PERFORMANCE TECHNOLOGIES INC \DE\
Form 10-Q
August 08, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter Ended June 30, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 0-27460

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

Delaware	16-1158413
(State or other jurisdiction of incorporation of organization)	(I.R.S. Employer Identification No.)
205 Indigo Creek Drive, Rochester, New York	14626
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

The number of shares outstanding of the registrant's common stock was 12,219,824 as of July 31, 2003.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

	June 30, 2003	December 31, 2002

	(unaudited)	
Current assets:		
Cash and cash equivalents	$23,994,000	$22,077,000
Marketable securities		2,006,000
Accounts receivable, net	5,617,000	6,622,000
Inventories, net	7,810,000	4,550,000
Prepaid expenses and other assets	360,000	942,000
Deferred taxes	1,626,000	1,574,000
Total current assets	39,407,000	37,771,000
Property, equipment and improvements, net	2,815,000	3,012,000
Software development costs, net	2,207,000	2,068,000
Note receivable from unconsolidated company	1,000,000	1,000,000
Investment in unconsolidated company	1,202,000	1,353,000
Total assets	$46,631,000	$45,204,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 2,661,000	$1,926,000
Income taxes payable	650,000	502,000
Accrued expenses	2,884,000	3,213,000
Total current liabilities	6,195,000	5,641,000
Deferred taxes	774,000	754,000
Total liabilities	6,969,000	6,395,000
Stockholders' equity:		
Preferred stock - $.01 par value; 1,000,000 shares authorized; none issued		
Common stock - $.01 par value; 50,000,000 shares authorized; 13,260,038 shares issued	133,000	133,000
Additional paid-in capital	10,890,000	10,961,000
Retained earnings	41,526,000	40,565,000
Treasury stock - at cost; 1,058,796 and 1,013,696 shares held at June 30, 2003 and December 31, 2002, respectively	(12,825,000)	(12,782,000
Accumulated other comprehensive loss	(62,000)	(68,000
Total stockholders' equity	39,662,000	38,809,000
Total liabilities and stockholders' equity	$46,631,000	$45,204,000

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

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

	Three Months Ended		Six M
	June 30,		J
	2003	2002	2003
Sales	$12,636,000	$6,619,000	$23,675,00
Cost of goods sold	6,510,000	2,676,000	12,546,00
Gross profit	6,126,000	3,943,000	11,129,00
Operating expenses:			
Selling and marketing	1,446,000	1,210,000	2,808,00
Research and development	2,471,000	1,683,000	4,778,00
General and administrative	1,199,000	582,000	2,262,00
Restructuring charge			
Total operating expenses	5,116,000	3,475,000	9,848,00
Income from operations	1,010,000	468,000	1,281,00
Other income, net	127,000	121,000	254,00
Income before income taxes and equity in loss of unconsolidated company	1,137,000	589,000	1,535,00
Income tax provision	352,000	182,000	476,00
Income before equity in loss of unconsolidated company	785,000	407,000	1,059,00
Equity in loss of unconsolidated company, net of tax	(81,000)		(98,00
Net income	$ 704,000	$ 407,000	$ 961,00
Basic earnings per share	$ .06	$ .03	$ .0
Diluted earnings per share	$ .06	$ .03	$ .0
Weighted average number of common shares used in basic earnings per share	12,191,954	12,260,554	12,211,82
Potential common shares	236,897	124,782	119,86
Weighted average number of common shares used in diluted earnings per share	12,428,851	12,385,336	12,331,69

