P&F INDUSTRIES INC
Form 10-Q
November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2016

.. **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 1 - 5332

P&F INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**22-1657413** (I.R.S. Employer Identification Number)
445 Broadhollow Road, Suite 100, Melville, New York (Address of principal executive offices)	**11747** (Zip Code)

Registrant's telephone number, including area code: **(631) 694-9800**

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of November 11, 2016 there were 3,597,870 shares of the registrant's Class A Common Stock outstanding.

P&F INDUSTRIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (unaudited)	December 31, 2015 (See Note 1)
ASSETS		
CURRENT ASSETS		
Cash	$ 941,000	$ 927,000
Accounts receivable — net	10,581,000	8,477,000
Inventories	20,322,000	19,783,000
Prepaid expenses and other current assets	2,974,000	1,032,000
Assets of discontinued operations	—	8,435,000
Assets held for sale, net of accumulated depreciation	1,780,000	—
TOTAL CURRENT ASSETS	36,598,000	38,654,000
PROPERTY AND EQUIPMENT		
Land	1,150,000	1,550,000
Buildings and improvements	5,209,000	7,677,000
Machinery and equipment	19,233,000	18,736,000
	25,592,000	27,963,000
Less accumulated depreciation and amortization	18,280,000	18,491,000
NET PROPERTY AND EQUIPMENT	7,312,000	9,472,000
GOODWILL	4,786,000	10,154,000
OTHER INTANGIBLE ASSETS — net	7,239,000	11,098,000
DEFERRED INCOME TAXES — net	1,006,000	—
OTHER ASSETS — net	136,000	234,000
TOTAL ASSETS	$ 57,077,000	$ 69,612,000

See accompanying notes to consolidated financial statements (unaudited).

1

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (unaudited)	December 31, 2015 (See Note 1)
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ 1,449,000	$ 9,623,000
Accounts payable	4,064,000	2,791,000
Accrued compensation and benefits	1,502,000	1,718,000
Accrued other liabilities	1,932,000	1,666,000
Current maturities of long-term debt	17,000	491,000
Liabilities of discontinued operations	—	1,342,000
TOTAL CURRENT LIABILITIES	8,964,000	17,631,000
Long–term debt, less current maturities	87,000	5,936,000
Deferred tax liabilities - net	—	2,175,000
Other liabilities	214,000	228,000
TOTAL LIABILITIES	9,265,000	25,970,000
SHAREHOLDERS' EQUITY		
Preferred stock - $10 par; authorized - 2,000,000 shares; no shares issued	—	—
Common stock		
Class A - $1 par; authorized - 7,000,000 shares; issued – 4,181,000 at September 30, 2016 and 4,170,000 at December 31, 2015	4,181,000	4,170,000
Class B - $1 par; authorized - 2,000,000 shares; no shares issued	—	—
Additional paid-in capital	12,913,000	12,884,000
Retained earnings	36,179,000	31,495,000
Treasury stock, at cost – 584,000 shares at September 30, 2016 and 554,000 shares at December 31, 2015	(4,821,000)	(4,566,000)
Accumulated other comprehensive loss	(640,000)	(341,000)
TOTAL SHAREHOLDERS' EQUITY	47,812,000	43,642,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 57,077,000	$ 69,612,000

See accompanying notes to consolidated financial statements (unaudited).

2

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net revenue	$14,633,000	$15,924,000	$44,769,000	$46,541,000
Cost of sales	10,128,000	10,294,000	29,743,000	29,580,000
Gross profit	4,505,000	5,630,000	15,026,000	16,961,000
Selling, general and administrative expenses	4,915,000	4,787,000	15,088,000	14,834,000
Impairment of goodwill and other intangible assets	—	—	8,311,000	—
Operating (loss) income	(410,000)	843,000	(8,373,000)	2,127,000
Other (income) expense, net	(43,000)	38,000	(75,000)	(234,000)
Interest expense	26,000	29,000	164,000	87,000
(Loss) income from continuing operations before income taxes	(393,000)	776,000	(8,462,000)	2,274,000
Income tax (benefit) expense	(107,000)	271,000	(2,872,000)	764,000
(Loss) income from continuing operations	(286,000)	505,000	(5,590,000)	1,510,000
Discontinued operations (Note 2)				
Net income from discontinued operations, net of tax of $-0- and $38,000 for the three and nine-month periods ended September 30, 2016 and $334,000 and $946,000 for the three and nine-month periods ended September 30, 2015	—	545,000	72,000	1,633,000
Gain on sale of discontinued operations, net of tax benefit of $187,000 and $328,000 for the three and nine-month periods ended September 30, 2016	187,000	—	12,358,000	—
Net income from discontinued operations, net of tax	187,000	545,000	12,430,000	1,633,000
Net (loss) income	$(99,000)	$1,050,000	$6,840,000	$3,143,000
Basic (loss) earnings per share				
Continuing operations	$(0.08)	$0.14	$(1.55)	$0.42
Discontinued operations	0.05	0.15	3.45	0.45
Net (loss) income	$(0.03)	$0.29	$1.90	$0.87
Diluted (loss) earnings per share				

Continuing operations	$(0.08)	$0.13	$(1.55)	$0.40
Discontinued operations	0.05	0.15	3.45	0.44
Net (loss) income	$(0.03)	$0.28	$1.90	$0.84
Weighted average common shares outstanding:				
Basic	3,598,000	3,616,000	3,598,000	3,604,000
Diluted	3,598,000	3,792,000	3,598,000	3,764,000
Net (loss) income	$(99,000)	$1,050,000	$6,840,000	$3,143,000
Other comprehensive loss-foreign currency translation adjustment	(63,000)	(99,000)	(299,000)	(55,000)
Total comprehensive (loss) income	$(162,000)	$951,000	$6,541,000	$3,088,000

See accompanying notes to consolidated financial statements (unaudited).

3

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (unaudited)

		Class A common stock, $1 par		Additional paid-in	Retained	Treasury stock		Accumulated other comprehensive
	Total	Shares	Amount	capital	earnings	Shares	Amount	loss
Balance, January 1, 2016	$43,642,000	4,170,000	$4,170,000	$12,884,000	$31,495,000	(554,000)	$(4,566,000)	$(341,000)
Net income	6,840,000	—	—	—	6,840,000	—	—	—
Exercise of stock options	23,000	6,000	6,000	17,000	—	—	—	—
Purchase of Class A common stock	(255,000)	—	—	—	—	(30,000)	(255,000)	—
Restricted common stock compensation	39,000	5,000	5,000	34,000	—	—	—	—
Stock-based compensation	(22,000)	—	—	(22,000)	—	—	—	—
Dividends	(2,156,000)	—	—	—	(2,156,000)	—	—	—
Foreign currency translation adjustment	(299,000)	—	—	—	—	—	—	(299,000)
Balance, September 30, 2016	$47,812,000	4,181,000	$4,181,000	$12,913,000	$36,179,000	(584,000)	$(4,821,000)	$(640,000)

See accompanying notes to consolidated financial statements (unaudited).

4

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine months ended September 30, 2016	2015
Cash Flows from Operating Activities:		
Net (loss) income from continuing operations	$(5,590,000)	$1,510,000
Net income from discontinued operations	12,430,000	1,633,000
Adjustments to reconcile net (loss) income from operations to net cash (used in) provided by operating activities:		
Non-cash charges:		
Depreciation and amortization	1,227,000	1,155,000
Amortization of other intangible assets	803,000	928,000
Amortization of debt issue costs	118,000	83,000
Provision for losses on accounts receivable - net	—	14,000
Stock-based compensation	13,000	72,000
Restricted stock-based compensation	39,000	30,000
Loss on sale of fixed assets	3,000	5,000
Deferred income taxes	(3,163,000)	52,000
Fair value reduction in contingent consideration	—	(126,000)
Impairment of goodwill and other intangible assets	8,311,000	—
Changes in operating assets and liabilities:		
Accounts receivable	(2,166,000)	(671,000)
Inventories	(681,000)	(712,000)
Prepaid expenses and other current assets	(1,947,000)	104,000
Other assets	60,000	76,000
Accounts payable	1,304,000	698,000
Accrued compensation and benefits	(209,000)	(243,000)
Accrued liabilities	287,000	(320,000)
Other liabilities	(14,000)	(13,000)
Total adjustments	3,985,000	1,132,000
Net cash (used in) provided by operating activities – continuing operations	(1,605,000)	2,642,000
Net cash (used in) provided by operating activities – discontinued operations	(653,000)	2,472,000
Net cash (used in) provided by operating activities	$(2,258,000)	$5,114,000

See accompanying notes to consolidated financial statements (unaudited).

5

P&F INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine months ended September 30, 2016	2015
Cash Flows from Investing Activities:		
Capital expenditures	$(894,000)	$(1,044,000)
Proceeds from disposal of assets	30,000	31,000
Net cash used in investing activities – continuing operations	(864,000)	(1,013,000)
Net cash provided by (used in) investing activities – discontinued operations	20,149,000	(100,000)
Net cash provided by (used in) investing activities	19,285,000	(1,113,000)
Cash Flows from Financing Activities:		
Dividend payments	(2,156,000)	—
Proceeds from exercise of stock options	23,000	73,000
Purchase of Class A common stock	(255,000)	—
Proceeds from short-term borrowings	43,853,000	55,827,000
Repayments of short-term borrowings	(33,317,000)	(56,182,000)
Repayments of term loans	(6,343,000)	(3,012,000)
Repayments of notes payable	(27,000)	(30,000)
Payments of bank financing costs	(30,000)	—
Net cash provided by (used in) financing activities – continuing operations	1,748,000	(3,324,000)
Net cash used in financing activities – discontinued operations	(18,716,000)	—
Net cash used in financing activities	(16,968,000)	(3,324,000)
Effect of exchange rate changes on cash	(45,000)	(6,000)
Net increase in cash	14,000	671,000
Cash at beginning of period	927,000	1,011,000
Cash at end of period	$941,000	$1,682,000
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$123,000	$492,000
Income taxes	$88,000	$1,149,000
Supplemental disclosures of non-cash investing activities:		
Exchange of property and equipment	$—	$64,000

See accompanying notes to consolidated financial statements (unaudited).

6

P&F INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

NOTE 1 - BUSINESS AND SUMMARY OF ACCOUNTING POLICIES

Basis of Financial Statement Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, and with the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Accordingly, these interim financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the management of the Company, as defined below, these unaudited consolidated financial statements include all adjustments necessary to present fairly the information set forth therein. All such adjustments, except for those adjustments relating to discontinued operations are of a normal recurring nature. Results for interim periods are not necessarily indicative of results to be expected for a full year.

The consolidated balance sheet information as of December 31, 2015 was derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”). The interim financial statements contained herein should be read in conjunction with the 2015 Form 10-K.

The consolidated financial statements have been reported in U.S. dollars by translating asset and liability amounts of a foreign wholly-owned subsidiary at the closing exchange rate, equity amounts at historical rates and the results of operations and cash flow at the average of the prevailing exchange rates during the periods reported. As a result, the Company is exposed to foreign currency translation gains or losses. These gains or losses are presented in the Company’s consolidated financial statements as “Other comprehensive loss - foreign currency translation adjustment”.

Principles of Consolidation

The unaudited consolidated financial statements contained herein include the accounts of P&F Industries, Inc. and its subsidiaries, (“P&F” or the “Company”). All significant intercompany balances and transactions have been eliminated.

Reclassification

Certain amounts in the consolidated financial statements of the Company have been reclassified to conform to classifications used in the current year. The reclassifications had no effect on previously reported results of operations or retained earnings.

The Company

P&F is a Delaware corporation incorporated on April 19, 1963. Prior to February 11, 2016, the effective date of the sale of its Nationwide Industries, Inc. (“Nationwide”) subsidiary, P&F operated in two primary lines of business or segments: (i) tools and other products (“Tools”) and (ii) hardware and accessories (“Hardware”). As a result of the sale of Nationwide, the Company currently only operates in the Tools segment. See Note 2 to Consolidated Financial Statements for further discussion.

Tools

The Company conducts its Tools business through a wholly-owned subsidiary, Continental Tool Group, Inc. (“Continental”), which in turn operates through its wholly-owned subsidiaries, Florida Pneumatic Manufacturing Corporation (“Florida Pneumatic”) and Hy-Tech Machine, Inc. (“Hy-Tech”). Exhaust Technologies Inc. (“ETI”) and Universal Air Tool Company Limited (“UAT”) are wholly-owned subsidiaries of Florida Pneumatic. The business of Air Tool Service Company (“ATSCO”) operates through a wholly-owned subsidiary of Hy-Tech.

Florida Pneumatic is engaged in the importation and sale of pneumatic hand tools, primarily for the retail, industrial and automotive markets, and the importation and sale of compressor air filters. Florida Pneumatic also markets, through its Berkley Tool division (“Berkley”), a product line which includes pipe and bolt dies, pipe taps, wrenches, vises and stands, pipe and tubing cutting equipment, hydrostatic test pumps, and replacement electrical components for a widely-used brand of pipe cutting and threading machines.

Hy-Tech manufactures and distributes its own line of industrial pneumatic tools. Hy-Tech also produces and markets impact wrenches, grinders, drills, and motors. Further, it also manufactures tools to customer specifications. Its customers include refineries, chemical plants, power generation facilities, heavy construction enterprises, oil and gas and mining companies. In addition, Hy-Tech manufactures an extensive line of pneumatic tool replacement parts that are sold to original equipment manufacturers (“OEMs”). It also manufactures and distributes high pressure stoppers for hydrostatic testing fabricated pipe, gears, sprockets, splines and racks and produces a line of siphons.

Hardware

Prior to the sale of Nationwide, which was effective February 11, 2016 (the “Closing Date”), the Company conducted its Hardware business through its wholly-owned subsidiary, Countrywide Hardware, Inc. (“Countrywide”). Countrywide conducted its business operations through its wholly-owned subsidiary, Nationwide. As of the Closing Date, Nationwide was an importer and manufacturer of door, window and fencing hardware and accessories, including rollers, hinges, window operators, sash locks, custom zinc castings and door closers. On the Closing Date, Countrywide sold Nationwide to an unrelated third party for approximately $22.2 million. See Note 2 to Consolidated Financial Statements for further discussion.

Management Estimates

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses in those financial statements. Certain significant accounting policies that contain subjective management estimates and assumptions include those related to revenue recognition, inventory, goodwill, intangible assets and other long-lived assets, income taxes and deferred taxes. Descriptions of these policies are discussed in the Company's 2015 Form 10-K. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, and makes adjustments when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from those estimates and assumptions. Significant changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in future periods.

Assets Held for Sale

The Company classifies assets as held for sale when specific criteria have been met. Assets classified as held for sale are recorded at the lower of the carrying value or the estimated fair value less cost to sell those assets. We cease depreciation and amortization of the assets in the period they are considered held for sale.

