PERFORMANCE TECHNOLOGIES INC \DE\
Form 10-Q
May 13, 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 March 31, 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 12,189,992 as of April 30, 2003.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31, 2003 (unaudited)	December 31, 2002
Current assets:		
Cash and cash equivalents	$20,140,000	$22,077,000
Marketable securities	2,001,000	2,006,000

Accounts receivable, net	7,722,000	6,622,000
Inventories, net	6,391,000	4,550,000
Prepaid expenses and other assets	432,000	942,000
Deferred taxes	1,583,000	1,574,000
Total current assets	38,269,000	37,771,000
Property, equipment and improvements, net	2,786,000	3,012,000
Software development costs, net	2,104,000	2,068,000
Note receivable from unconsolidated company	1,000,000	1,000,000
Investment in unconsolidated company	1,327,000	1,353,000
Total assets	$45,486,000	$45,204,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 2,396,000	$ 1,926,000
Income taxes payable	564,000	502,000
Accrued expenses	2,876,000	3,213,000
Total current liabilities	5,836,000	5,641,000
Deferred taxes	756,000	754,000
Total liabilities	6,592,000	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	10,961,000	10,961,000
Retained earnings	40,822,000	40,565,000
Treasury stock - at cost; 1,064,346 and 1,013,696 shares held at March 31, 2003 and December 31, 2002, respectively	(12,956,000)	(12,782,000)
Accumulated other comprehensive loss	(66,000)	(68,000)
Total stockholders' equity	38,894,000	38,809,000
Total liabilities and stockholders' equity	$45,486,000	$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 March 31,	
	2003	2002

Sales	$11,039,000	$6,407,000
Cost of goods sold	6,036,000	2,652,000
Gross profit	5,003,000	3,755,000
Operating expenses:		
Selling and marketing	1,362,000	1,063,000
Research and development	2,307,000	1,498,000
General and administrative	1,063,000	577,000
Restructuring charge		163,000
Total operating expenses	4,732,000	3,301,000
Income from operations	271,000	454,000
Other income, net	127,000	116,000
Income before income taxes and equity in loss of unconsolidated company	398,000	570,000
Income tax provision	124,000	177,000
Income before equity in loss of unconsolidated company	274,000	393,000
Equity in loss of unconsolidated company, net of tax	(17,000)	
Net income	$ 257,000	$ 393,000
Basic and diluted earnings per share	$ .02	$ .03
Weighted average number of common shares used in basic earnings per share	12,231,691	12,238,095
Potential common shares	2,838	313,542
Weighted average number of common shares used in diluted earnings per share	12,234,529	12,551,637

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

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

Three Months Ended
March 31,

	2003	2002
Cash flows from operating activities:		
Net income	$ 257,000	$ 393,000
Non-cash adjustments:		
Depreciation and amortization	570,000	401,000
Equity in loss of unconsolidated company, net of tax	17,000	
Other	69,000	12,000
Changes in operating assets and liabilities:		
Accounts receivable	(1,169,000)	79,000
Inventories	(1,840,000)	(107,000)
Prepaid expenses and other assets	510,000	35,000
Accounts payable and accrued expenses	168,000	(327,000)
Income taxes payable	62,000	83,000
Net cash (used) provided by operating activities	(1,356,000)	569,000
Cash flows from investing activities:		
Purchases of property, equipment and improvements	(101,000)	(190,000)
Capitalized software development costs	(278,000)	(352,000)
Purchase of marketable securities	5,000	
Other	(33,000)	
Net cash used by investing activities	(407,000)	(542,000)
Cash flows from financing activities:		
Exercise of stock options and warrants		32,000
Purchase of treasury stock	(174,000)	
Net cash (used) provided by financing activities	(174,000)	32,000
Net (decrease) increase in cash and cash equivalents	(1,937,000)	59,000
Cash and cash equivalents at beginning of period	22,077,000	26,913,000
Cash and cash equivalents at end of period	$20,140,000	$26,972,000

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

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 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 March 31, 2003, the Company had one stock-based employee compensation plan. The Company accounts for this plan 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 plan. Had compensation cost for the stock option plan 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 March 31, 2003	2002
Net income, as reported	$257,000	$ 393,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(274,000)	(571,000)
Pro forma net loss	$(17,000)	$(178,000)
Earnings (loss) per share:		
Basic - as reported	$ .02	$ .03
Basic - pro forma	$ .00	$ (.01)
Diluted - as reported	$ .02	$ .03
Diluted - pro forma	$ .00	$ (.01)

There were no stock options granted in the first quarter 2003. The assumptions regarding the annual vesting of stock options were 25% per year for options granted in 2002. 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 2002: Dividend yield of 0%; expected volatility of 68%, risk-free interest rate of 3.7%, and expected life of 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 1,924,000 and 858,000 options for the first quarter 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 Inventories consisted of the following at March 31, 2003 and December 31, 2002:

	March 31, 2003	December 31, 2002
Purchased parts and components	$5,007,000	$3,967,000
Work in process	2,602,000	2,046,000
Finished goods	2,253,000	2,088,000
	9,862,000	8,101,000
Less: reserve for inventory obsolescence	(3,471,000)	(3,551,000)
Net	$6,391,000	$4,550,000

Note - C 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 essentially completed 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 March 31, 2003 in the restructuring accrual is as follows:

	Severance and related costs	Leasehold commitments	Asset impairment
2002 charge	$341,000	$177,000	$55,000
2002 utilization	(332,000)	(23,000)	(55,000)
Balance at December 31, 2002	9,000	154,000	
2003 utilization		(33,000)	
Balance at March 31, 2003	$ 9,000	$121,000	$

In January 2002, the uncertain economic conditions and the lack of visibility of customer orders led the Company to improve its cost structure by reducing annualized expenses by approximately $1.6 million.