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

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

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Cash flows from operating activities:		
Net income	$ 961,000	$ 800,000
Non-cash adjustments:		
Depreciation and amortization	1,129,000	861,000
Equity in loss of unconsolidated company, net of tax	98,000	
Other	123,000	246,000
Changes in operating assets and liabilities:		
Accounts receivable	918,000	1,261,000
Inventories	(3,260,000)	(424,000)
Prepaid expenses and other assets	582,000	101,000
Accounts payable and accrued expenses	441,000	(486,000)
Income taxes payable	148,000	221,000
Net cash provided by operating activities	1,140,000	2,580,000
Cash flows from investing activities:		
Purchases of property, equipment and improvements	(459,000)	(615,000)
Capitalized software development costs	(612,000)	(633,000)
Purchase of marketable securities		(2,016,000)
Maturities of marketable securities	2,006,000	
Other	(33,000)	
Net cash provided (used) by investing activities	902,000	(3,264,000)
Cash flows from financing activities:		
Exercise of stock options and warrants	69,000	250,000
Purchase of treasury stock	(194,000)	
Net cash (used) provided by financing activities	(125,000)	250,000
Net increase (decrease) in cash and cash equivalents	1,917,000	(434,000)
Cash and cash equivalents at beginning of period	22,077,000	26,913,000
Cash and cash equivalents at end of period	$23,994,000	$26,479,000

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

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2003
(Unaudited)

Note - A The unaudited Consolidated Financial Statements of Performance Technologies, Incorporated and Subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the Consolidated Financial Statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The results for the interim periods are not necessarily indicative of the results to be expected for the year. The accompanying Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of the Company as of December 31, 2002, as reported in its Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Stock-Based Employee Compensation: At June 30, 2003, the Company had three stock option plans, including the newly adopted Performance Technologies, Incorporated 2003 Omnibus Incentive Plan. The Company accounts for the plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no stock-based employee compensation cost has been recognized in net income for the stock option plans. Had compensation cost for the stock option plans been determined based on the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income (loss) and earnings (loss) per share would have been as follows:

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six 200
Net income, as reported	$704,000	$ 407,000	$961,
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(377,000)	(571,000)	(651,
Pro forma net income (loss)	$327,000	$(164,000)	$310,
Earnings (loss) per share:			
Basic - as reported	$ .06	$ .03	$
Basic - pro forma	$ .03	$ (.01)	$

Diluted - as reported	$ .06	$ .03	$
Diluted - pro forma	$ .03	$ (.01)	$

The assumptions regarding the annual vesting of stock options were 33% per year and 25% per year for options granted in 2003 and 2002, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2003 and 2002, respectively: Dividend yield of 0%; expected volatility of 67% and 68%, risk-free interest rate of 2.0% and 3.7%, and expected life of three and four years.

Earnings Per Share: Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share calculations reflect the assumed exercise of dilutive employee stock options, applying the treasury stock method. Dilutive earnings per share calculations exclude the effect of approximately 1,609,000 and 1,797,000 options for the second quarter 2003 and 2002, respectively, and 1,767,000 and 1,327,000 for the first six months of 2003 and 2002 respectively, since such options have an exercise price in excess of the average market price of the Company's common stock for the respective periods.

Note - B During the six months ended June 30, 2003, 11,250 common shares were issued upon the exercise of stock options.

Note - C Inventories, net

Inventories consisted of the following:

	June 30, 2003	December 31, 2002
Purchased parts and components	$5,465,000	$3,967,000
Work in process	3,289,000	2,046,000
Finished goods	2,518,000	2,088,000
	11,272,000	8,101,000
Less: reserve for inventory obsolescence	(3,462,000)	(3,551,000)
Net	$7,810,000	$4,550,000

Note - D Restructuring Programs

During 2002, the Company improved its cost structure primarily through reductions in the Company's staff and by consolidating the engineering operations of its Raleigh, North Carolina facility into its Ottawa, Canada Signaling Group. The programs were initiated during the first and third quarters of 2002 as the continuing decline in capital spending in the Company's target markets resulted in lower than anticipated Company revenue. Substantially all actions under these programs were completed in 2002, although lease commitments will continue through 2005. A summary of the activity and the remaining balance at June 30, 2003 in the restructuring accrual is as follows:

	Severance and related costs	Lease commitments	Asset impairment	Total

2002 charge	$341,000	$177,000	$55,000	$573,000
2002 utilization	(332,000)	(23,000)	(55,000)	(410,000)
Balance at December 31, 2002	9,000	154,000		163,000
Q1 2003 utilization		(33,000)		(33,000)
Balance at March 31, 2003	9,000	121,000		130,000
Q2 2003 utilization	(9,000)	(31,000)		(40,000)
Balance at June 30, 2003	$	$ 90,000	$	$ 90,000

Note - E Subsequent Event

On July 1, 2003, the litigation settlement agreement associated with the class action lawsuits filed during the second quarter 2000 against the Company, as well as several of its officers and directors, alleging violations of federal securities laws was accepted and approved by the United States District Court for the Western District of New York and all claims therein were dismissed with prejudice. The costs associated with the settlement of this litigation were recorded in the third quarter of 2002.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

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

Matters discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company's actual results could differ materially from those discussed in the forward-looking statements.

Overview

Business Strategy: Performance Technologies has a proven history of successfully adapting its products, services and organization to a constantly changing technology-driven marketplace. This adaptation has been demonstrated through the course of several business cycles that have occurred since its founding in 1981. With the Computing Products Group acquisition in October 2002, a new business strategy was defined that management believes will continue to drive the Company's growth. This strategy is to supply "comprehensive" embedded system platforms incorporating multiple components from the Company's product portfolio. Please refer to the Company's Annual Report on Form 10-K, PART 1, Item 1, under the caption "Business," for a discussion of the Company's new corporate and product strategies for 2003.

Financial Information: Revenue in the second quarter 2003 was $12.6 million, compared to $6.6 million in the second quarter 2002. For the second quarter 2003, the results of operations include the Computing Products Group acquired in October 2002. Net income for the second quarter 2003 amounted to $.7 million, or $.06 per diluted share, compared to $.4 million, or $.03 per diluted share for the second quarter 2002, based on 12.4 million shares outstanding for each quarter.

Revenue for the six months ended June 30, 2003 was $23.7 million, compared to $13.0 million in the corresponding period a year earlier. Net income amounted to $1.0 million, or $.08 per diluted share for the first six months 2003, based on 12.3 million shares outstanding. Net income for the first six months 2002 amounted to $.8 million, or $.06 per diluted share including expenses associated with a restructuring charge recorded in the first quarter amounting to $.2 million (pre-tax), or $.01 per diluted share. Excluding the restructuring charge, net income for the first six months 2002 amounted to $.9 million, or $.07 per diluted share, based on 12.5 million shares outstanding.

Cash and marketable securities amounted to $24.0 million at June 30, 2003, compared to $24.1 million at December 31, 2002, and no long-term debt existed at either date.

The following includes 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 is subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

With the Computing Products Group acquisition in October 2002, the Company substantially broadened its product offering to include computing and system platform products, and more than doubled its addressable market. More importantly, this acquisition enabled the Company to elevate its market position as a more complete supplier to its customers. Furthermore, a new business strategy was defined following the acquisition that management believes will continue to drive the Company's growth. This strategy is to supply "comprehensive" embedded system platforms incorporating multiple components from the Company's product portfolio.

Nine months after embarking on this expanded strategy, there are clear indications that the Company's products are being evaluated for new programs earlier in the customer's design cycle. This increases the opportunity for "pull-through" of the Company's entire product line of network access, switching and signaling products into the customer's final product design. One clear example of the success and growth potential of this strategy is the Company's recent announcement of the Stratus Technologies design win. This customer transitioned from considering one of the Company's products before the Ziatech acquisition, to designing their next-generation, high availability communications server solution with four distinct Performance Technologies products. It was the Company's expanded product capabilities, combined with the Company's ability to assure system interoperability that resulted in this significant design win.

Another measurable result of the new business strategy is the quarterly sequential revenue growth, margin improvement and enhanced profitability that the Company realized during the second quarter. The organization is focused on the continuation of this new momentum. In addition, management continues to aggressively seek opportunities to acquire elements, products and technologies to add to its current capabilities.