New Accounting Pronouncements

Recently Issued Accounting Pronouncements

Not Yet Adopted

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The standard reduces complexity in several aspects of the accounting for employee share-based compensation, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company is still evaluating the impact this standard will have on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This ASU is a comprehensive new leases standard that amends various aspects of existing guidance for leases and requires additional disclosures about leasing arrangements. It will require companies to recognize lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. Topic 842 retains a distinction between finance leases and operating leases. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous leases guidance. The ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years; earlier adoption is permitted. In the financial statements in which the ASU is first applied, leases shall be measured and recognized at the beginning of the earliest comparative period presented with an adjustment to equity. Practical expedients are available for election as a package and if applied consistently to all leases. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial condition, results of operations and cash flows.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which supersedes existing accounting standards for revenue recognition and creates a single framework. The new guidance requires either a retrospective or a modified retrospective approach at adoption. Early adoption is permitted, but not before the Company's fiscal year that begins on April 1, 2017 (the original effective date of the ASU). Additional updates to Topic 606 issued by the FASB in 2015 and 2016 include the following:

- ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of the new guidance such that the new provisions will now be required for fiscal years, and interim periods within those years, beginning after December 15, 2017.

- ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations*, which clarifies the implementation guidance on principal versus agent considerations (reporting revenue gross versus net).
- ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensin*g, which clarifies the implementation guidance on identifying performance obligations and classifying licensing arrangements.
- ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, which clarifies the implementation guidance in a number of other areas.

The Company is currently in the process of assessing the impact the adoption of the new revenue standards will have on its consolidated financial statements and related disclosures, as well as the available transition methods.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory* ("ASU 2015-11"). The standard simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value for entities using the first-in-first out method of valuing inventory. ASU 2015-11 eliminates other measures required by current guidance to determine net realizable value. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years and early adoption is permitted. The Company has not early adopted ASU 2015-11 and does not expect the new guidance to have a material effect on its consolidated financial statements when adopted for fiscal 2017 and beyond.

There are currently no other accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption.

Recently Adopted

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*. ASU 2015-17 is aimed at reducing complexity in accounting standards. Currently, GAAP requires the deferred taxes for each jurisdiction to be presented as a net current asset or liability and net noncurrent asset or liability. This requires a jurisdiction-by-jurisdiction analysis based on the classification of the assets and liabilities to which the underlying temporary differences relate, or, in the case of loss or credit carryforwards, based on the period in which the attribute is expected to be realized. Any valuation allowance is then required to be allocated on a pro rata basis, by jurisdiction, between current and noncurrent deferred tax assets. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction; companies are still prohibited from offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. The new guidance is effective in fiscal years beginning after December 15, 2016, including interim periods within those years, with early adoption permitted. The Company early adopted and applied the new standard retrospectively to the prior period presented in the Consolidated Balance Sheets.

The Company reported Deferred income taxes-net in its 2015 Form 10-K as Current assets of $1,131,000. After adoption of this ASU, and giving effect to the sale of Nationwide, discussed in Note 2, the Company now presents $229,000 of deferred tax assets being included in the Current assets from discontinued operations, and the balance of $902,000 included net against the long-term deferred income tax liability.

In April 2015, the FASB issued ASU 2015-03, "*Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*" (ASU 2015-03). The update requires that deferred debt issuance costs be reported as a reduction to long-term debt (previously reported in other noncurrent assets). The Company adopted ASU 2015-03 in the first quarter of 2016 and for all retrospective periods, as required. The impact of the adoption was not material to our consolidated financial statements, and is discussed further in Note 9.

NOTE 2 – DISCONTINUED OPERATIONS

The Company, as part of its strategic plan, which is to focus on expanding its position in the power-tool and accessories market, sold Nationwide. On the Closing Date, P&F, Countrywide, Nationwide and Argosy NWI Holdings, LLC, a Delaware limited liability company ("Buyer"), entered into a Stock Purchase and Redemption Agreement (the "Stock Purchase Agreement"), pursuant to which, among other things, after giving effect to certain contributions and redemptions of Nationwide's common shares ("Nationwide Shares"), the Buyer acquired all of the outstanding Nationwide Shares from Countrywide (the "Acquisition"). The purchase price for the Nationwide Shares acquired in the Acquisition was approximately $22,200,000, before giving effect to an estimated working capital adjustment, as defined in the Stock Purchase Agreement, of approximately $802,000. Further, in accordance with the Stock Purchase Agreement, the Company placed into escrow $1,955,000 ("escrow funds"), of which $250,000 related to the final working capital adjustment. Pursuant to the terms of the Stock Purchase Agreement, the final working capital amount was determined to be approximately $75,000 in the Company's favor. As a result, during the three-month period ended June 30, 2016, the $250,000 portion of the escrow funds was released to the Company, and the final working capital adjustment amount of $75,000 was paid to the Company by the Buyer. The Stock Purchase Agreement also requires Countrywide, under certain circumstances, to contribute an additional $400,000 into escrow. After paying closing costs, the net cash received from the Buyer was approximately $18.7 million.

The remaining $1,705,000 of the escrow funds, which is classified as Prepaid expenses and other current assets on the Company's Consolidated Balance Sheet, is intended to be released eighteen months from the Closing Date, which is August 2017, less any claims made against these escrow funds, in accordance with the Stock Purchase Agreement. The Company believes that these escrow funds are highly collectible, and that it is more likely than not that with respect to any or all such potential claims made against the Company, these claims will not exceed the minimum dollar threshold amount of $150,000 required under the Stock Purchase Agreement. The Company has therefore included the full amount of the $1,705,000 portion of the escrow funds in its gain on sale of Nationwide. Should claims made against the Company pursuant to the Stock Purchase Agreement exceed the minimum threshold, then to the extent such claims are resolved in favor of the Buyer under the terms of the Stock Purchase Agreement, the total amount of such claims will be recorded as a loss on sale of Nationwide in future periods.

As Nationwide was a substantial and unique business unit of the Company, its sale was a strategic shift. Accordingly, in accordance with Accounting Standard Code Topic 360, the Company has classified Nationwide as discontinued operations for all periods presented.

Net income from discontinued operations, net of taxes in the accompanying Consolidated Statements of Operations and Comprehensive (Loss) Income, is comprised of the following:

	January 1, 2016 through the Closing Date	Three months ended September 30, 2015	Nine months ended September 30, 2015
Revenue	$ 1,830,000	$ 5,754,000	$ 17,523,000
Cost of goods sold	1,177,000	3,519,000	10,681,000
Gross margin	653,000	2,235,000	6,842,000
Selling and general and administrative expenses	483,000	1,212,000	3,784,000
Interest expense-net	60,000	144,000	479,000
Income before income taxes	110,000	879,000	2,579,000
Income taxes	38,000	334,000	946,000
Net income	$ 72,000	$ 545,000	$ 1,633,000

The components of discontinued operations in the accompanying Consolidated Balance Sheet are as follows:

	December 31, 2015
Accounts receivable-net	$ 1,245,000
Inventories	4,211,000
Prepaid expenses and other current assets	92,000
Net property and equipment	768,000
Goodwill	1,873,000
Other intangible assets-net	12,000
Other assets- net	5,000
Deferred taxes - net	229,000
Assets of discontinued operations	$ 8,435,000
Accounts payable	$ 765,000
Accrued compensation and benefits	247,000
Accrued other liabilities	330,000
Liabilities of discontinued operations	$ 1,342,000

On the Closing Date, the Company and the president of Nationwide, entered into a purchase agreement pursuant to which, among other things the Company acquired 30,000 shares of the Company's Class A Common Stock ("Common Stock") at the aggregate purchase price of $254,940 and options to acquire 6,667 shares of the Company's Common Stock at an aggregate price of $16,597.

Effective as of the Closing Date, Countrywide, as landlord, and Nationwide, as tenant, entered into a new lease relating to the Tampa, Florida real property (the "Premises"). The lease provides for, among other things, a seven-year term commencing on the Closing Date and an annual base rent of approximately $252,000 with annual escalations. The lease also provides that the tenant will pay certain taxes and operating expenses associated with the Premises. The lease replaces the previous lease between Countrywide and Nationwide.

Lastly, effective as of the Closing Date, Countrywide and Nationwide entered into an Option and Right of First Refusal Agreement relating to the Premises, pursuant to which Countrywide granted a purchase option to Nationwide relating to the Premises if such option is initiated within 60 days following the Closing Date, which has since lapsed. In addition, Countrywide granted to Nationwide a right of first refusal relating to certain offers made by third parties during the five-year period following the Closing Date.

The Company recognized a gain of $12,185,000, on the sale of Nationwide during the three-month period ended March 31, 2016, which represents the difference between the adjusted net purchase price and the carrying book value of Nationwide. During the three-month period ended June 30, 2016 the Company incurred an additional $14,000 in expenses related to the sale. For income tax purposes, the Company's tax basis in Nationwide was greater than the net proceeds, thus resulting in a tax loss. This tax loss may only be applied against future capital gain transactions. During the three-month period ended March 31, 2016, the Company recorded a tax benefit of $141,000, net of a valuation allowance against the gain on sale. Subsequent to September 30, 2016, Countrywide completed the sale of the Premises, which is treated as a capital gain transaction for tax purposes. As a result, during the three-month period ended September 30, 2016, the Company removed the valuation allowance initially recorded against the tax loss, resulting in an additional $187,000 tax benefit recorded against the gain on sale. See Note 12-Subsequent Events, for further discussion.

NOTE 3 - (LOSS) EARNINGS PER SHARE

Basic (loss) earnings per common share is based only on the average number of shares of Common Stock outstanding for the periods. Diluted (loss) earnings per common share reflects the effect of shares of Common Stock issuable upon the exercise of options, unless the effect on earnings is antidilutive.

Diluted (loss) earnings per common share is computed using the treasury stock method. Under this method, the aggregate number of shares of Common Stock outstanding reflects the assumed use of proceeds from the hypothetical exercise of any outstanding options to purchase shares of Common Stock. The average market value for the period is used as the assumed purchase price.

The following table sets forth the elements of basic and diluted (loss) earnings per common share:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Numerator for basic and diluted (loss) earnings per common share:				
Net (loss) income from continuing operations	$(286,000)	$505,000	$(5,590,000)	$1,510,000
Net income from discontinued operations	187,000	545,000	12,430,000	1,633,000
Net (loss) income	$(99,000)	$1,050,000	$6,840,000	$3,143,000
Denominator:				
For basic (loss) earnings per share - weighted average common shares outstanding	3,598,000	3,616,000	3,598,000	3,604,000
Dilutive securities [1]	—	176,000	—	160,000
For diluted (loss) earnings per share - weighted average common shares outstanding	3,598,000	3,792,000	3,598,000	3,764,000

[1] Dilutive securities consist of "in the money" stock options.

At September 30, 2016 and 2015 and during the nine-month periods ended September 30, 2016 and 2015, there were outstanding stock options whose exercise prices were higher than the average market values of the underlying Common Stock for the period. Options for the three and nine months ended September 30, 2015 are anti-dilutive and are excluded from the computation of diluted earnings per share. For the three and nine months ended September 30, 2016, we experienced a net loss from continuing operations, as such, these options were not included in the computation of diluted (loss) earnings per share from continuing operations. The weighted average of anti-dilutive stock options outstanding was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Weighted average antidilutive stock options outstanding	73,000	88,000	78,000	150,000

NOTE 4 - STOCK-BASED COMPENSATION

In connection with an equity restructuring event, which occurred during the three-month period ended March 31, 2016 relating to a special dividend granted by the Company, the Company modified all previously issued outstanding options to purchase its Common Stock. This modification resulted in an aggregate increase of 19,174 options. The Company did not record any compensation expense in connection with the issuance of these options, as the issuance was made as the result of an equity restructuring event. Other than the aforementioned issuance, there were no other options granted or issued during the three and nine-month periods ended September 30, 2016.

The following is a summary of the changes in outstanding options during the nine-month period ended September 30, 2016:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding, January 1, 2016	457,000	$ 6.15	4.0	$ 1,431,000
Granted	19,174	5.89		
Exercised	(6,000)	3.81		
Forfeited	(26,500)	6.55		
Expired	(16,723)	10.72		
Outstanding and Vested, September 30, 2016	426,951	$ 5.71	3.1	$ 1,283,000

Included in the forfeited options in the table above are 20,998 options the Company purchased from Nationwide employees for $50,000 in connection with the sale of Nationwide.

The following is a summary of changes in non-vested options for the nine months ended September 30, 2016:

	Option Shares	Weighted Average Grant-Date Fair Value
Non-vested options, January 1, 2016	23,840	$ 6.72
Granted	829	6.45
Vested	(19,167)	6.71
Forfeited	(5,502)	6.72
Non-vested options, September 30, 2016	—	$ —

The number of shares of Common Stock available for issuance under the P&F Industries, Inc. 2012 Stock Incentive Plan (the “2012 Plan”) as of September 30, 2016 was 173,093. At September 30, 2016, there were 115,451 options outstanding issued under the 2012 Plan and 311,500 options outstanding issued under the 2002 Stock Incentive Plan.

Restricted Stock

Pursuant to the 2012 Plan, the Company, in May 2016, granted 1,000 restricted shares of its Common Stock to each non-employee member of its Board of Directors, totaling 5,000 restricted shares. The Company determined that the fair value of these shares was $8.72, which was the closing price of the Company’s Common Stock on the date of the grant. These shares cannot be traded earlier than the first anniversary of the grant date. As such, the Company is ratably amortizing the total non-cash compensation expense of approximately $44,000 in its selling, general and administrative expenses through May 2017.

NOTE 5 – FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the Company is required to classify certain assets and liabilities based on the following hierarchy:

Level 1: Quoted prices for identical assets or liabilities in active markets that can be assessed at the measurement date.

Level 2: Inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instruments valuation.

The guidance requires the use of observable market data if such data is available without undue cost and effort.

As of September 30, 2016 and December 31, 2015, the carrying amounts reflected in the accompanying consolidated balance sheets for current assets and current liabilities approximated fair value due to the short-term nature of these accounts.

The fair value of the Prepaid expenses and other current assets, which consists primarily of escrowed funds from the sale of Nationwide, which was estimated to be the same as its carrying value, based on Level 3 inputs. The escrow will be released to the Company in August 2017, in accordance with the terms and conditions set forth in the Stock Purchase Agreement.

Assets and liabilities measured at fair value on a non-recurring basis include goodwill, and intangible assets. Such assets are reviewed quarterly for impairment indicators. If a triggering event has occurred, the assets are re-measured when the estimated fair value of the corresponding asset group is less than the carrying value. The fair value measurements, in such instances, are based on significant unobservable inputs (level 3).

NOTE 6 – ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

Accounts receivable - net consists of:

	September 30, 2016	December 31, 2015
Accounts receivable	$ 10,663,000	$ 8,559,000
Allowance for doubtful accounts	(82,000)	(82,000)
	$ 10,581,000	$ 8,477,000

NOTE 7 – INVENTORIES

Inventories consist of:

	September 30, 2016	December 31, 2015
Raw material	$ 1,907,000	$ 2,070,000
Work in process	664,000	1,366,000
Finished goods	17,751,000	16,347,000
	$ 20,322,000	$ 19,783,000

15

NOTE 8 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets with indefinite lives are tested for impairment annually or whenever events or circumstances indicate the carrying value of these assets may not be recoverable.

