012 and first quarter 2013 restructuring actions.

General and administrative expenses were \$.8 million and \$.9 million in the first quarter 2013 and 2012, respectively. The decrease is primarily due to the elimination of positions in the Company's recent restructuring actions.

Restructuring expenses were \$.2 million in the first quarter 2013. The Company reduced its personnel by ten employees, or 8% of its workforce, in a restructuring action commenced in January 2013 and completed in the same quarter. 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, guaranteed investment contracts and money market funds. Other expense, net, amounted to \$.01 million for the first quarter 2013 while other expense, net, amounted to \$.03 million for the first quarter 2012. Other expense, net included a \$.06 million out-of-period charge in 2012 to adjust the recorded balance of accumulated other comprehensive income.

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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 income tax provision for the first quarter 2013 amounted to \$.02 million, compared to a benefit for the first quarter 2012 of \$.02 million. PT's annual estimated effective income tax rate is -2% for 2013, as compared to an estimated effective income tax rate of -8% for the first quarter 2012. The expected annual effective income tax rate in the first quarter 2013 is different than in the corresponding quarter in 2012 primarily due to a change in the classification of refundable Canadian provincial tax credits the Company expects to receive for 2013.

Liquidity and Capital Resources

PT's primary sources of liquidity are cash, cash equivalents and long-term investments, which totaled \$12.5 million at March 31, 2013 and \$14.3 million at December 31, 2012. The Company had working capital of \$16.5 million and \$15.5 million at March 31, 2013 and December 31, 2012, respectively. The \$1.8 million decrease in cash, cash equivalents and long-term investments during the first quarter 2013 was primarily due to a \$1.6 million increase in accounts receivable, capital expenditures of \$.1 million, and capitalized software development costs of \$.4 million, offset partially by changes in other current assets and liabilities which totaled \$.3 million.

For the first quarter 2013, cash used by operating activities amounted to \$1.3 million. This amount included the net loss of \$.9 million, depreciation and amortization charges of \$.6 million, amortization of purchased intangible assets of \$.2 million, and stock-based compensation expense of \$.1 million. Changes in operating assets and liabilities included an increase of accounts receivable of \$1.6 million, a decrease in inventories of \$.4 million and a net increase in accounts payable, accrued expenses and deferred revenue of \$.1 million. The increase in accounts receivable was primarily due to the higher level of sales in the month of March 2013, compared to the month of December 2012.

Cash provided by investing activities during the first quarter 2013 totaled \$2.8 million, as proceeds from the maturity of investments totaling \$3.3 million was partially offset by \$.1 million of capital expenditures and capitalized software development costs of \$.4 million.

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.

Actions taken by management that change the business may affect cash or cash generated from operations. In addition, the company's ability to profitably generate revenue depends not only on the execution of its business plans, but also on general market factors that are outside of its control. The Company's ability to profitably generate revenue would be adversely impacted by further deterioration of macroeconomic condition in the markets that the Company serves.

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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.

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

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.

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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, potential material weaknesses in internal control over financial reporting, and the potential ramifications of our possible inability to comply with NASDAQ's continued listing requirements. 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.

ITEM 4. CONTROLS AND PROCEDURES

A. Evaluation of Disclosure Controls and Procedures

PT's Chief Executive Officer and its Chief 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.

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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

* 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.

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

May 6, 2013 By: /s/ John M. Slusser
John M. Slusser
Chief Executive Officer (Principal Executive Officer)

May 6, 2013 By: /s/ Dorrance W. Lamb
Dorrance W. Lamb
Senior Vice President and Chief Financial Officer (Principal Financial and Principal
Accounting 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; 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.
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.

May 6, 2013 By: /s/ John M. Slusser
John M. Slusser

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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.
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.

May 6, 2013 By: /s/ Dorrance W. Lamb
Dorrance W. Lamb

Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting 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 March 31, 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.

May 6, 2013 By: /s/ John M. Slusser
John M. Slusser
Chief Executive Officer (Principal Executive Officer)

May 6, 2013 By: /s/ Dorrance W. Lamb
Dorrance W. Lamb
Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)