Forward Looking Guidance for the Third Quarter 2003 (published July 23, 2003):

The Company's products are integrated into current and next-generation embedded systems infrastructure. Traditionally, design wins have been an important metric for management to judge the Company's product acceptance in its marketplace. Typically, design wins reach production volumes at varying rates, generally beginning twelve to eighteen months after the design win occurs. A variety of risks such as schedule delays, cancellations and changes in customer markets and economic conditions can adversely affect a design win before production is reached or during deployment. While management still believes that design wins are an important metric in evaluating the market acceptance of the Company's products, as the economy slowed in 2001 and 2002 fewer customers were doing new design activity, and a smaller number of these design wins were moving into production than in the past. In addition, during difficult economic periods, frequently a substantial portion of the Company's revenue is derived from orders placed within the quarter and shipped in the final month of the quarter.

In the Company's target markets, capital spending appeared to stabilize during the fourth quarter 2002, and beginning in 2003 certain customers appear to be moving projects toward production. However, overall, new project development culminating in actual design wins in the second quarter was still sluggish. Nonetheless, during the second quarter 2003, the Company realized two new design wins for its IPnexusTM (including rebranded ZiatechTM products) and SEGwayTM product families. Forward-looking visibility in the market is still limited.

Based upon the current business mix, the current backlog and review of sales forecasts, management expects revenue to be $12.5 million to $13.5 million in the third quarter 2003. Gross margin is expected to be approximately 47.5% to 49.5% and diluted earnings per share for the third quarter are expected to be between $.05 and $.09. The effective income tax rate for the third quarter is assumed to be 31%.

More in-depth discussions of the Company's strategy and financial performance can be found in the Company's recent Annual and Quarterly Reports, on Form 10-K and Form 10-Q, as filed with the Securities and Exchange Commission.

Quarter and Six Months Ended June 30, 2003, Compared with
the Quarter and Six Months Ended June 30, 2002

The following table presents the percentage of sales represented by each item in the Company's consolidated statements of income for the periods indicated. The table includes the results of operations of the Computing Products Group, acquired by the Company in October 2002.

	Three Months Ended June 30,	
	2003	2002
Sales	100.0%	100.0%
Cost of goods sold	51.5	40.4
Gross profit	48.5	59.6
Operating expenses:		
Selling and marketing	11.4	18.3
Research and development	19.6	25.4
General and administrative	9.5	8.8
Restructuring charge		
Total operating expenses	40.5	52.5
Income from operations	8.0	7.1

Other income, net	1.0	1.8	
Income before income taxes and equity in loss of unconsolidated company	9.0	8.9	
Income tax provision	(2.8)	(2.8)	
Income before equity in loss of unconsolidated company	6.2	6.1	
Equity in loss of unconsolidated company, net of tax	(0.6)		
Net income	5.6%	6.1%	

Sales. Total revenue for the second quarter 2003 amounted to $12.6 million, compared to $6.6 million for the same quarter in 2002. For the second quarter 2003, the Computing Products Group contributed $5.5 million to revenue. During the second quarter 2003, the Company had two customers that each represented greater than 10% of sales, and the four largest customers represented 58% of sales. Shipments to customers outside of North America represented 17% and 23% of sales during the second quarter of 2003 and 2002, respectively.

Total revenue for the first six months of 2003 was $23.7 million, compared to $13.0 million for the same period in 2002. For the first six months of 2003, the Computing Products Group contributed $11.2 million to revenue.

For the periods indicated, the Company's products are grouped into four distinct categories in one market segment: Signaling and network access products, Computing products, IPnexus switch products, and other products. Revenue from each product category is expressed as a percentage of sales for the three and six months ending June 30, 2003 and 2002:

	Three Months Ended June 30,		S
	2003	2002	200
Signaling and network access products	47%	89%	41%
Computing products	43%	0%	47%
IPnexus switch products	9%	10%	11%
Other	1%	1%	1%
Total	100%	100%	100%

Signaling and network access products: Network access products provide a connection between embedded systems platforms and a variety of networks (including the signaling network) and are used to control the network and/or process information being transported over networks. Many of the Company's signaling products enable the transport of signaling messages over packet-switched (IP) networks. Revenue from this category in the second quarter

2003 amounted to $5.9 million, compared to $3.8 million in the first quarter 2003 and compared to $5.9 million in the second quarter 2002. For the first six months of 2003, revenue from this category was down 16%, compared to the same period in 2002. During the past two years, the decline in capital expenditure investments by customers in the Company's target markets significantly reduced signaling and network access product revenue. Revenue for this category during the second quarter 2003 reflects a potential reversal of this trend.