The impairment testing is performed in two steps: (i) The Company compares the fair value of a reporting unit with its carrying value, and (ii) if there is impairment, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. The Company determines the fair value using the income approach methodology of valuation, which considers the expected present value of future cash flows. As an integral part of the valuation process the Company utilizes its latest cash flows forecasts for the remainder of the current fiscal year, if applicable, the next four fiscal years, and then applies projected minimal growth for all remaining years, based upon available statistical data and management's estimates.

During the second quarter of 2016, the Company determined that an interim impairment analysis of the goodwill recorded in connection with its Hy-Tech reporting unit was necessary based on consideration of a number of factors or assumptions, which included:

- Negative changes in revenue, which was driven primarily by continued weakness in the oil and gas exploration and extraction industries;
- the recent loss of a major portion of revenue from one of its larger customers;
- recent significant reductions/guidance of forecasted purchases from the largest customer acquired in the ATSCO acquisition; and
- changes in gross margin, driven primary by product mix and customer mix.

The combination of these factors was considered to be a triggering event requiring an interim impairment test.

Certain of the factors considered by management in the performance of the impairment test included:

- Cash flows was determined to be a key assumption primarily due to reductions in future revenue and gross margins; and
- Discount rates. The discount rates applied to internally developed cash flow projections were 14.5% for the previous annual impairment test as of November 30, 2015 and 13.8% at May 31, 2016, which was the date of the interim impairment test. The discount rate represents the weighted average cost of capital consistent with our views of the rate that an expected market participant would utilize for valuation, including the risk inherent in future cash flows, taking into account the capital structure, debt ratings and current debt yields of comparable public companies as well as an estimate of return on equity that reflects historical market returns.

Based on step one of the impairment analysis, it was determined that the fair value of the reporting unit was less than the carrying value. Step two of the goodwill impairment test resets the implied fair value of goodwill through a reallocation of the assets. That is, an entity shall allocate the fair value of a reporting unit, in this case, Hy-Tech to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. Accordingly, after resetting the carrying values of its intangible assets, other than Goodwill, which resulted in a $2,968,000 impairment of intangible assets (see below), the Company adjusted the carrying value of Goodwill by recording an impairment charge of $5,343,000 in the second quarter of 2016.

The carrying value of Hy-Tech exceeded its estimated fair value by approximately 15.7% at November 30, 2015. The fair value of Hy-Tech was estimated using 100% value based on internally developed cash flow projections. The internally developed cash flow projections reflect annual estimates through a terminal year calculated using a terminal year EBITDA multiple approach.

The impairment determinations involved significant assumptions and judgments. The calculations supporting the estimates of the fair value of Hy-Tech and the fair values of its assets and liabilities utilized models that take into consideration multiple inputs other than those discussed above. Assumptions regarding each of these inputs could have a significant effect on the related valuations. In performing these calculations, we also take into consideration assumptions on how current market participants would value Hy-Tech and its operating assets and liabilities. Changes to assumptions that reflect the views of current market participants can also have a significant effect on the related valuations. The fair value measurements resulting from these models are classified as non-recurring Level 3 measurements consistent with accounting standards related to the determination of fair value. Because of the volatility of these factors, we cannot predict the likelihood of any future impairment.

Trademarks and tradenames were previously considered an indefinite-lived intangible asset. However, as a result of the testing for impairment, which determined the carrying value of Hy-Tech's trademarks and tradenames exceeded the fair value, and an impairment charge of $229,000 was recorded at June 30, 2016. The Company will commence amortizing this intangible asset in July 2016 over a 15 year useful life. Further, future amortization is included in the estimated future amortization expense table below.

Changes in the carrying amount of goodwill are as follows:

	Florida Pneumatic	Hy-Tech	Total
Balance, January 1, 2016	$3,931,000	$6,223,000	$10,154,000
Impairment of goodwill	—	(5,343,000)	(5,343,000)
Currency translation adjustment	(25,000)	—	(25,000)
Balance, September 30, 2016	$3,906,000	$880,000	$4,786,000

Other intangible assets were as follows:

	September 30, 2016			December 31, 2015		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Other intangible assets:						
Customer relationships (1)	$5,568,000	$933,000	$4,635,000	$11,285,000	$3,486,000	$7,799,000
Trademarks and trade names (1)	1,524,000	—	1,524,000	1,576,000	—	1,576,000
Trademarks and trade names (2)	210,000	4,000	206,000	439,000	—	439,000
Engineering drawings	330,000	141,000	189,000	410,000	159,000	251,000
Non-compete agreements (1)	217,000	138,000	79,000	362,000	134,000	228,000
Patents	1,205,000	599,000	606,000	1,205,000	400,000	805,000
Totals	$9,054,000	$1,815,000	$7,239,000	$15,277,000	$4,179,000	$11,098,000

Included in the table above is the impairment charge recorded during the second quarter of 2016.

	September 30, 2016
Customer relationships	$ 2,619,000
Trademarks and trade names (2)	229,000
Engineering drawings	37,000
Non-compete agreements	83,000
	$ 2,968,000

(1) A portion of these intangibles are maintained in a foreign currency, and are therefore subject to foreign exchange rate fluctuations.

(2) These were previously considered an indefinite lived intangible asset of Hy-Tech, however as the result of the testing for impairment the Company began amortizing these intangible assets over a fifteen year useful life.

17

Amortization expense of intangible assets from continuing operations subject to amortization was as follows:

Three months ended September 30,		Nine months ended September 30,	
2016	2015	2016	2015
$ 217,000	$ 309,000	$ 803,000	$ 928,000

The weighted average amortization period for intangible assets was as follows:

	September 30, 2016	December 31, 2015
Customer relationships	9.6	10.0
Trademarks and trade names (2)	14.7	—
Engineering drawings	8.9	8.5
Non-compete agreements	1.4	2.7
Patents	5.9	5.8

Amortization expense for each of the next five years and thereafter is estimated to be as follows:

2017	$810,000
2018	618,000
2019	595,000
2020	562,000
2021	549,000
Thereafter	2,581,000
	$5,715,000

NOTE 9 – DEBT

In October 2010, the Company entered into a Loan and Security Agreement (“Credit Agreement”) with an affiliate of Capital One, National Association (“Capital One”, or the “Bank”). The Credit Agreement provides for a Revolver Loan (“Revolver”), borrowings under which are secured by the Company’s accounts receivable, mortgages on its real property located in Cranberry, PA, Tampa, FL and Jupiter, FL (“Real Property”), inventory and equipment. P&F and certain of its subsidiaries are borrowers under the Credit Agreement, and their obligations are cross-guaranteed by certain other subsidiaries. Revolver borrowings will bear interest at either LIBOR (“London InterBank Offered Rate”) or the Base Rate, as defined in the Credit Agreement, plus the Applicable Margin, as defined in the Credit Agreement. Further, the interest rate, either LIBOR or Base Rate, which is added to the Applicable Margin, is at the option of the Company.

The Company is limited as to the number of LIBOR borrowings.

The Company, in August 2014, entered into an Amended and Restated Loan and Security Agreement, (the "Restated Loan Agreement"), with Capital One. The Restated Loan Agreement, among other things, amended the Credit Agreement by: (1) increasing the total amount of the credit facility from $29,423,000 to $33,657,000, (2) increasing the Revolver from $20,000,000 to $22,000,000, (3) creating a new Term Loan, as defined in the Restated Loan Agreement ("Term Loan B"), and (4) re-designating as "Term Loan A", the previously existing outstanding Term Loan, which relates primarily to the Company's Real Property. In addition, the Restated Loan Agreement also reset certain financial covenants.

Contemporaneously with the sale of Nationwide, as discussed in Note 2, the Company entered into the Consent and Second Amendment to the Restated Loan Agreement (the "Amendment") with Capital One. The Amendment, among other things; (a) provided the Bank's consent to the transactions contained in the Stock Purchase Agreement and the repurchase of certain shares and options discussed in Note 2 and Note 4 to the Consolidated Financial Statements; (b) amended the Restated Loan Agreement by: (i) reducing the aggregate Commitment (as defined in the Restated Loan Agreement) to $11,600,000; (ii) reducing the Term Loan A to $100,000; (iii) reducing the Revolver Commitment to $10,000,000 (less the new Term Loan A balance of $100,000); (iv) reducing the Capex Loan Commitment to $1,600,000; (v) modifying certain financial covenants, (vi) lowering interest rate margins and fee obligations; and (vii) extending the expiration of the Credit Agreement to February 11, 2019. Additionally, the Bank released the mortgage on the Company's Real Property located in Tampa Florida.

The Company provides Capital One with, among other things, monthly financial statements, and monthly borrowing base certificates. The Company is required to comply with certain financial covenants. Under certain circumstances the Company would be required to submit certificates of compliance. The Company believes it is in compliance with all covenants under the current Credit Facility.

The net proceeds provided by the sale of Nationwide of approximately $18.7 million were used to pay down the Revolver and the Capex Term Loans in their entirety, and paid approximately $6 million against the Term Loan A, discussed below.

SHORT–TERM BORROWINGS

At September 30, 2016 and December 31, 2015, the Company's Revolver borrowings were $1,449,000 and $9,623,000, respectively. Applicable LIBOR Margins added to Revolver borrowings at September 30, 2016 and December 31, 2015 were 1.50% and 2.00%, respectively. The Applicable Base Rate Margin added to Revolver borrowings at September 30, 2016 and December 31, 2015 were 0.50% and 1.00%, respectively.

The Company purchased vehicles for use by its UAT salesforce. The current portion of the balance due on these vehicles is $17,000 at September 30, 2016 and was $31,000 at December 31, 2015.

LONG –TERM BORROWINGS

The Restated Loan Agreement provides for Term Loan A, which is secured by mortgages on the Real Property, accounts receivable, inventory and equipment. Term Loan A borrowings can be at either LIBOR, or at the Base Rate, or a combination of the two plus the Applicable Margins. LIBOR borrowings at September 30, 2016 and at December 31, 2015 were 1.5% and 3.0% respectively. The Applicable Margin for borrowings at the Base Rate for the same timeframes were 0.5% and 2.0%, respectively. A portion of the net proceeds from the sale of Nationwide repaid all but $100,000 of this Term Loan A and, accordingly, such remaining balance is being borrowed at the Base Rate, and is included in Long-term debt, less current maturities on the Company's Consolidated Balance Sheet at September 30, 2016.

During 2012, the Company borrowed $380,000 and $519,000, as loans to purchase machinery and equipment ("Capex Term Loans"). These loans were fully repaid with funds from the sale of Nationwide.

The long-term portion of the balance due on the purchased vehicles used by the UAT salesforce is $0 at September 30, 2016 and was $16,000 at December 31, 2015.

In accordance with ASU 2015-03, the Company reduced its long-term debt by $13,000 and $64,000, respectively, relating to deferred financing fees as of September 30, 2016 and December 31, 2015.

NOTE 10 – DIVIDEND PAYMENTS

On March 8, 2016, the Company's Board of Directors declared a special cash dividend of $0.50 per common share, which was paid on or about April 4, 2016, to shareholders of record at the close of business on March 21, 2016. The total amount of this special dividend payment was approximately $1.8 million. The Company's Board of Directors declared quarterly cash dividends of $0.05 per share to shareholders of record at the close of business on March 31, 2016 and July 18, 2016. These respective dividend payments of approximately $180,000 each were paid on or about April 14, 2016 and July 25, 2016. See Note 12 for discussion relating to dividends paid subsequent to September 30, 2016.

NOTE 11 – RELATED PARTY TRANSACTIONS

The president of one of the Company's subsidiaries is part owner of one of the subsidiary's vendors. During the three and nine-month periods ended September 30, 2016, the Company purchased approximately $137,000 and $413,000, respectively, of product from this vendor. During the three and nine-month periods ended September 30, 2015, the Company purchased approximately $154,000 and $477,000, respectively, of product from this vendor. At September 30, 2016 and December 31, 2015, the Company had trade payables to this vendor of $78,000 and $63,000, respectively. Additionally, during the three and nine-month periods ended September 30, 2016, the Company recorded sales to this vendor of $2,000 and $8,000, respectively. During the three and nine-month periods ended September 30, 2015, the Company recorded sales to this vendor of $2,000 and $7,000, respectively.

Additionally, this same individual is part owner of the facility located in Punxsutawney, Pennsylvania, which one of the Company's subsidiaries leases. This lease expires in 2021, with rent of approximately $76,000 per annum.

NOTE 12 – SUBSEQUENT EVENTS

On November 1, 2016, the Company's Countrywide subsidiary completed the sale (the "Real Estate Sale") of the Premises to an unrelated third party for a purchase price of $3,750,000. After broker fees and certain other expenses relating to the Real Estate Sale, the Company received approximately $3,500,000. The Premises are used by the Company's former Nationwide subsidiary. As a result of the Real Estate Sale, Countrywide is no longer a party to the lease relating to the Premises and has no further obligations relating to the Option and Right of First Refusal Agreement. Additionally, in accordance with the terms set forth in the Stock Purchase Agreement relating to the sale of Nationwide, Countrywide placed $400,000 of the proceeds from the Real Estate Sale into the escrow account established with the sale of Nationwide. The full escrow amount is scheduled to be released to the Company in August 2017, less any permissible claims allowed under the Stock Purchase Agreement. See Note 2 for more information about the Nationwide sale and the agreements referred to in this Note 12. These assets are classified as Assets held for sale, net of accumulated depreciation as of September 30, 2016. The net book value of these assets was $1,843,000 at December 31, 2015.

On October 18, 2016, the Company's Board of Directors declared a $0.05 per common share dividend to all stockholders of record as of October 28, 2016. The dividend was paid on or about November 8, 2016. The total amount was approximately $180,000.

P&F INDUSTRIES, INC. AND SUBSIDIARIES

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

Forward Looking Statement

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a safe harbor for forward-looking statements made by or on behalf of P&F Industries, Inc. and subsidiaries ("P&F", or the "Company"). P&F and its representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to shareholders. Generally, the inclusion of the words "believe," "expect," "intend," "estimate," "anticipate," "will," "may," "would," "could" a opposites and similar expressions identify statements that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and that are intended to come within the safe harbor protection provided by those sections. Any forward-looking statements contained herein, including those related to the Company's future performance, are based upon the Company's historical performance and on current plans, estimates and expectations. All forward-looking statements involve risks and uncertainties. These risks and uncertainties could cause the Company's actual results for the 2016 fiscal year and beyond to differ materially from those expressed in any forward-looking statement made by or on behalf of the Company for a number of reasons including, but not limited to, those relating to the strength of the markets in which the Company operates, the impact of competition, product demand and supply chain pricing, the Company's exposure to fluctuations in energy prices, the Company's ability to maintain mutually beneficial relationships with key customers, acquisitions of businesses, and as further previously disclosed in the Company's public filings, including in its Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 Form 10-K") and its subsequent Quarterly Reports on Form 10-Q. Forward-looking statements speak only as of the date on which they are made. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

Business

P&F and each of its subsidiaries are herein referred to collectively as the "Company." In addition, the words "we", "our" and "us" refer to the Company. Prior to February 11, 2016, (the "Closing Date"), the effective date of the sale of its Nationwide Industries, Inc. ("Nationwide") subsidiary, P&F operated in two primary lines of business or segments: (i) tools and other products ("Tools") and (ii) hardware and accessories ("Hardware"). As a result of the sale of Nationwide, the Company currently only operates in the Tools segment. See Note 2 to the Consolidated Financial Statements for further discussion.