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, the Company substantially broadened both its product offering and market coverage to include additional computing and system products that can be effectively supplied to a market that is twice the size of that which was available to the Company prior to the acquisition. Following the acquisition, a new corporate strategy was defined that integrates the Company's technological innovation and product breadth. 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 first quarter 2003 was $11.0 million, compared to $6.4 million in the first quarter 2002. For the first quarter 2003, the results of operations include the Computing Products Group acquired in October 2002. Net income for the first quarter 2003 amounted to $.3 million, or $.02 per share, compared to $.4 million, or $.03 per share for the first quarter 2002, based on 12.2 million and 12.6 million shares outstanding, respectively. First quarter 2002 results included expenses associated with a restructuring charge amounting to $.2 million (pre-tax), or $.01 per share. In January 2002, the uncertain economic conditions and the lack of visibility of customer orders led the Company to improve its cost structure by reducing annualized expenses by approximately $1.6 million.

Cash and marketable securities amounted to $22.1 million at March 31, 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.

As the Company began integrating the Computing Products Group acquired from Intel in October 2002, management sought to maximize the synergies between the two organizations, which it believed provided considerable opportunity to improve both future top and bottom line performance, despite current economic conditions. To capitalize on this opportunity, a new corporate strategy was defined that integrates the Company's technological innovation and product breadth, and emphasizes the Company's expanded capability to offer a "unified" solution to the customer base including software, hardware and system platforms through a single Performance Technologies offering. This new business strategy broadens the Company's market focus to more effectively address embedded systems requirements for communications, military and commercial applications. While early signs are encouraging, management expects the response to the Company's new strategy to be evolutionary as the marketplace and our customers better understand and embrace the Company's enhanced capabilities.

During the first quarter 2003, the Company made progress in implementing the initial phase of this strategy including adding three new sales people, initiating new advertising and marketing programs, and focusing on interoperability between all elements of our expanded product line. Furthermore, the Company received positive indications from customers validating the Company's new approach to providing a more comprehensive range of embedded products and system platforms, and our sales organization reports seeing increased involvement earlier in the customer's project development cycle.

Forward Looking Guidance for the Second Quarter 2003 (published April 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 continue to be an important metric in evaluating the market acceptance of the Company's product, in the current economic climate, fewer customers are doing new design activity and a smaller number of these design wins are moving into production than in the past. In addition, during difficult economic periods, customers' visibility deteriorates, causing delays in the placement of orders. These factors often result in a substantial portion of the Company's revenue being 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 certain customers appear to be moving projects toward production during the first quarter 2003. However, overall, new project deployments and design activity in the first quarter were still sluggish with only limited forward visibility in the market. During the first quarter 2003, the Company realized three new design wins for its IPnexusTM, SEGwayTM and ZiatechTM product families.

Based upon the current business mix, the current backlog and review of sales forecasts, management expects revenue to be $11.5 million to $12.5 million in the second quarter 2003. Gross margin is expected to be approximately 45% to 47% and diluted earnings per share for the second quarter is expected to be between $.02 and $.06. This guidance includes an increase in expenses of approximately $.3 million, reflecting the full quarter's impact for initiatives commenced during the first quarter to implement the new strategy. The income tax rate for the second 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 Ended March 31, 2003, Compared with
the Quarter Ended March 31, 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. Beginning in October 2002, the table includes the results of operations of the Computing Products Group.

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Sales	100.0%	100.0%

Cost of goods sold	54.7	41.4
Gross profit	45.3	58.6
Operating expenses:		
Selling and marketing	12.3	16.6
Research and development	20.9	23.4
General and administrative	9.6	9.0
Restructuring charge		2.5
Total operating expenses	42.8	51.5
Income from operations	2.5	7.1
Other income, net	1.1	1.8
Income before income taxes and equity in loss of unconsolidated company	3.6	8.9
Income tax provision	(1.1)	(2.8)
Income before equity in loss of unconsolidated company	2.5	6.1
Equity in loss of unconsolidated company, net of tax	(0.2)	
Net income	2.3%	6.1%

Sales. Total revenue for the first quarter 2003 was $11.0 million, compared to $6.4 million for the same quarter in 2002. For the first quarter 2003, the Computing Products Group contributed $5.7 million to revenue. During the first quarter 2003, the Company had two customers that each represented greater than 10% of sales, and the four largest customers represented 54% of sales. During the first quarter 2002, the Company had one customer that represented greater than 10% of sales and the four largest customers represented 32% of sales. Shipments to customers outside of North America represented 24% and 31% of sales during the first quarter of 2003 and 2002, respectively.