Computing products: The Computing Products Group was acquired during the third quarter 2002 and its products include a range of single board computers, a variety of embedded system chassis and associated chassis management products. These products enable Performance Technologies to provide comprehensive embedded system platforms incorporating multiple components from the Company's portfolio.

IPnexus switch products: The Company's IPnexus switch product family has been designed for the embedded systems market and is based on the PICMG 2.16 systems architecture, which was ratified by the industry standards group in September 2001. The Company is now shipping nine distinct switch models to customers, with new models scheduled for release later this year. Revenue from this category increased 78% to $1.1 million in the second quarter 2003, compared to $.6 million in the respective quarter of 2002. For the first six months of 2003, revenue from this category exceeded switch shipments for all of 2002 and were up 128%, compared to the same period in 2002.

Other product revenue: This revenue is related to legacy products. Over the past twenty-four months, customer demand for these products has declined significantly as customers have moved to newer technologies. Many of these products are project oriented and shipments can fluctuate on a quarterly basis.

Gross profit. Gross profit consists of sales, less cost of goods sold including material costs, manufacturing expenses, amortization of software development costs, expenses associated with engineering contracts and technical support function expenses. For the second quarter, gross margin amounted to 48.5% and 59.6% of sales in 2003 and 2002, respectively. Gross margin during the second quarter 2003 improved from 45.3% in the first quarter 2003 primarily because fixed manufacturing overhead was spread over more units produced and shipped during the second quarter. Overall, the decrease in gross margin during the second quarter 2003, compared to the second quarter 2002 is primarily attributable to the lower gross margin for computing products, acquired in the fourth quarter 2002.

Total Operating Expenses. Total operating expenses were $5.1 million and $3.5 million for the second quarter 2003 and 2002, respectively. For the six months, total operating expenses were $9.8 million and $6.8 million in 2003 and 2002, respectively. In October 2002, the Computing Products Group was acquired. During the first quarter 2003, the Company began to selectively increase expenditures in the Computing Products Group and in sales and marketing, to implement the first phase of its new business strategy. During January and September 2002, staff reductions were initiated throughout the organization to more closely align expenses with the then current revenue levels.

Selling and marketing expenses were $1.4 million and $1.2 million for the second quarter 2003 and 2002, respectively. For the six months, selling and marketing expenses were $2.8 million and $2.3 million in 2003 and 2002, respectively. In October 2002, the Computing Products Group was acquired. During the first quarter 2003, the Company began to increase expenditures in sales and marketing to implement the first phase of its new business strategy. During January and September 2002, sales and marketing staff reductions were initiated to more closely align expenses with the then current revenue levels.

Research and development expenses were $2.5 million and $1.7 million for the second quarter 2003 and 2002, respectively. For the six months, research and development expenses were $4.8 million and $3.2 million in 2003 and 2002, respectively. In October 2002, the Computing Products Group was acquired. During the first quarter 2003, the Company increased research and development expenditures in its Computing Products Group. During January and September 2002, engineering staff reductions were initiated to more closely align expenses with the then current revenue levels. The Company capitalizes certain software development costs, which reduces the amount of engineering costs charged to operating expense. Amounts capitalized were $.6 million in each of the first six months of 2003 and 2002, respectively.

General and administrative expenses were $1.2 million and $.6 million for the second quarter 2003 and 2002, respectively. For the first six months, general and administrative expenses were $2.3 million and $1.2 million in 2003 and 2002, respectively. The increase in expense is primarily attributable to 2003 expenses associated with the Computing Products Group acquired in October 2002 and expenses associated with the Chief Strategic Officer position created in January 2003.