Tools

The Company conducts its Tools business through a wholly-owned subsidiary, Continental Tool Group, Inc. ("Continental"), which in turn operates through its wholly-owned subsidiaries, Florida Pneumatic Manufacturing Corporation ("Florida Pneumatic") and Hy-Tech Machine, Inc. ("Hy-Tech"). Exhaust Technologies Inc. ("ETI") and Universal Air Tool Company Limited ("UAT") are wholly-owned subsidiaries of Florida Pneumatic. The business of Air Tool Service Company ("ATSCO") operates through a wholly-owned subsidiary of Hy-Tech.

Florida Pneumatic is engaged in the importation and sale of pneumatic hand tools, primarily for the retail, industrial and automotive markets, and the importation and sale of compressor air filters. Florida Pneumatic also markets, through its Berkley Tool division ("Berkley"), a product line which includes pipe and bolt dies, pipe taps, wrenches, vises and stands, pipe and tubing cutting equipment, hydrostatic test pumps, and replacement electrical components for a widely-used brand of pipe cutting and threading machines.

Hy-Tech manufactures and distributes its own line of industrial pneumatic tools. Hy-Tech also produces and markets impact wrenches, grinders, drills, and motors. Further, it also manufactures tools to customer specifications. Its customers include refineries, chemical plants, power generation facilities, heavy construction enterprises, oil and gas and mining companies. In addition, Hy-Tech manufactures an extensive line of pneumatic tool replacement parts that are sold to original equipment manufacturers ("OEMs"). It also manufactures and distributes high pressure stoppers for hydrostatic testing fabricated pipe, gears, sprockets, splines and racks and produces a line of siphons.

Hardware

Prior to the sale of Nationwide, which was effective on the Closing Date, the Company conducted its Hardware business through its wholly-owned subsidiary, Countrywide Hardware, Inc. (“Countrywide”). Countrywide conducted its business operations through its wholly-owned subsidiary, Nationwide. Nationwide was an importer and manufacturer of door, window and fencing hardware and accessories, including rollers, hinges, window operators, sash locks, custom zinc castings and door closers. On the Closing Date, Countrywide sold Nationwide to an unrelated third party for approximately $22.2 million. See Notes 2 and 12 to Consolidated Financial Statements for further discussion.

KEY INDICATORS

Economic Measures

Much of our business is driven by the ebbs and flows of the general economic conditions in both the United States and, to a lesser extent, abroad. We focus on a wide array of customer types including, but not limited to large retailers, aerospace, large and small resellers of pneumatic tools and parts, and automotive related customers. We tend to track the general economic conditions of the United States, industrial production and general retail sales.

A key economic measure relevant to us is the cost of the raw materials in our products. Key materials include metals, especially various types of steel and aluminum. Also important is the value of the United States Dollar (“USD”) in relation to the Taiwanese dollar (“TWD”), as we purchase a significant portion of our products from Taiwan. Purchases from Chinese sources are made in USDs. However, if the Chinese currency, the Renminbi (“RMB”), were to be revalued against the USD, there could be a significant negative impact on the cost of our products. As the result of the UAT acquisition, we closely monitor the fluctuation in the Great British Pound (“GBP”) to the USD, and the GBP to TWD, both of which can have an impact on the consolidated results. In addition, we monitor the number of operating rotary drilling rigs in the United States, as a means of gauging oil production, which is a key factor in our sales into the oil and gas exploration and extraction sector.

The cost and availability of a quality labor pool in the countries where products and components are manufactured, both overseas as well as in the United States, could materially affect our overall results.

Operating Measures

Key operating measures we use to manage our operations are: orders; shipments; development of new products; customer retention; inventory levels and productivity. These measures are recorded and monitored at various intervals, including daily, weekly and monthly. To the extent these measures are relevant; they are discussed in the detailed sections below.

Financial Measures

Key financial measures we use to evaluate the results of our business include: various revenue metrics; gross margin; selling, general and administrative expenses; earnings before interest and taxes; operating cash flows and capital expenditures; return on sales; return on assets; days sales outstanding and inventory turns. These measures are reviewed at monthly, quarterly and annual intervals and compared to historical periods as well as established objectives. To the extent that these measures are relevant, they are discussed in the detailed sections below for each operating segment.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Descriptions of these policies are discussed in the 2015 Form 10-K. Certain of these accounting policies require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities, revenues and expenses. On an ongoing basis, we evaluate estimates, including, but not limited to those related to bad debts, inventory reserves, goodwill and intangible assets, warranty reserves and taxes and deferred taxes. We base our estimates on historical data and experience, when available, and on various other assumptions that are believed to be reasonable under the circumstances, the combined results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. As future events and their effects cannot be determined with precision, actual results could differ significantly from those estimates and assumptions. Significant changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in future periods.

Overview

During the third quarter of 2016, our results of operations were impacted by:

The on-going weakness in the oil and gas exploration and extraction sector continues to negatively impact Hy-Tech's and, to a lesser degree, Florida Pneumatic's results.

Additional increase to Hy-Tech's allowance for slow moving inventory.

RESULTS OF OPERATIONS

Continuing operations

Unless otherwise discussed elsewhere in the Management's Discussion and Analysis, we believe that our relationships with our key customers and suppliers, given current economic conditions, remain satisfactory. The on-going weakness in the global oil and gas exploration and extraction markets continues to hamper both Hy-Tech and to a lesser degree, Florida Pneumatic. Further, there is a persistent weakness in the other markets that Hy-Tech serves, including power generation and construction. Other than the aforementioned on-going weakness, and those factors discussed in more detail below, there were no major trends or uncertainties that had, or we could reasonably expect could have, a material impact on our revenue, nor was there any unusual or infrequent event, transaction or any significant economic change that materially affected our results of operations.

During the first quarter of 2016, we sold Nationwide to an unrelated third party for approximately $22.2 million. As a result of this transaction, Nationwide's results are reported under discontinued operations, and are therefore excluded from continuing operations for all periods presented. Please see Note 2 - Discontinued Operations, to our Consolidated Financial Statements for additional information.

The table below provides an analysis of our net revenue from continuing operations for the three and nine-month periods ended September 30, 2016 and 2015:

	Three months ended September 30,			
			Increase (decrease)	
	2016	2015	$	%
Tools				
Florida Pneumatic	$11,702,000	$11,729,000	$(27,000)	(0.2)%
Hy-Tech	2,931,000	4,195,000	(1,264,000)	(30.1)
Consolidated	$14,633,000	$15,924,000	$(1,291,000)	(8.1)%

	Nine months ended September 30,			
			Increase (decrease)	
	2016	2015	$	%
Tools				
Florida Pneumatic	$35,270,000	$33,986,000	$1,284,000	3.8 %
Hy-Tech	9,499,000	12,555,000	(3,056,000)	(24.3)
Consolidated	$44,769,000	$46,541,000	$(1,772,000)	(3.8)%

Florida Pneumatic

Florida Pneumatic markets its air tool products to three primary sectors within the pneumatic tool market; retail, industrial/catalog and the automotive market. It also generates revenue from its Berkley products line as well as a line of air filters and other OEM parts ("Other").

	Three months ended September 30,					
	2016		2015		Increase (decrease)	
	Revenue	Percent of revenue	Revenue	Percent of revenue	$	%
Retail customers	$6,631,000	56.7 %	$7,035,000	60.0 %	$(404,000)	(5.7)%
Automotive	3,723,000	31.8	2,982,000	25.4	741,000	24.8
Industrial/catalog	1,115,000	9.5	1,412,000	12.0	(297,000)	(21.0)
Other	233,000	2.0	300,000	2.6	(67,000)	(22.3)
Total	$11,702,000	100.0 %	$11,729,000	100.0 %	$(27,000)	(0.2)%

	Nine months ended September 30,								
	2016			2015			Increase (decrease)		
	Revenue	Percent of revenue		Revenue	Percent of revenue		$	%	
Retail customers	$19,411,000	55.1	%	$19,352,000	56.9	%	$59,000	0.3	%
Automotive	11,336,000	32.1		9,122,000	26.8		2,214,000	24.3	
Industrial/catalog	3,843,000	10.9		4,679,000	13.8		(836,000)	(17.9)	
Other	680,000	1.9		833,000	2.5		(153,000)	(18.4)	
Total	$35,270,000	100.0	%	$33,986,000	100.0	%	$1,284,000	3.8	%

24

Primary factors contributing to the 24.8% growth in Florida Pneumatic's automotive revenue this quarter, compared to the same period in 2015, are the ongoing efforts to upgrade the lines with new innovative products, as well as expanding its marketing efforts in the United States., and in Europe. UAT's revenue is included in the Automotive sector. A portion of UAT's revenue is derived from the sale of pneumatic air tools to customers that are located and operate in the North Sea region of Scotland, and whose businesses are in the oil and gas sector. This sector continues to feel the effects of the ongoing weakness in global oil and gas exploration. Further impacting our consolidated revenue this quarter was the negative effects of the "Brexit", the portmanteau of "British" "Exit" from the European Union. We believe that Brexit was the key factor in the recent decline in the GBP in the world currency. As a result, the average exchange rate that was applied when converting UAT's local currency revenue into USDs, for the three-month periods ended September 30, 2016 and 2015, declined, resulting in reduced UAT revenue reported in USDs of approximately $118,000. As a result, UAT's overall revenue declined this quarter compared to the same three months in 2015. We are currently developing a marketing strategy that is intended to enable UAT to expand its presence into other Western European countries; however, no specific timetable has been established for this expansion. The decline in Florida Pneumatic's third quarter 2016 Retail revenue, compared to the third quarter of 2015, was due primarily to the timing of shipments to Sears that occurred in the third quarter of 2015 that we believe could occur during the fourth quarter of 2016. This decline was partially offset by increased shipments to The Home Depot. We continue to encounter weaknesses in the Industrial/catalog market, with the decline this quarter compared to the same period a year ago, occurring most notably in the aerospace and oil and gas exploration/production channels. Additionally, contributing to the decline in our Industrial/catalog revenue was the fact that during the third quarter of 2015, we shipped special orders aggregating approximately $220,000, which did not reoccur this year.

When comparing the nine-month periods ended September 30, 2016 and 2015, the growth in the Automotive sector is the most significant component of Florida Pneumatic's overall revenue improvement. This growth continues to be driven by the release of new, improved and enhanced products, broadening the product line offering, as well as expanded marketing efforts. Florida Pneumatic's Industrial/catalog revenue remains sluggish, as the oil and gas sector, which is a component of this category remains, in our opinion, extremely constricted. Further, special order shipments declined $458,000, when comparing the nine-month periods ended September 30, 2016 and 2015, which also contributed to the decline in revenue.

<u>Hy-Tech</u>

Hy-Tech focuses primarily on the industrial sector of the pneumatic tools market. Hy-Tech manufactures and markets its own value-added line of air tools and parts, including the ATSCO product line, as well as distributes a complementary line of sockets, which in the aggregate are referred to as "ATP". Hy-Tech Machine also manufactures products primarily marketed to the mining, construction and industrial manufacturing sectors. These products along with gears, sprockets, splines, and hydraulic stoppers are aggregated as "Other".

Three months ended September 30,		
2016	2015	Decrease

	Revenue	Percent of revenue		Revenue	Percent of revenue		$	%
ATP	$2,515,000	85.8	%	$3,551,000	84.6	%	$(1,036,000)	(29.2)%
Other	416,000	14.2		644,000	15.4		(228,000)	(35.4)
Total	$2,931,000	100.0	%	$4,195,000	100.0	%	$(1,264,000)	(30.1)%

	Nine months ended September 30,							
	2016			2015			Decrease	
	Revenue	Percent of revenue		Revenue	Percent of revenue		$	%
ATP	$8,411,000	88.5	%	$10,681,000	85.1	%	$(2,270,000)	(21.3)%
Other	1,088,000	11.5		1,874,000	14.9		(786,000)	(41.9)
Total	$9,499,000	100.0	%	$12,555,000	100.0	%	$(3,056,000)	(24.3)%

25

The on-going weakness in the oil and gas exploration and extraction sector continues to be the primary factor contributing to the decline in Hy-Tech's ATP third quarter of 2016 revenue, when compared to the same period in the prior year. This weakness continues to be a significant factor in the decline in demand of Hy-Tech's pneumatic tools, spare/replacement parts and drilling motors. Evidencing this decline is the fact that according to information published by Baker Hughes Incorporated: (a) The average U.S. rig count for September 2016 was 509, down 339 from the 848 in September 2015; (b) The average Canadian rig count for September 2016 was 141, down 42 from the 183 counted in September 2015 and (c) The worldwide rig count for September 2016 was 1,584, down 587 from the 2,171 counted in September 2015. Further contributing to the decline in revenue is the fact that a former major customer of Hy-Tech is currently sourcing internally, certain impact wrenches and other products that it had formerly purchased from Hy-Tech. Additionally, a large customer that was acquired in the ATSCO acquisition has dramatically reduced purchases, which we believe is also the result of the weakness in the oil and gas exploration sector. We believe that purchases from this customer may not recover until the oil and gas exploration and extraction market recovers, if at all. The decline in Hy-Tech's Other revenue was driven primarily due to weakness this quarter in specialty manufacturing for the mining, mine safety and railroad markets.

ATP's revenue for the nine-month period ended September 30, 2016, declined, compared to the same period in 2015, due primarily to: i) on-going weakness in the oil and gas exploration and extraction and related services sector; ii) loss of revenue due to a customer's decision to source certain products internally; iii) a major downturn in orders from a large customer, and iv) weakness in the other sectors in which Hy-Tech markets its products, such as mining, and railroad. We believe that should the oil and gas sector remain at or near current levels of exploration and extraction, it is likely that future periods may not reflect an increase over comparable prior periods for some time, even if trending upwards, chronologically. Significant factors contributing to the decline in Hy-Tech's Other year to date revenue is a $240,000 order that shipped in the first quarter of 2015, not recurring thus far in 2016, and overall weakness in the specialty manufacturing for the mining, mine safety and railroad markets. To mitigate this sluggishness, Hy-Tech is continuing to pursue alternate markets and applications of its air tools and motors, as well as to utilize and emphasize its manufacturing expertise. We believe this course of action should generate new sources of revenue in late 2016 or early 2017; however, no assurance can be given that these efforts will be successful.

Gross margins / profits

	Three months ended September 30,		Increase (decrease)	
	2016	2015	Amount	%
Florida Pneumatic	$4,219,000	$4,007,000	$212,000	5.3 %
As percent of respective revenue	36.1%	34.2%	1.9 %pts	
Hy-Tech	$286,000	$1,623,000	$(1,337,000)	(82.4)
As percent of respective revenue	9.8 %	38.7%	(28.9)%pts	
Total	$4,505,000	$5,630,000	$(1,125,000)	(20.0)%
As percent of respective revenue	30.8%	35.4%	(4.6)%pts	

	Nine months ended September 30,		Increase (decrease)	
	2016	2015	Amount	%
Florida Pneumatic	$13,070,000	$12,059,000	$1,011,000	8.4 %
As percent of respective revenue	37.1%	35.5%	1.6 %pts	
Hy-Tech	$1,956,000	$4,902,000	$(2,946,000)	(60.1)
As percent of respective revenue	20.6%	39.0%	(18.4)%pts	
Total	$15,026,000	$16,961,000	$(1,935,000)	(11.4)%
As percent of respective revenue	33.6%	36.4%	(2.8)%pts	

Florida Pneumatic's third quarter of 2016 gross margin improvement over the same period a year ago was driven primarily by improved product mix emanating from the growth of its Automotive revenue. Additionally, the foreign exchange rate of the U.S. Dollar to the Taiwan Dollar was more favorable than during the third quarter of 2015. Lastly, material costs are down slightly this quarter, compared to the same period a year ago. With respect to Hy-Tech's third quarter gross margin, during the three-month period ended September 30, 2016, we increased Hy-Tech's allowance for obsolete / slow moving inventory ("OSMI"). The primary reason for the additional OSMI reserve this quarter was due to the notification by a Hy-Tech vendor that it would not re-stock certain inventory items. In addition, the ongoing sluggish conditions in power generation and manufacturing caused a severe slowdown in Hy-Tech's inventory turnover. The adjustment to OSMI was the key contributing factor in this quarter's poor gross margin at Hy-Tech. Further, Hy-Tech's gross margin this quarter is lower compared to the same period in 2015, due in part to lower overhead absorption, which in turn is due primarily to lower manufacturing activity, being driven by the ongoing weakness in the oil and gas sector and key customer declines.

The primary factors contributing to the increase in Florida Pneumatic's gross margin for the nine months ended September 30, 2016, compared to the same period in the prior year include more favorable product mix, favorable foreign exchange and slightly lower cost of product. Hy-Tech's gross margin during the nine-month period ended September 30, 2016, has been adversely affected by the effects of the ongoing downturn in the oil and gas sector, along with weakness in power generation and manufacturing, sectors important contributors to Hy-Tech's revenue. This has caused Hy-Tech to further increase its OSMI. Additionally, Hy-Tech manufactures and sells a very low gross margin product line to a key ATSCO customer. We do not intend to continue to manufacture and market this product line after Hy-Tech has sold its remaining related inventory. It is possible that this decision may have an effect on

Hy-Tech’s 2017 revenue; however it should improve its future overall gross margin.

Selling and general and administrative expenses

Selling, general and administrative expenses, ("SG&A") include salaries and related costs, commissions, travel, administrative facilities, communications costs and promotional expenses for our direct sales and marketing staff, administrative and executive salaries and related benefits, legal, accounting and other professional fees as well as general corporate overhead and certain engineering expenses.

During the third quarter of 2016, our SG&A was $4,915,000 or 33.6% of revenue, compared to $4,787,000, or 30.1% of revenue during the same three-month period in 2015. The increase was due in large part to the increase in Automotive revenue, which drives variable expenses. As such, variable expenses increased this quarter $82,000 compared to the same period in 2015. Our compensation expense, which is comprised of base salaries and wages, accrued performance-based bonus incentives, associated payroll taxes and employee benefits increased $74,000, and professional fees and related expenses increased $111,000 this quarter compared to the same three-month period in 2015 due primarily to the Company's mergers and acquisitions initiatives. Depreciation and amortization expenses declined $97,000 when comparing the third quarter of 2016 to the same period in 2015 due primarily to the reduction of intangible assets associated with the impairment of intangible assets during the second quarter of 2016.

During the nine months ended September 30, 2016, our SG&A was $15,088,000 or 33.7% of revenue, compared to $14,834,000, or 31.9% of revenue during the same nine-month period in 2015. A significant component of this change is due to an increase in incremental variable costs and expenses, which increased by $377,000, compared to the same period in the prior year. This increase is due in large part to the increase in the Automotive revenue of $2.2 million. Additionally, when comparing the nine-month periods ended September 30, 2016 and 2015, total compensation, increased $80,000. Partially offsetting the above increases were reductions in professional fees and related expenses of $75,000, depreciation and amortization expenses of $119,000 and lower stock-based compensation of $45,000.

Impairment of goodwill and other intangible assets

During the second quarter of 2016, we determined that an interim impairment analysis of the goodwill recorded in connection with Hy-Tech and ATSCO was necessary based upon consideration of a number of factors, which included: i) continued weakness in oil and gas exploration and extraction; ii) the recent loss of a major portion of revenue from one of its larger customers; and iii) recent significant reductions/guidance of forecasted purchases from the largest customer acquired in the ATSCO acquisition. As a result of the aforementioned it was determined that Hy-Tech's short and long-term projections indicated an inability to generate sufficient discounted future cash flows to support the recorded amounts of goodwill, other intangible assets and other long-lived assets necessitating the impairment charge. As a result, in accordance with current accounting literature, we recorded an impairment charge of $8,311,000 relating to goodwill and other intangible assets during the second quarter of 2016. Should market conditions in the sectors in which Hy-Tech operates worsen, we could incur additional impairment charges in future periods.

Other (income) expense – net

The table below provides an analysis of our Other (income) expense-net from continuing operations for the three and nine-month periods ended September 30, 2016 and 2015:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Lease income-net	$(43,000)	$(37,000)	$(75,000)	$(108,000)
Fair value adjustment to contingent consideration -UAT	—	75,000	—	(126,000)
Total	$(43,000)	$38,000	$(75,000)	$(234,000)

Lease income-net is income and related expenses incurred in connection with the lease discussed in Note 2 to our Consolidated Financial Statements. The fair value adjustment to contingent consideration – UAT reflect the adjustments relating to the carrying value of the additional consideration due to the sellers of UAT settled in 2015.

Interest

	Three months ended September 30,		Increase (decrease)	
	2016	2015	Amount	%
Interest expense attributable to:				
Short-term borrowings	$ 15,000	$ —	$ 15,000	NA %
Term loans, including Capital Expenditure Term Loans	1,000	3,000	(2,000)	(66.7)
Amortization expense of debt financing costs	10,000	26,000	(16,000)	(61.5)
Total	$ 26,000	$ 29,000	$ (3,000)	(10.3)%

	Nine months ended September 30,		Increase (decrease)	
	2016	2015	Amount	%
Interest expense attributable to:				
Short-term borrowings	$41,000	$ —	$ 41,000	NA %
Term loans, including Capital Expenditure Term Loans	5,000	4,000	1,000	25.0 %
Amortization expense of debt financing costs	118,000	83,000	35,000	42.2 %
Total	$ 164,000	$ 87,000	$ 77,000	88.5 %

In accordance with current accounting guidance we have reported our short-term and term loan interest expense incurred during the three and nine-month periods ended September 30, 2015 of $144,000 and $479,000, respectively, and for the period January 1, 2016 through the Closing Date of $60,000, which was the effective date of sale of Nationwide, in Discontinued operations. Additionally, the $18.7 million cash received from the sale of Nationwide significantly reduced or eliminated the term loans that were included in the Credit Agreement. As a result, we wrote down the deferred financing costs associated with the repayment of those term loans. As such, $80,000 is included in amortization expense of debt financing costs in our interest expense for the nine-month period ended September 30, 2016. See Notes 2 and 9 to our Consolidated Financial Statements for further discussion on the sale of Nationwide and the Amendment to our Credit Agreement. See Liquidity and Capital Resources elsewhere in this Management's Discussion and Analysis section for further information regarding our bank loans.

Primarily the result of the cash received from the sale of Nationwide, our average balance of short-term borrowings during the three-month period ended September 30, 2016, was $2,585,000, compared to $13,550,000 during the three-month period ended September 30, 2015. The average balance of our short-term borrowings during the nine-month period ended September 30, 2016, was $3,593,000, compared to $14,807,000 during the nine-month period ended September 30, 2015.

Income taxes

At the end of each interim reporting period, the Company estimates its effective tax rate expected to be applied for the full year. This estimate is used to determine the income tax provision or benefit applicable to continuing operations, on a year-to-date basis, and may change in subsequent interim periods. As a result, our effective tax rate applicable to continuing operations for the three and nine-months ended September 30, 2016 was 27.2% and 33.9%, respectively. For the same periods in 2015 our effective tax rate applicable to continuing operations were 34.9% and 33.6%, respectively. The Company’s effective tax rates for both periods were affected primarily by state taxes and non-deductible expenses.

29

Discontinued operations

Nationwide's results of operations in our Consolidated Financial Statements and Note 2 presents their revenue and cost of goods sold for the period January 1, 2016 through the Closing Date. The SG&A incurred during the same period includes that of Nationwide plus $19,000 of expenses incurred at the corporate level that is specifically attributable to Nationwide. Nationwide's data for the three and nine-month periods ended September 30, 2015, represents their revenue and cost of goods sold. The SG&A for the three and nine-month periods ended September 30, 2015, includes all of Nationwide plus approximately $54,000 and $298,000, respectively, of corporate expenses directly attributable to Nationwide. In accordance with current accounting guidance, we have included, as part of discontinued operations, all interest expense incurred attributable to our Bank borrowings during the three and nine-month periods ended September 30, 2015, and for the period January 1, 2016 through the Closing Date.

We recognized a gain of $12,185,000, on the sale of Nationwide during the three-month period ended March 31, 2016, which represents the difference between the adjusted net purchase price and the carrying book value of Nationwide. During the three-month period ended June 30, 2016 we incurred an additional $14,000 in expenses related to the sale. For income tax purposes, our tax basis in Nationwide was greater than the net proceeds, thus resulting in a tax loss. This tax loss may only be applied against future capital gain transactions. During the three-month period ended March 31, 2016 we recorded a tax benefit of $141,000, net of a valuation allowance against the gain on sale. Subsequent to September 30, 2016, Countrywide completed the sale of the Tampa, Florida real property, which is treated as a capital gain transaction for tax purposes. As a result, during the three-month period ended September 30, 2016, we removed the valuation allowance initially recorded against the tax loss, resulting in an additional $187,000 tax benefit recorded against the gain on sale. See Note 12-Subsequent Events, in our Consolidated Financial Statements for further discussion.

LIQUIDITY AND CAPITAL RESOURCES

We monitor such metrics as days' sales outstanding, inventory requirements, inventory turns, estimated future purchasing requirements and capital expenditures to project liquidity needs, as well as evaluate return on assets. Our primary sources of funds are operating cash flows and our Revolver Loan ("Revolver") with our Bank.

We gauge our liquidity and financial stability by various measurements, some of which are shown in the following table:

	September 30, 2016	December 31, 2015
Working Capital	$ 27,634,000	$ 21,023,000

Current Ratio	4.08 to 1	2.19 to 1
Shareholders' Equity	$ 47,812,000	$ 43,642,000

Credit facility

In October 2010, we entered into a Loan and Security Agreement ("Credit Agreement") with an affiliate of Capital One, National Association ("Capital One", or the "Bank"). The Credit Agreement, among other things, provides the ability to borrow funds under the Revolver arrangement. Revolver borrowings are secured by the Company's accounts receivable, inventory, equipment and mortgages on real property located in Cranberry, PA, Tampa, FL and Jupiter, FL ("Real Property"). P&F and certain of its subsidiaries are borrowers under the Credit Agreement, and their obligations are cross-guaranteed by certain other subsidiaries.

At our option, Revolver borrowings bear interest at either LIBOR (“London InterBank Offered Rate”) or the Base Rate, as the term is defined in the Credit Agreement, plus an Applicable Margin, as defined in the Credit Agreement. We are subject to limitations on the number of LIBOR borrowings.

In August 2014, we entered into an Amended and Restated Loan and Security Agreement, (the “Restated Loan Agreement”), with Capital One. The Restated Loan Agreement, among other things, amended the Credit Agreement by: (1) increasing the total amount of the credit facility from $29,423,000 to $33,657,000, (2) increasing the Revolver from $20,000,000 to $22,000,000, (3) creating a new Term Loan, as defined in the Restated Loan Agreement (“Term Loan B”), and (4) re-designating as “Term Loan A”, the previously existing outstanding Term Loan, which relates primarily to the Company’s Real Property. In addition, the Restated Loan Agreement also reset certain financial covenants.

Contemporaneously with the sale of Nationwide in February 2016, we entered into the Consent and Second Amendment to the Restated Loan Agreement (the “Amendment”) with Capital One. The Amendment, among other things; provided the Bank’s consent to the transactions contained in the Stock Purchase Agreement and the repurchase of certain shares and options discussed in Note 2, and Note 4 to the Consolidated Financial Statements, and amended the Restated Loan Agreement by: (a) reducing the aggregate Commitment (as defined in the Restated Loan Agreement) to $11,600,000; (b) reducing the Term Loan A to $100,000; (c) reducing the Revolver Commitment to $10,000,000 (less the new Term Loan A balance of $100,000); (d) reducing the Capex Loan Commitment to $1,600,000; (e) modifying certain financial covenants, (f) lowering interest rate margins and fee obligations; and (g) extending the expiration of the Credit Agreement to February 11, 2019. Additionally, the bank released the mortgage on our Tampa, FL Real Property. We believe that despite the reduction in the overall facility, our cash requirements to operate our business will be funded by operations and the Revolver. Further, we believe that should a need arise whereby the current credit facility is insufficient, we can borrow additional amounts against our Real Property or other assets.

The net funds provided by the sale of Nationwide of approximately $18.7 million were used to pay down the Revolver, the Cap-Ex loans and the Term Loan A; however, the Amendment provided for $100,000 to remain outstanding under the Term Loan A, rather than pay it off in full so that the Company and Capital One could facilitate potential increased future term loan borrowings more inexpensively and efficiently.

At September 30, 2016 and December 31, 2015, Revolver borrowings outstanding were $1,449,000 and $9,623,000, respectively. Applicable LIBOR Margins added to Revolver borrowings at September 30, 2016 was 1.50% and at December 31, 2015 was 2.00%. The Applicable Base Rate Margin added to Revolver borrowings at September 30, 2016 and December 31, 2015 were 0.50% and 1.00%, respectively.

We purchase vehicles for use by our UAT salesforce. The current portion of the balance due on these loans applicable to these purchased vehicles was $17,000 at September 30, 2016 and $31,000 at December 31, 2015.