Restructuring charges were zero and $.2 million for the first six months of 2003 and 2002, respectively. In January 2002, the Company improved its cost structure primarily through the reduction of the Company's staff resulting in a decrease in its workforce of approximately 10%.

Other income, net. Other income consists primarily of interest income from marketable securities and cash equivalents. The funds are primarily invested in high quality Municipal, U.S. Treasury and corporate obligations with maturities of less than one year.

Income taxes. The provision for income taxes for the second quarter and first six months of 2003 and 2002 is based on an assumed combined federal, state and foreign effective tax rate of 31%. The difference between the effective tax rate and the federal statutory rate of 34% is attributable to certain permanent items.

Equity in Loss of Unconsolidated Company, net of tax. In September 2002, the Company completed a 47% minority interest investment in Momentum Computer, Inc., a developer of specialized single board computer solutions located in Carlsbad, California. During the second quarter and first six months 2003, losses were recorded reflecting the allocation of Momentum's net loss to the Company, based on the Company's ownership percentage.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2003, the Company's primary source of liquidity included cash and cash equivalents of $24.0 million. The Company had working capital of $33.2 million and $32.1 million at June 30, 2003 and December 31, 2002, respectively. The Company allowed its revolving credit facility in the amount of $5 million to expire in April 2003.

Cash provided by operating activities amounted to $1.1 million and $2.6 million for the first six months of 2003 and 2002, respectively.

Capital equipment purchases amounted to $.5 million and $.6 million for the first six months 2003 and 2002, respectively. Capitalization of certain software development costs amounted to $.6 million in each of the first six months of 2003 and 2002, respectively.

In August 2002, the Board of Directors authorized a plan to repurchase up to one million shares of the Company's common stock. During the first six months of 2003, the Company repurchased a total of 56,000 shares at a total cost of $.2 million under this program.

Assuming there is no significant change in the Company's business, management believes that its current cash and cash equivalents will be sufficient to meet the Company's anticipated needs, including working capital and capital expenditure requirements, for at least the next twelve months. However, management is continuing its strategic acquisition program to further accelerate its new product and market penetration efforts. This program could have an impact on the Company's working capital, liquidity or capital resources.

Recently Issued Accounting Pronouncements

FIN 45 - In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Interpretation No. 45 required that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee. This interpretation is applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company does not currently provide significant guarantees on a routine basis. The Company adopted this interpretation and it did not have a material impact on the results of operations or the financial position of the Company.

FIN 46 - In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation No. 46 requires companies with a variable interest entity to apply this guidance to that entity as of the beginning of the first interim period beginning after June 15, 2003 for existing interests and immediately for new interests. The application of the guidance could result in the consolidation of a variable interest entity. The only variable interest entity of the Company is its investment in Momentum Computer, Inc. The Company adopted this interpretation and it did not have a material impact on the financial results.

Critical Accounting Estimates and Assumptions

In preparing the financial statements in accordance with GAAP, management is required to make estimates and assumptions that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information disclosures by the Company, including information about contingencies, risk and financial condition. The Company believes, given current facts and circumstances, its estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates, and estimates may vary as new facts and circumstances arise. The critical accounting policies, judgments and estimates, which management believes have the most significant effect on the financial statements are set forth below:

- Revenue Recognition
- Software Development Costs
- Valuation of Inventory

Revenue Recognition: The Company recognizes revenue in accordance with the SEC Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements." The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured. Additionally, the Company sells its products on terms, which transfer title and risk of loss at a specified location, typically shipping point. Accordingly, revenue recognition from product sales occurs when all factors are met, including transfer of title and risk of loss, which generally occurs upon shipment by the Company. Revenue earned from arrangements for software systems requiring significant production, modification, or customization of software is recognized over the contract period as performance milestones are fulfilled. If all conditions of revenue recognition are not met, the Company defers revenue recognition. Revenue from consulting and other services is recognized at the time the services are rendered. Any anticipated losses on contracts are charged to operations as soon as such losses are determined. Revenue from software maintenance contracts is recognized ratably over the contractual period. The Company believes that the accounting estimate related to revenue recognition is a "critical accounting estimate" because the Company's terms of sale can vary, and management exercises judgment in determining whether to defer revenue recognition. Such judgments may materially affect net sales for any period. Management exercises judgment within the parameters of GAAP in determining when contractual obligations are met, title and risk of loss are transferred, sales price is fixed or determinable and collectability is reasonably assured.