Cash flows

During the nine-month period ended September 30, 2016, our net cash increased $14,000 to $941,000 from $927,000 at December 31, 2015. Our total bank debt at September 30, 2016 was $1,549,000, compared to $16,066,000 at December 31, 2015. As discussed earlier and in Notes 2 and 9 to the Consolidated Financial Statements, our reduction in debt is primarily due to the sale of Nationwide. The total debt to total book capitalization (total debt divided by total debt plus equity); at September 30, 2016 was 3.1%, compared to 26.9% at December 31, 2015.

Our Board of Directors approved the initiation of a dividend policy under which the Company intends to declare quarterly cash dividends to its stockholders in the amount of $0.05 per quarter. Additionally, the Board of Directors also approved a special $0.50 per common share dividend. Both the special dividend totaling $1.8 million and the first quarterly $0.05 per common share dividend totaling approximately $180,000, were paid in April 2016, with subsequent $0.05 dividends paid in July and November 2016. As all cash remitted to us by our customers is delivered to a Capital One Lockbox, the cash required for the payment of the aforementioned dividends, was from Revolver borrowings. We currently believe that the quarterly dividend payments of approximately $180,000 are not material to our cash requirements.

On November 1, 2016, we sold the real property located in Tampa Florida for $3,750,000. After broker and other fees, we received approximately $3,500,000, which paid down all outstanding Revolver debt.

We believe that net cash flows from our current operating units and our ability to borrow against the Revolver should provide cash to fund our consolidated cost structure for at least the next twelve months.

Our capital spending from continuing operations was $894,000 for the nine-month period ended September 30, 2016, compared to $1,044,000 during the same period in the prior year. Capital expenditures for the balance of 2016 are expected to be approximately $100,000, some of which may be financed through our credit facilities or financed through independent third party financial institutions. The remaining 2016 capital expenditures will primarily be for expansion of existing product lines and replacement of equipment.

Customer concentration

We have two customers that in the aggregate account for 57.4% at September 30, 2016, and 47.0% at December 31, 2015 of our accounts receivable. To date, these customers, with minor exceptions, are current in their payments. Further, these two customers in the aggregate, accounted for 45.3% and 43.4%, respectively, of our revenue from continuing operations for the three-month and nine-month periods ended September 30, 2016, compared to 44.2% and 41.6%, respectively, for the same three-month and nine-month periods in 2015.

We believe that the loss of one or both of these customers would negatively impact our financial condition, but would not affect our ability to remain a going concern. One of these customers, Sears, has announced that it is seeking bids for the sale of its product group that purchases our products. There can be no assurance that we would continue to supply these products on similar terms or at all should this product group be sold.

RECENT ACCOUNTING PRONOUNCEMENTS

Management does not believe that any other recently issued, but not yet effective accounting standards, if currently adopted would have a material effect on our consolidated financial statements.

Item 3. Quantitative And Qualitative Disclosures About Market Risk

Not required.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), evaluated, as of September 30, 2016, the effectiveness of the Company's disclosure controls and procedures, which were designed to be effective at the reasonable assurance level. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Company's disclosure controls and procedures as of September 30, 2016, the Company’s management, including its CEO and CFO, concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level at that date.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting, identified in connection with the evaluation required by Exchange Act Rule 13a-15(d), that occurred during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material changes to the legal proceedings disclosure described in our 2015 Form 10-K.

Item 1A. Risk Factors

There were no material changes to the risk factors previously disclosed in our 2015 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

See "Exhibit Index" immediately following the signature page.

SIGNATURE

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.

	P&F INDUSTRIES, INC. (Registrant)
	/s/ JOSEPH A. MOLINO, Jr. Joseph A. Molino, Jr. Chief Financial Officer
Dated: November 14, 2016	(Principal Financial and Chief Accounting Officer)

EXHIBIT INDEX

The following exhibits are either included in this report or incorporated herein by reference as indicated below:

Exhibit Number	Description of Exhibit
31.1	Certification of Richard A. Horowitz, Principal Executive Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Joseph A. Molino, Jr., Principal Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Richard A. Horowitz, Principal Executive Officer of the Registrant, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 .
32.2	Certification of Joseph A. Molino, Jr., Principal Financial Officer of the Registrant, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	* Interactive Data

* Attached as Exhibit 101 are the following, each formatted in Extensible Business Reporting Language ("XBRL"): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations and Comprehensive (Loss) Income; (iii) Consolidated Statement of Shareholders' Equity; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements.

A copy of any of the foregoing exhibits to this Quarterly Report on Form 10-Q may be obtained, upon payment of the Registrant's reasonable expenses in furnishing such exhibit, by writing to P&F Industries, Inc., 445 Broadhollow Road, Suite 100, Melville New York 11747, Attention: Corporate Secretary.

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11

%

	12 %
	12 %
Products	
	4 %
	3 %
	4 %
	3 %
Insurance	
	0 %
	1 %
	0 %
	1 %
Other	
	0 %
	0 %
	0 %
	0 %
Total cost of revenues	
	28 %
	27 %

28
%
28
%
Gross profit
72
%
73
%
72
%
72
%
Operating expenses:
Sales and marketing
39
%
32
%
39
%
32
%
Research and development
11
%
12
%
10
%
11
%
General and administrative
15
%

14
%
15
%
15
%
Total operating expenses
65
%
58
%
64
%
58
%
Income from operations
7
%
15
%
8
%
14
%
Other income (expense), net
5
%
7
%
6
%
6
%
Income before income taxes
12

%

22

%

14

%

20

%

Provision for income taxes

0

%

0

%

0

%

0

%

Net income

12

%

22

%

14

%

20

%

14

Revenue. Our revenue is derived primarily from four sources: (1) service fees charged to customers for use of our PC Postage service; (2) PhotoStamps revenue from the sale of PhotoStamps; (3) product sales consisting of Supplies Store revenue from the direct sale of consumables and supplies; (4) insurance revenue from our branded insurance offering; and (5) other revenue consisting of advertising revenue from controlled access advertising to our existing customer base and licensing revenue. Total revenue increased to $20.3 million in the third quarter 2007 from $18.9 million in the third quarter 2006, an increase of 7%. Total revenue increased to $61.7 million during the nine months ended September 30, 2007 from $59.6 million during the nine months ended September 30, 2006, an increase of 4%.

Service fee revenue increased to $14.1 million in the third quarter 2007 from $13.1 million in the third quarter 2006, an increase of 8%. Service fee revenue increased to $41.3 million during the nine months ended September 30, 2007 from $40.1 million during the nine months ended September 30, 2006, an increase of 3%. The increase is primarily attributable to the increase in the number of paid customers during the third quarter 2007 as a result of our increased customer acquisition spend during the year. The total number of paid customers we successfully collected service fees from at least once during the quarter was approximately 345,000 and 311,000 during the third quarter 2007 and 2006, respectively. Average monthly service fee revenue per paid customer was approximately $13.64 and $14.00 during the third quarter 2007 and 2006, respectively. The decrease is primarily attributable to having a greater number of paid customers on lower priced plans as compared to last year. As a percentage of total revenue, service fee revenue increased one percentage point to 70% in the third quarter 2007 as compared to 69% in third quarter 2006. As a percentage of total revenue, service free revenue remained at 67% during each of the nine months ended September 30, 2007 and 2006. We intend to continue to increase our level of spending on customer acquisition in order to grow our service fee revenue in future periods.

PhotoStamps revenue increased to $3.5 million in the third quarter 2007 from $3.1 million in the third quarter 2006, an increase of 12%. PhotoStamps revenue increased to $11.3 million during the nine months ended September 30, 2007 from $10.8 million during the nine months ended September 30, 2006, an increase of 5%. The increase both during the quarter and the nine months ended September 30, 207 is primarily attributable to the increase in PhotoStamps sheets shipped. Total PhotoStamps sheets shipped were approximately 225,000 and 176,000 during the third quarter 2007 and 2006, respectively, and 705,000 and 596,000 during the nine months ended September 30, 2007 and 2006, respectively. Average revenue per PhotoStamps sheet shipped was approximately $15.75 and $17.89 during the third quarter 2007 and 2006, respectively. Both the increase in sheets shipped and the decrease in average revenue per sheet were primarily attributable to a higher mix of high volume business PhotoStamps orders, which carry a lower per sheet price. As a percentage of total revenue, PhotoStamps revenue during the third quarter 2007 and 2006 was 17% and 18% during the nine months ended September 30, 2007 and 2006. We plan to reduce our future level of sales and marketing spending on PhotoStamps in future periods on a year-over-year basis to improve profitability in PhotoStamps, which we expect will result in declining PhotoStamps revenue on a year-over-year basis.

Product revenue increased to $2.3 million in the third quarter 2007 from $1.9 million in the third quarter 2006, an increase of 19%. Product revenue increased to $7.1 million during the nine months ended September 30, 2007 from $6.3 million during the nine months ended September 30, 2006, an increase of 13%. The increase was attributable to the following: (1) we launched a new supplies store interface in September 2006 (2) growth in the paid customer base (3) marketing the store to our existing base (4) additional SKUs we added to the store and (5) growth in postage printed which helps drive sales of consumable supplies such as labels. Total postage printed was approximately $68 million and $55 million during the third quarter 2007 and 2006, respectively, and $195 million and $167 million during the nine months ended September 30, 2007 and 2006, respectively. As a percentage of total revenue, product revenue increased one percentage point to 11% in the third quarter 2007 as compared to 10% in the third quarter 2006. As a percentage of total revenue, product revenue increased slightly to 11% in the third quarter 2007 as compared to 10% in the third quarter 2006 and to 12% during the nine months ended September 30, 2007 as compared to 11% in the nine months ended September 30, 2006. We expect product revenue to continue to increase in future periods as we plan to add additional products to our supplies store, and as we continue to market these products to our new and existing customers.

Insurance revenue increased to $339,000 in the third quarter 2007 from $326,000 in the third quarter of 2006, an increase of 4%. The increase is primarily attributable to the increase in the average of dollar value insured per transaction. Insurance revenue was approximately $1.1 million each during the nine months ended September 30, 2007 and 2006. As a percentage of total revenue, insurance revenue remained at 2% in each of the three and nine months ended September 30, 2007 and 2006, respectively. We expect insurance revenue to increase in future periods to the extent that we realize our plans to grow our PC Potage business.

15

Other revenue decreased to $0 in the third quarter 2007 from $453,000 in the third quarter 2006, a decrease of 100%. Other revenue decreased to $906,000 during the nine months ended September 30, 2007 from $1.4 million during the nine months ended September 30, 2006, a decrease of 34%. As a percentage of total revenue, other revenue decreased to 0% in the third quarter 2007 as compared to 2% in the third quarter 2006, and to 1% during the nine months ended September 30, 2007 as compared to 2% during the nine months ended September 30, 2006. The decrease in other revenue, both on an absolute basis and as a percentage of total revenue is mainly attributable to the expiration of a licensing agreement in June 2007. We do not expect other revenue to be material in future periods.

Cost of Revenue. Cost of revenue principally consists of the cost of customer service, certain promotional expenses, system operating costs, credit card processing fees, the cost of postage for PhotoStamps, image review, printing and fulfillment costs for PhotoStamps, parcel insurance offering costs, customer misprints and products sold through our Supplies Store and the related costs of shipping and handling. Cost of revenue increased from $5.1 million in the third quarter 2006 to $5.7 million in the third quarter 2007, an increase of 12%. Cost of revenue increased to $5.7 million in the third quarter 2007 from $5.1 million in the third quarter 2006, an increase of 12%. Cost of revenue increased to $17.5 million during the nine months ended September 30, 2007 from $16.6 million during the nine months ended September 30, 2006, an increase of 6%. As a percentage of total revenue, cost of revenue was 27% and 28% during the third quarters of September 30, 2006 and 2007, respectively, and 28% during each of the nine months ended September 30, 2006 and 2007.

Cost of service revenue increased to $2.4 million in the third quarter of 2007 from $2.3 million in the third quarter of 2006, an increase of 2%. Cost of service revenue decreased to $7.1 million during the nine months ended September 30, 2007 from $7.3 million during the nine months ended September 30, 2006, a decrease of 2%. The increase during the third quarter 2007 is mainly attributable to headcount related expenses increasing in customer service. The decrease during the nine months ended September 30, 2007 is mainly attributable to the decrease in promotional expense as a result of a decrease in coupon redemption rates. As a percentage of total revenue, cost of service revenue remained at 12% during each of the three and nine months ended September 30, 2007 and 2006, respectively.

Included in cost of service revenue are promotional expenses. This includes free postage and a free digital scale offered to new customers, and was approximately $399,000 and $439,000 in the third quarter 2007 and 2006, respectively, and $1.2 million and $1.7 million during the nine months ended September 30, 2007 and 2006, respectively. Promotional expense, which represents a material portion of total cost of service revenue, is expensed in the period in which a customer qualifies for the promotion. However, the revenue associated with the acquired customer is earned over the customer's lifetime. Therefore, promotional expense for newly acquired customers may be higher than the revenue earned from those customers in the initial period.

Cost of PhotoStamps revenue increased to $2.5 million in the third quarter 2007 from $2.1 million in the third quarter 2006, an increase of 19%. Cost of PhotoStamps revenue increased to $7.6 million during the nine months ended September 30, 2007 from $6.9 million during the nine months ended September 30, 2006, an increase of 11%. As a percentage of total revenue, cost of PhotoStamps increased to 12% in the third quarter 2007 as compared to 11% in the third quarter 2006 and was 12% during each of the nine months ended September 30, 2006 and 2007. The increase, both on an absolute basis and as a percentage of total revenue, is primarily due to the increase in high volume business orders. Additionally, the gross margin from PhotoStamps is significantly lower than that of our other sources of revenue because we include the stated value of US Postal Service postage as part of our cost of PhotoStamps revenue. As a result, future increases in PhotoStamps sales would further increase the overall cost of Photostamps revenue as a percentage of total revenue. While we expect PhotoStamps revenue to decrease on year-over-year basis in future periods, cost of PhotoStamps revenue may grow on a year-over-year basis in future periods if high volume business PhotoStamps orders, which carry a lower gross margin compared with PhotoStamps website orders, compose a higher percentage of total orders.

Cost of product revenue increased to $760,000 in the third quarter of 2007 from $553,000 in the third quarter of 2006, an increase of 37%. Cost of product revenue increased to $2.4 million during the nine months ended September 30, 2007 from $2.0 million during the nine months ended September 30, 2006, an increase of 20%. As a percentage of total revenue, cost of product revenue increased to 4% during each of the three and nine months ended September 30, 2007, as compared to 3% in each of the three and nine months ended September 30, 2006. The increase, both on an absolute basis and as a percentage of revenue is mainly attributable to the increase in product sales. See "Product Revenue" in Results of Operation above for further discussion. We expect the cost of product sales to increase in future periods, which is consistent with our expectation that product sales will increase in future periods.

Cost of insurance revenue increased to $105,000 in the third quarter of 2007 from $99,000 in the third quarter of 2006, an increase of 6%. Cost of insurance revenue increased to $331,000 during the nine months ended September 30, 2007 from $325,000 during the nine months ended September 30, 2006, an increase of 2%. This is mainly attributable to the increase in insurance sales as a result of the increase in the average of dollar value insured per transaction. As a percentage of total revenue, cost of insurance revenue decreased to less than one percentage point during each of the three and nine months ended September 30, 2007, as compared to 1% for each of the three and nine months ended September 30, 2006. We expect the cost of insurance to increase in future periods, which is consistent with our expectation that insurance revenue will increase in future periods.

Cost of other revenue decreased to $0 in the third quarter of 2007 from $26,000 in the third quarter of 2006, a decrease of 100%. Cost of other revenue decreased to $52,000 during the nine months ended September 30, 2007 from $78,000 during the nine months ended September 30, 2006, a decrease of 33%. The decrease in cost of other revenue is mainly attributable to the expiration of a licensing agreement in June 2007. As a percentage of total revenue, cost of other revenue remained at less than one percent during each of the three and nine months ended September 30, 2007 and 2006.

Sales and Marketing. Sales and marketing expense principally consists of costs associated with strategic partnership relationships, advertising, and compensation and related expenses for personnel engaged in sales, marketing, and business development activities. Sales and marketing expense increased to $8.0 million in the third quarter 2007 from $6.0 million in the third quarter 2006, an increase of 33%. Sales and marketing expense increased to $23.7 million during the nine months ended September 30, 2007 from $19.2 million during the nine months ended September 30, 2006, an increase of 23%. As a percentage of total revenue, sales and marketing expense increased seven percentage points to 39% during each of the three and nine months ended September 30, 2007, as compared to 32% in each of the three and nine months ended September 30, 2006. The increase, both on an absolute basis and as a percentage of total revenue is primarily due to the increase in various marketing program expenditures relating to the acquisition of customers for our PC Postage business, partially offset by a decrease in marketing expenditures related to PhotoStamps. During the third quarter 2007, both PC Postage and PhotoStamps marketing expenditures increased as compared to the third quarter 2006. Ongoing marketing programs include the following: traditional advertising, partnerships, customer referral programs, customer re-marketing efforts, telemarketing, direct mail, and online advertising. We expect sales and marketing expenses in our PC Postage business to increase significantly on a year-over-year basis in future periods as we plan to continue our increased level of direct mail activity. We expect sales and marketing expenses in our PhotoStamps business to decrease on a year-over-year basis going forward, as we plan to decrease our spending on marketing programs with lower anticipated returns.

Research and Development. Research and development expense principally consists of compensation for personnel involved in the development of our services, depreciation of equipment and software and expenditures for consulting services and third party software. Research and development expense decreased to $2.1 million in the third quarter 2007 from $2.2 million in the third quarter 2006, a decrease of 6%. Research and development expense decreased to $6.3 million during the nine months ended September 30, 2007 from $6.7 million during the nine months ended September 30, 2006, a decrease of 6%. This decrease is primarily due to the decrease in SFAS 123R stock-based compensation and lower headcount related expenses. As a percentage of total revenue, research and development expense decreased by one percentage point to 11% and 10% in each of the three and nine months ended September 30, 2007, respectively, as compared to 12% and 11% in the three and nine months ended September 30, 2006, respectively. We currently expect research and development expense to increase in future periods primarily related to expected increase in headcount related expenses.

General and Administrative. General and administrative expense principally consists of compensation and related costs for executive and administrative personnel, fees for legal and other professional services, depreciation of equipment and software used for general corporate purposes and amortization of intangible assets. General and administrative expense increased to $3.1 million in the third quarter 2007 from $2.6 million in the third quarter 2006, an increase of 19%. General and administrative expense increased to $9.1 million during the nine months ended September 30, 2007 from $9.0 million during the nine months ended September 30, 2006, an increase of 1%. The increase in general and administrative expense during the third quarter is primarily due to the increase in legal expenses relating to existing litigation and to increased SFAS 123R stock-based compensation expense. Stock-based compensation expense increased to $382,000 in the third quarter 2007 from $255,000 in the third quarter 2006 and decreased to $865,000 during the nine months ended September 30, 2007 from $973,000 during the nine months ended September 30, 2006. As a percentage of total revenue, general and administrative expense increased one percentage point to 15% in the third quarter of 2007 as compared to 14% in the third quarter of 2006 and was 15% during each of the nine months ended September 30, 2007 and 2006. We currently expect general and administrative expenses to increase in future periods primarily because of increased activity in existing litigation.

Other Income, Net. Other income, net consists of interest income from cash equivalents and short-term and long-term investments. Other income, net decreased to $1.1 million in the third quarter 2007 from $1.3 million in the third quarter 2006, a decrease of 21%. Other income, net decreased to $3.4 million during the nine months ended September 30, 2007 from $3.8 million during the nine months ended September 30, 2006, a decrease of 10%. As a percentage of total revenue, other income, net decreased two percentage points to 5% in the third quarter 2007 as compared to 7% in the third quarter 2006 and was 6% during each of the nine months ended September 30, 2007 and 2006. The decrease, both on an absolute basis and as a percentage of total revenue is primarily attributable to lower investment balances as we sold certain investments and used the cash to repurchase shares of our common stock. We expect other income to decrease in future periods as a result of lower invested cash balance and lower interest rates.

Liquidity and Capital Resources

As of September 30, 2007 and December 31, 2006 we had approximately $84 million and $106 million, respectively, in cash, restricted cash and short-term and long-term investments. We invest available funds in short and long-term money market funds, commercial paper, corporate notes and municipal securities and do not engage in hedging or speculative activities.

In November 2003, we entered into a facility lease agreement commencing in March 2004 for our new corporate headquarters with aggregate lease payments of approximately $4 million through February 2010.

The following table is a schedule of our contractual obligations and commercial commitments which is comprised of the future minimum lease payments under operating leases at September 30, 2007 (in thousands):

		Operating
Nine months ending December 31, 2007	$	179
Years ending December 31:		
2008		751
2009		787
2010		134
2011		-
	$	1,851

During the third quarter of 2007 we repurchased approximately 1.2 million shares of common stock for approximately $14.0 million. As of September 30, 2007 we have completed our latest stock repurchase program.

Net cash provided by operating activities was $10.2 million and $13.3 million during the nine months ended September 30, 2007 and 2006, respectively. The decrease in net cash provided by operating activities resulted primarily from the payment of marketing expenses which principally consist of costs associated with direct mail and online marketing.

Net cash provided by investing activities was $25.1 million during the nine months ended September 30, 2007. Net cash used in investing activities was $20.5 million during the nine months ended September 30, 2006. The decrease in net cash used in investing activities resulted primarily from the sale of investments to fund the repurchase of stock, as noted above.

Net cash used in financing activities was $32.0 million during the nine months ended September 30, 2007. Net cash provided by financing activities was $224,000 during the nine months ended September 30, 2006. The decrease in net cash provided by financing activities resulted primarily from the repurchase of our stock, as noted above.

We believe our available cash and marketable securities, together with the cash flow from operations will be sufficient to fund our business for the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We have not used derivative financial instruments in our investment portfolio. Our cash equivalents and investments are comprised of money market, U.S. government obligations and public corporate debt securities with weighted average maturities of 317 days at September 30, 2007. Our cash equivalents and investments, net of restricted cash, approximated $83.4 million and had a related weighted average interest rate of approximately 4.9%. Interest rate fluctuations can impact the carrying value of our portfolio. We do not believe that the future market risks related to the above securities will have a material adverse impact on our financial position, results of operations or liquidity.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

As of the end of the period covered by this Report, our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report in the timely and accurate recording, processing, summarizing and reporting of material financial and non-financial information within the time periods specified in the SEC’s rules and forms. Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has concluded that our disclosure controls and procedures are also effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Principal Executive Officer and Principal Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Controls

During the third quarter ended September 30, 2007, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 22, 2004, Kara Technology Incorporated filed suit against us in the United States District Court for the Southern District of New York, alleging, among other claims, that Stamps.com infringed certain Kara Technology patents and that Stamps.com misappropriated trade secrets owned by Kara Technology, most particularly with respect to our NetStamps feature. Kara Technology seeks an injunction, unspecified damages, and attorneys' fees. On February 9, 2005, the court granted our motion to transfer this suit to the United States District Court for the Central District of California. On August 23, 2006, the court granted our summary judgment motions on the trade secret and other non-patent claims. The court issued a "Markman" ruling, construing the terms of the Kara Technology patents on September 10, 2007. Following the Markman ruling, we filed two summary judgment motions regarding the patent claims, which have not yet been ruled on by the Court. The Court has scheduled a trial commencement date of January 22, 2008.

On November 22, 2006, we filed a lawsuit against Endicia, Inc. and PSI Systems, Inc. in the United States District Court for the Central District of California for infringement of eleven Stamps.com patents covering, among other things, Internet postage technology. On January 8, 2007, Endicia, Inc. and PSI Systems, Inc. filed counterclaims asking for a declaratory judgment that all eleven patents are invalid, unenforceable and not infringed. The Court has scheduled a trial commencement date of March 25, 2008.

In May and June 2001, we were named, together with certain of our current and former board members and/or officers, as a defendant in 11 purported class-action lawsuits, filed in the U.S. District Court for the Southern District of New York. The lawsuits allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with our initial public offering and a secondary offering of our common stock. The lawsuits also name as defendants the principal underwriters in connection with our public offerings, and allege that the underwriters engaged in improper commission practices and stock price manipulations in connection with the sale of our common stock. The lawsuits allege that we and/or certain of our officers or directors knew of or recklessly disregarded these practices by the underwriter defendants, and failed to disclose them in our public filings. Plaintiffs seek damages and statutory compensation, including interest, costs and expenses (including attorneys' fees). Over 1,000 similar lawsuits have been brought against over 250 companies which issued stock to the public in 1998-2000, and their underwriters. All of these lawsuits have been consolidated for pretrial purposes before U.S. District Court Judge Shira Scheindlin.

In June 2003, we approved a proposed Memorandum of Understanding among the plaintiffs, issuers and insurers as to terms for a settlement of the litigation against us, which was further documented in a Stipulation and Agreement of Settlement filed with the court. The proposed settlement, which would not require Stamps.com to make any payments, was preliminarily approved by the court in February 2005 and was the subject of a fairness hearing in April 2006.

In October 2004, however, the court issued an order regarding class certification in certain related matters. In December 2006, the U.S. Court of Appeals for the Second Circuit vacated that order, and determined that the related matters could not be certified as a class as currently defined. That appellate decision rendered uncertain whether our proposed settlement could be finally approved and consummated, and, in June 2007, the proposed settlement was terminated. As a result, plaintiffs have filed an amended complaint and proposed an alternative class definition in related litigation. If such a class definition does not receive final court approval and/or a later settlement is not consummated for any reason, we intend to defend the lawsuits vigorously.

On August 30, 2007, Sterling Realty Organization Co. filed suit against us in the Superior Court for the State of Washington for King County, alleging they are entitled under the doctrine of equitable subrogation to recover a $575,929 sales tax related payment for improvements under a lease related to our discontinued iShip business. The lawsuit also seeks pre-judgment interest and costs.

We are subject to various other routine legal proceedings and claims incidental to our business, or which involve primarily a claim for damages that does not exceed 10% of our consolidated assets. We believe that the ultimate results from these actions will not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

You should carefully consider the following risks and the other information in this Report and our other filings with the SEC before you decide to invest in our company or to maintain or increase your investment. The risks and uncertainties described below are not the only ones facing Stamps.com. Additional risks and uncertainties may also adversely impact and impair our business. If any of the following risks actually occur, our business, results of operations or financial condition would likely suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

This Report contains forward-looking statements based on the current expectations, assumptions, estimates and projections about Stamps.com and the Internet. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of many factors, including those described in this section and elsewhere in this Report. Stamps.com does not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Risks Related to Our Business

We may not successfully implement strategies to increase the adoption of our services and products which would limit our growth, adversely affect our business and cause the price of our common stock to decline.

Our continuing profitability depends on our ability to successfully implement our strategy of increasing the adoption of our services and products. Factors that might cause our revenues, margins and operating results to fluctuate include the factors described in the subheadings below as well as:

- The costs of our marketing programs to establish and promote the Stamps.com brands;
- The demand for our services and products;
- Our ability to develop and maintain strategic distribution relationships;
- The number, timing and significance of new products or services introduced by us and by our competitors;
- Our ability to develop, market and introduce new and enhanced products and services on a timely basis;
- The level of service and price competition;
- Our operating expenses;
- US Postal Service regulation and policies relating to PC Postage and PhotoStamps; and
- General economic factors.

We have implemented pricing plans that may adversely affect our future revenues and margins.

Our ability to generate gross margins depends upon the ability to generate significant revenues from a large base of active customers. In order to attract customers in the future, we may run special promotions and offers such as trial periods, discounts on fees, postage and supplies, and other promotions. We cannot be sure that customers will be receptive to future fee structures and special promotions that we may implement. Even though we have established a sizeable base of users, we still may not generate sufficient gross margins to remain profitable. In addition, our ability to generate revenues or sustain profitability could be adversely affected by the special promotions or additional changes to our pricing plans.

If we do not successfully attract and retain skilled personnel for permanent management and other key personnel positions, we may not be able to effectively implement our business plan.

Our success depends largely on the skills, experience and performance of the members of our senior management and other key personnel. Any of the individuals can terminate his or her employment with us at any time. If we lose key employees and are unable to replace them with qualified individuals, our business and operating results could be seriously harmed. In addition, our future success will depend largely on our ability to continue attracting and retaining highly skilled personnel. As a result, we may be unable to successfully attract, assimilate or retain qualified personnel. Further, we may be unable to retain the employees we currently employ or attract additional qualified personnel to replace those key employees that may depart. The failure to attract and retain the necessary personnel could seriously harm our business, financial condition and results of operations.

The success of our business will depend upon the continued acceptance by customers of our service.

We must minimize the rate of loss of existing customers while adding new customers. Customers cancel their subscription to our service for many reasons, including a perception that they do not use the service sufficiently. Also customers may feel the costs for service are too high, they may be going out of business, or they may have other issues that are not satisfactorily resolved. We must continually add new customers both to replace customers who cancel and to continue to grow our business beyond our current customer base. If too many of our customers cancel our service, or if we are unable to attract new customers in numbers sufficient to grow our business, our operating results will be adversely affected. Further, if excessive numbers of customers cancel our service, we may be required to incur significantly higher marketing expenditures than we currently anticipate to replace these customers with new customers.

If we fail to effectively market and sell our services and products, our business will be substantially harmed and could fail.

In order to acquire customers and achieve widespread distribution and use of our services and products, we must develop and execute cost-effective marketing campaigns and sales programs. We currently rely on a combination of marketing techniques to attract new customers including direct mail, online marketing and business partnerships. We may be unable to continue marketing our services and products in a cost-effective manner. If we fail to acquire customers in a cost-effective manner, our results of operations will be adversely affected.

If we fail to meet the demands of our customers, our business will be substantially harmed and could fail.