Software Development Costs: All software development costs incurred in establishing the technological feasibility of computer software products to be sold are research and development costs. Software development costs incurred subsequent to the establishment of technological feasibility of a computer software product to be sold and prior to general release of that product are capitalized. Amounts capitalized are amortized commencing after general release of that product over the estimated remaining economic life of that product, generally three years, or using the ratio of current revenues to current and anticipated revenues from such product, whichever provides greater amortization. If in the judgment of management, technological feasibility for a particular project has not been met or recoverability of amounts capitalized is in doubt, project costs are expensed as research and development or charged to costs of goods sold, as applicable. The Company believes that the accounting estimate related to software development costs is a "critical accounting estimate" because the Company's management exercises judgment in determining whether project costs are expensed as research and development. Such judgments may materially affect expense amounts for any period. Management exercises judgment within the parameters of GAAP in determining when technological feasibility has been met and recoverability of software development costs is reasonably assured.

Valuation of Inventories: Inventories are stated at the lower of cost or market, using the first-in, first-out method. The Company's inventory includes purchased parts and components, work in process and finished goods. The Company provides inventory reserves for excess, obsolete or slow moving inventory after periodic evaluation of historical sales, current economic trends, forecasted sales, estimated product lifecycles and estimated inventory levels. The factors that contribute to inventory valuation risks are the Company's purchasing practices, electronic component obsolescence, accuracy of sales and production forecasts, introduction of new products, product lifecycles and the associated product support. The Company manages its exposure to inventory valuation risks by maintaining safety stocks, minimum purchase lots, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing certain inventory minimization strategies such as vendor-managed inventories. The Company believes that the accounting estimate related to valuation of inventories is a "critical accounting estimate" because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors ranging from purchasing, to sales, to production, to after-sale support. If actual demand, market conditions or product lifecycles are adversely different from those estimated by management, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs and a decrease to gross margins.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This Quarterly Report on Form 10-Q contains forward-looking statements, which reflect the Company's current views with respect to future events and financial performance, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and is subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements are subject to certain risks and uncertainties, including those identified below, which could cause actual results to differ materially from historical results or those anticipated. The words "believes," "anticipates," "plans," "may," "intend," "estimate," "will," "should," "could," "feels," "is optimistic," "expects," and other expressions which indicate future events and trends also identify forward-looking statements. However, the absence of such words does not mean that a statement is not forward-looking.

The Company's future operating results are subject to various risks and uncertainties and could differ materially from those discussed in the forward-looking statements and may be affected by various trends and factors which are beyond the Company's control. These include, among other factors, general business and economic conditions, rapid or unexpected changes in technologies, cancellation or delay of customer orders including those relating to the "design wins" referenced above, unreliability of customer forecasts, changes in the product or customer mix of sales, delays in new product development, delays or lack of availability of electronic components, customer acceptance of new products and customer delays in qualification of products. This report on Form 10-Q should be read in conjunction with the Consolidated Financial Statements, the notes thereto, Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2002 and "Risk Factors" as reported in the Company's Annual Report on Form 10-K, and other reports as filed with the Securities and Exchange Commission.

Stockholders are cautioned not to place undue reliance on the forward-looking statements which speak as of the date of this Quarterly Report or the date of the documents incorporated by reference in this Quarterly Report. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any such statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to various market risks in the normal course of business, primarily interest rate risk, Canadian currency fluctuation risk and changes in the market value of its investments, and believes its exposure to such risk is minimal. The Company's investments are made in accordance with the Company's investment policy and primarily consist of U.S. Treasury securities, municipal securities and corporate obligations. The Company does not participate in the investment of derivative financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation Of Disclosure Controls And Procedures. Our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer) evaluated our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of such date.