Our services and products must meet the commercial demands of our customers, which include home businesses, small businesses, corporations and individuals. We cannot be sure that our services will appeal to or be adopted by an ever-growing range of customers. If we are unable to ship products such as items from our Supplies Store or PhotoStamps in a timely manner to our customers, our business may be harmed. Moreover, our ability to obtain and retain customers depends, in part, on our customer service capabilities. If we are unable at any time to address customer service issues adequately or to provide a satisfactory customer experience for current or potential customers, our business and reputation may be harmed. If we fail to meet the demands of our customers our results of operations will be adversely affected.

A failure to further develop and upgrade our services and products could adversely affect our business.

Any delays or failures in developing our services and products, including upgrades of current services and products, may have a harmful impact on our results of operations. The need to extend our core technologies into new features and services and to anticipate or respond to technological changes could affect our ability to develop these services and features. Delays in features or upgrade introductions could cause a decline in our revenue, earnings or stock price. We cannot determine the ultimate effect these delays or the introduction of new features or upgrades will have on our revenue or results of operations.

Increases in payment processing fees would increase our operating expenses and adversely affect our results of operations.

Our customers pay for our services predominately using credit cards and debit cards and, to a lesser extent, by use of automated clearing house, (“ACH”). Our acceptance of these payment methods requires our payment of certain fees. From time to time, these fees may increase, either as a result of rate changes by the payment processing companies or as a result in a change in our business practices which increase the fees on a cost-per-transaction basis. If these fees for accepting payment methods increase in future periods, it may adversely affect our results of operations.

A decline in our ability to effectively bill our customers by credit card and debit card would adversely affect our results of operations.

22

Our ability to effectively charge our customers through credit cards and debit cards is subject to many variables, including our own billing technology and practices, the practices and rules of payment processing companies, and the practices and rules of issuing financial institutions. If we do not effectively charge and bill our customers in future periods through credit cards and debit cards, it would adversely affect our results of operations.

Third party assertions of violations of their intellectual property rights could adversely affect our business.

Substantial litigation regarding intellectual property rights exists in our industry. Third parties may currently have, or may eventually be issued, patents upon which our products or technology infringe. Any of these third parties might make a claim of infringement against us. We may become aware of, or we may increasingly receive correspondence claiming, potential infringement of other parties' intellectual property rights. We could incur significant costs and diversion of management time and resources to defend claims against us regardless of their validity. Any associated costs and distractions could have a material adverse effect on our business, financial condition and results of operations. In addition, litigation in which we are accused of infringement might cause product development delays, require us to develop non-infringing technology or require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our business could be significantly harmed or fail. Any loss resulting from intellectual property litigation could severely limit our operations, cause us to pay license fees, or prevent us from doing business.

A failure to protect our own intellectual property could harm our competitive position.

We rely on a combination of patent, trade secret, copyright and trademark laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our rights in our products, services, know-how and information. We have a portfolio of issued and pending US and international patents. We also have a number of registered and unregistered trademarks. We plan to apply for more patents in the future. We may not receive patents for any of our patent applications. Even if patents are issued to us, claims issued in these patents may not protect our technology. In addition, a court might hold any of our patents, trademarks or service marks invalid or unenforceable. Even if our patents are upheld or are not challenged, third parties may develop alternative technologies or products without infringing our patents. If our patents fail to protect our technology or our trademarks and service marks are successfully challenged, our competitive position could be harmed. We also generally enter into confidentiality agreements with our employees, consultants and other third parties to control and limit access and disclosure of our confidential information. These contractual arrangements or other steps taken to protect our intellectual property may not prove to be sufficient to prevent misappropriation of technology or deter independent third party development of similar technologies. Additionally, the laws of foreign countries may not protect our services or intellectual property rights to the same extent as do the laws of the United States.

System and online security failures could harm our business and operating results.

Our services depend on the efficient and uninterrupted operation of our computer and communications hardware systems. In addition, we must provide a high level of security for the transactions we execute. We rely on internally-developed and third-party technology to provide secure transmission of postage and other confidential information. Any breach of these security measures would severely impact our business and reputation and would likely result in the loss of customers. Furthermore, if we are unable to provide adequate security, the US Postal Service could prohibit us from selling postage over the Internet.

Our systems and operations are vulnerable to damage or interruption from a number of sources, including fire, flood, power loss, telecommunications failure, break-ins, earthquakes and similar events. Our Internet host provider does not guarantee that our Internet access will be uninterrupted, error-free or secure. Our servers are also vulnerable to computer viruses, physical, electrical or electronic break-ins and similar disruptions. We have experienced minor system interruptions in the past and may experience them again in the future. Any substantial interruptions in the future could result in the loss of data and could completely impair our ability to generate revenues from our service. We do not presently have a full disaster recovery plan in effect to cover the loss of facilities and equipment. In addition, we do not have a fail-over site that mirrors our infrastructure to allow us to operate from a second location. We have business interruption insurance; however, we cannot be certain that our coverage will be sufficient to compensate us for losses that may occur as a result of business interruptions.

A significant barrier to electronic commerce and communications is the secure transmission of confidential information over public networks. Anyone who is able to circumvent our security measures could misappropriate confidential information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against potential security breaches or to alleviate problems caused by any breach. We rely on specialized technology from within our own infrastructure to provide the security necessary for secure transmission of postage and other confidential information. Advances in computer capabilities, new discoveries in security technology, or other events or developments may result in a compromise or breach of the algorithms we use to protect customer transaction data. Should someone circumvent our security measures, our reputation, business, financial condition and results of operations could be seriously harmed. Security breaches could also expose us to a risk of loss or litigation and possible liability for failing to secure confidential customer information. As a result, we may be required to expend a significant amount of financial and other resources to protect against security breaches or to alleviate any problems that they may cause.

Risks Related to Our Industry

US Postal Service regulations or fee assessments may cause disruptions or discontinuance of our business.

We are subject to continued US Postal Service scrutiny and other government regulations. The availability of our services is dependent upon our service continuing to meet US Postal Service performance specifications and regulations. The US Postal Service could change its certification requirements or specifications for PC Postage or revoke or suspend the approval of one or more of our services at any time. If at any time our service fails to meet US Postal Service requirements, we may be prohibited from offering this service and our business would be severely and negatively impacted. In addition, the US Postal Service could suspend or terminate our approval or offer services which compete against us, any of which could stop or negatively impact the commercial adoption of our service. Any changes in requirements or specifications for PC Postage could adversely affect our pricing, cost of revenues, operating results and margins by increasing the cost of providing our service.

The US Postal Service could also decide that PC Postage should no longer be an approved postage service due to security concerns or other issues. Our business would suffer dramatically if we are unable to adapt our services to any new requirements or specifications or if the US Postal Service were to discontinue PC Postage as an approved postage method. Alternatively, the US Postal Service could introduce competitive programs or amend PC Postage requirements to make certification easier to obtain, which could lead to more competition from third parties or the US Postal Service itself. If we are unable to compete successfully, particularly against large, traditional providers of postage products like Pitney Bowes who enter the online postage market, our revenues and operating results will suffer.

The US Postal Service could decide to suspend or cancel the current market test of PhotoStamps, and may do so in the event that there is sufficient cause to believe that the market test presents unacceptable risk to US Postal Service revenues, degrades the ability of the US Postal Service to process or deliver mail produced by the test participants, exposes the US Postal Service or its customers to legal liability, or causes public or political embarrassment or harm to the US Postal Service in any way. If the US Postal Service decides to suspend or cancel the market test of PhotoStamps, our revenues and operating results will likely suffer.

Additionally, the US Postal Service could decide to amend, renegotiate or terminate our credit card cost sharing agreement, which is a key agreement that governs the allocation of credit card fees paid by the US Postal Service and us for the postage purchased by our customers. If the US Postal Service decides to amend, renegotiate or terminate our credit card cost sharing agreement, our revenues and operating results will likely suffer.

In addition, US Postal Service regulations may require that our personnel with access to postal information or resources receive security clearance prior to doing relevant work. We may experience delays or disruptions if our personnel cannot receive necessary security clearances in a timely manner, if at all. The regulations may limit our ability to hire qualified personnel. For example, sensitive clearance may only be provided to US citizens or aliens who are specifically approved to work on US Postal Service projects.

If we are unable to compete successfully, particularly against large, traditional providers of postage products such as Pitney Bowes, our revenues and operating results will suffer.

The PC Postage segment of the market for postage is relatively new and is competitive. At present, Pitney Bowes and Endicia.com are authorized PC Postage providers with commercially available software and Zazzle.com and FujiFilm offer a competitive product to PhotoStamps using Pitney Bowes technology. If any more providers become authorized, or if Pitney Bowes or Endicia.com provide enhanced offerings, our operations could be adversely impacted. We also compete with other forms of postage, including traditional postage meters provided by companies such as Pitney Bowes, postage stamps and permit mail.

We may not be able to establish or maintain a competitive position against current or future competitors as they enter the market. Many of our competitors have longer operating histories, larger customer bases, greater brand recognition, greater financial, marketing, service, support, technical, intellectual property and other resources than us. As a result, our competitors may be able to devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to web site and systems development than us. This increased competition may result in reduced operating margins, loss of market share and a diminished brand. We may from time to time make pricing, service or marketing decisions or acquisitions as a strategic response to changes in the competitive environment. These actions could result in reduced margins and seriously harm our business.

We could face competitive pressures from new technologies or the expansion of existing technologies approved for use by the US Postal Service. We may also face competition from a number of indirect competitors that specialize in electronic commerce and other companies with substantial customer bases in the computer and other technical fields. Additionally, companies that control access to transactions through a network or Web browsers could also promote our competitors or charge us a substantial fee for inclusion. In addition, changes in postal regulations could adversely affect our service and significantly impact our competitive position. We may be unable to compete successfully against current and future competitors, and the competitive pressures we face could seriously harm our business.

If we do not respond effectively to technological change, our services and products could become obsolete and our business will suffer.

The development of our services, products and other technology entails significant technical and business risks. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our online operations. The Internet and the electronic commerce industry are characterized by rapid technological change; changes in user and customer requirements and preferences; frequent new product and service introductions embodying new technologies; and the emergence of new industry standards and practices.

The evolving nature of the Internet or the postage markets could render our existing technology and systems obsolete. Our success will depend, in part, on our ability to license or acquire leading technologies useful in our business; enhance our existing services; develop new services or features and technology that address the increasingly sophisticated and varied needs of our current and prospective users; and respond to technological advances and emerging industry and regulatory standards and practices in a cost-effective and timely manner.

Future advances in technology may not be beneficial to, or compatible with, our business. Furthermore, we may not be successful in using new technologies effectively or adapting our technology and systems to user requirements or emerging industry standards on a timely basis. Our ability to remain technologically competitive may require substantial expenditures and lead time. If we are unable to adapt in a timely manner to changing market conditions or user requirements, our business, financial condition and results of operations could be seriously harmed.

Our operating results could be impaired if we or the Internet become subject to additional government regulation and legal uncertainties.

Due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted with respect to the Internet, relating to user privacy, pricing, content, copyrights, distribution, characteristics and quality of products and services, and export controls.

The adoption of any additional laws or regulations may hinder the expansion of the Internet. A decline in the growth of the Internet could decrease demand for our products and services and increase our cost of doing business. Moreover, the applicability of existing laws to the Internet is uncertain with regard to many issues, including property ownership, export of specialized technology, sales tax, libel and personal privacy. Our business, financial condition and results of operations could be seriously harmed by any new legislation or regulation. The application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the Internet and other online services could also harm our business.

We have employees and offer our services in multiple states, and we may in the future expand internationally. These jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. Our failure to qualify as a foreign corporation in a jurisdiction where we are required to do so could subject us to taxes and penalties. Other states and foreign countries may also attempt to regulate our services or prosecute us for violations of their laws. Further, we might unintentionally violate the laws of foreign jurisdictions and those laws may be modified and new laws may be enacted in the future.

Risks Related to Our Stock

The tax value of our net operating losses could be impaired if we trigger a change of control pursuant to Section 382 of the Internal Revenue Code.

Under Internal Revenue Code Section 382 rules, a change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more five-percent shareholders within a three-year period. When a change of ownership is triggered, the NOLs may be impaired. We estimate that, as of September 30, 2007 we were approximately at 35% compared with the 50% level that would trigger impairment of our NOL asset.

As part of our ongoing program to preserve future use of our NOL assets, we strongly urge any person contemplating owning more than 900,000 of our shares to contact us before doing so.

Our charter documents could deter a takeover effort, which could inhibit your ability to receive an acquisition premium for your shares.

The provisions of our certificate of incorporation, bylaws and Delaware law could make it difficult for a third party to acquire us, even if it would be beneficial to our stockholders. In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which could prohibit or delay a merger or other takeover of our Company, and discourage attempts to acquire us.

The US Postal Service may object to a change of control of our common stock.

The US Postal Service may raise national security or similar concerns to prevent foreign persons from acquiring significant ownership of our common stock or of Stamps.com. The US Postal Service also has regulations regarding the change of control of approved PC Postage providers. These concerns may prohibit or delay a merger or other takeover of our Company. Our competitors may also seek to have the US Postal Service block the acquisition by a foreign person of our common stock or our Company in order to prevent the combined company from becoming a more effective competitor in the market for PC Postage.

Our stock price is volatile

The price at which our common stock has traded since our initial public offering in June 1999 has fluctuated significantly. The price may continue to be volatile due to a number of factors, including the following, some of which are beyond our control:

- variations in our operating results,
- variations between our actual operating results and the expectations of securities analysts,
- investors and the financial community,
- announcements of developments affecting our business, systems or expansion plans by us or others, and
- market volatility in general.

As a result of these and other factors, investors in our common stock may not be able to resell their shares at or above their original purchase price. In the past, securities class action litigation often has been instituted against companies following periods of volatility in the market price of their securities. This type of litigation, if directed at us, could result in substantial costs and a diversion of management's attention and resources.

Shares of our common stock held by existing stockholders may be sold into the public market, which could cause the price of our common stock to decline.

If our stockholders sell into the public market substantial amounts of our common stock purchased in private financings prior to our initial public offering, or purchased upon the exercise of stock options or warrants, or if there is a perception that these sales could occur, the market price of our common stock could decline. All of these shares are available for immediate sale, subject to the volume and other restrictions under Rule 144 of the Securities Act of 1933.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

We did not have any unregistered sales of common stock during the quarter ended September 30, 2007.

Issuer Purchases of Equity Securities

Period	Total Number of shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs (in 000's)
July 1, 2007 - July 31, 2007	203,749	$ 11.83	203,749	$ 11,589
August 1, 2007 - August 31, 2007	964,711	$ 12.01	964,711	—
September 1, 2007 - September 30, 2007	—	—	—	—

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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.

STAMPS.COM INC.
(Registrant)

November 8, 2007	By: /s/ KEN MCBRIDE
	Ken McBride **Chief Executive Officer**
November 8, 2007	By: /s/ KYLE HUEBNER
	Kyle Huebner **Chief Financial Officer**