(b) Changes In Internal Controls Over Financial Reporting. There has been no change in our internal control over financial reporting that occurred during the fiscal quarter covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On July 1, 2003, the litigation settlement agreement associated with the class action lawsuits filed during the second quarter 2000 against the Company, as well as several of its officers and directors, alleging violations of federal securities laws was accepted and approved by the United States District Court for the Western District of New York and all claims therein were dismissed with prejudice. The costs associated with the settlement of this litigation were recorded in the third quarter of 2002.

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

The 2003 Annual Meeting of Stockholders was held June 3, 2003. The Directors elected at the meeting were as follows:

	Votes Cast	
Nominees	For	Withheld
Robert L. Tillman	11,168,695	486,162
Donald L. Turrell	11,168,095	486,762

John M. Slusser, Bernard Kozel, Charles E. Maginness, Stuart B. Meisenzahl and John E. Mooney continue as Directors until the next Annual Meeting, or such times as their respective terms expire.

The stockholders voted to adopt the Performance Technologies, Incorporated 2003 Omnibus Incentive Plan. 7,575,675 shares of common stock were voted in favor of the proposal, 1,109,633 shares of common stock were voted against the proposal and 78,832 shares of common stock abstained.

The stockholders also voted to ratify the appointment of PricewaterhouseCoopers LLP as independent accountants for 2003. 11,087,884 shares of common stock were voted in favor of the proposal, 561,430 shares of common stock were voted against the proposal, and 5,543 shares of common stock abstained.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. Exhibits

31.1 Rule 13a-14a(a)/15d-14(a) Certification

31.2 Rule 13a-14a(a)/15d-14(a) Certification

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

B. Reports on Form 8-K

(1) On April 10, 2003, the Company filed a Current Report on Form 8-K, ITEM 5 - Other to inform stockholders: (A) On March 17, 2003, Performance Technologies announced it had appointed Robert Tillman, former president of Ziatech Corporation, to its Board of Directors, and (B) In a letter dated April 2, 2003 to the Chairman of our Board of Directors, Paul L. Smith indicated that he had decided not to stand for re-election to another term as a Director of Performance Technologies, Incorporated. Mr. Smith had

served as a Director since 1993 and his current term expired on June 3, 2003. A copy of the related press release was furnished as an exhibit under Item 7 to this Form 8-K. No financial statements were filed with the Form 8-K.

(2) On April 24, 2003, the Company filed a Current Report on Form 8-K, Item 12 - Results of Operations and Financial Condition to inform stockholders that on April 23, 2003, the Company announced its results of operations for the quarter ended March 31, 2003. A copy of the related press release was furnished as an exhibit under Item 7 to this Form 8-K.

SIGNATURES

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

PERFORMANCE TECHNOLOGIES, INCORPORATED

August 7, 2003

By: /s/ Donald L. Turrell

Donald L. Turrell
President and
Chief Executive Officer

August 7, 2003

By: /s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer and
Vice President, Finance

Exhibit 31.1

Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer

I, Donald L. Turrell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performance Technologies, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2003

/s/ Donald L. Turrell

Donald L. Turrell,
Chief Executive Officer

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer

I, Dorrance W. Lamb, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Performance Technologies, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2003

/s/ Dorrance W. Lamb

Dorrance W. Lamb,
Chief Financial Officer

Exhibit 32.1

Section 1350 Certification

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ("Section 906"), Donald L. Turrell and Dorrance W. Lamb, Chief Executive Officer and Chief Financial Officer, respectively, of Performance Technologies, Incorporated, certify that (i) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Performance Technologies, Incorporated.

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

/s/ Donald L. Turrell

Donald L. Turrell
Chief Executive Officer
(Principal Executive Officer)
Date: August 7, 2003

/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)
Date: August 7, 2003