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 switching products, and other products. Revenue from each product category expressed as a percentage of sales for the three months ended March 31, 2003 and 2002 is as follows:

	Three Months Ended March 31, 2003	2002
Signaling and network access products	34%	87%
Computing products	51%	0%
IPnexus switching products	13%	7%
Other	2%	6%
Total	100%	100%

Signaling and network access products: The continuing decline in capital expenditure investments by customers in the Company's target markets has significantly reduced the Company's signaling and network access product revenue.

Computing products: The newly acquired Computing Products Group generated the revenue in this category.

IPnexus switching products: Revenue from this category increased 195% to $1.4 million in 2003, compared to $.5 million in the respective quarter of 2002. 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 in September 2001. While still a modest percentage of the Company's revenue, IPnexus switch product revenue is expected to grow when customers move their new products into production.

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. In the first quarter, gross margin was 45.3% and 58.6% of sales in 2003 and 2002, respectively. During the first quarter 2003, fixed expenses such as certain manufacturing labor and overhead costs, technical support costs, and amortization of capitalized software development spread over lower sales volumes negatively impacted gross margin as a percentage of sales. The decrease in gross margin in 2003 is also attributable to the lower gross margins on the newly acquired computing products.

Total Operating Expenses. Total operating expenses were $4.7 million and $3.3 million in first quarter of 2003 and 2002, respectively. During January and September 2002, staff reductions were initiated throughout the organization to more closely align expenses with current revenue levels. In October 2002, the new Computing Products Group was acquired. During the first quarter 2003, the Company began to selectively increase expenditures in the new Computing Products Group and in sales and marketing, to implement the first phase of its new business strategy.

Selling and marketing expenses were $1.4 million and $1.1 million in first quarter of 2003 and 2002, respectively. During January and September 2002, sales and marketing staff reductions were initiated to more closely align expenses with current revenue levels. In October 2002, the new 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.

Research and development expenses were $2.3 million and $1.5 million in the first quarter of 2003 and 2002, respectively. During January and September 2002, engineering staff reductions were initiated to more closely align expenses with current revenue levels. In October 2002, the new Computing Products Group was acquired. During the first quarter 2003, the Company increased research and development expenditures in its Computing Products Group. In addition, the Company capitalizes certain software development costs, which reduce the amount of software development costs charged to operating expense. Amounts capitalized were $.3 million and $.4 million in the first quarter of 2003 and 2002, respectively.

General and administrative expenses were $1.1 million and $.6 million for the first quarter 2003 and 2002, respectively. This increase in expense is primarily attributable to expenses associated with the new Computing Products Group acquired in October 2002 and expenses associated with the newly created position of Chief Strategic Officer.

Restructuring charges were zero and $.2 million for the first quarter 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 first quarter 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 statutory rate 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 first quarter of 2003, a loss was recorded reflecting the allocation of Momentum's net loss to the Company, based on the Company's ownership percentage.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, the Company's primary source of liquidity included cash, cash equivalents and marketable securities of $22.1 million and available borrowings of $5.0 million under a revolving credit facility with a bank. No amounts were outstanding under this credit facility as of March 31, 2003 and this facility expired on April 15, 2003. The Company had working capital of $32.4 million at March 31, 2003, compared to $32.1 million at December 31, 2002.

Cash used by operating activities for the first quarter 2003 was $1.4 million, compared to cash provided by operating activities of $.6 million for the same period in 2002. The net change in cash from operating activities is primarily attributable to increases in inventory due to higher backlog and an increase in accounts receivable as a result of higher sales.

Capital equipment purchases amounted to $.1 million for the three months ended March 31, 2003, compared to $.2 million for the same period in 2002. Capitalization of certain software development costs amounted to $.3 million and $.4 million for the three months ended March 31, 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 quarter 2003, the Company repurchased a total of 51,000 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, cash equivalents and marketable securities 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, customer delays in qualification of products and difficulties of integrating the Computing Products Group's operations. Furthermore, if the Court does not approve the settlement agreement in the outstanding class action litigation this could have a material adverse effect on the Company's working capital. 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. The Company is not under any obligation, and it expressly disclaims any objection, 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

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), within 90 days prior to the filing date of this Quarterly Report on Form 10-Q, an evaluation was carried out under the supervision and with the participation of the Company's management, including the certifying officers of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the certifying officers concluded that the disclosure controls and procedures were effective as of the date of such evaluation to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

b. Changes in Internal Controls

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

No material changes have transpired since the Company's filing of its Annual Report on Form 10-K relative to Court acceptance and approval of the class action litigation settlement agreement.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. Exhibits

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

99.2 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

On January 31, 2003, the Company filed a Current Report on Form 8-K, Item 5 - Other. On January 20, 2003, the Board of Directors of the Company created the position of Chief Strategic Officer. John M. Slusser agreed to fill this position and will carry out the duties and responsibilities of this position in addition to his ongoing responsibilities as Chairman of the Board. No financial statements were filed with the 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

May 8, 2003 By: /s/ Donald L. Turrell

Donald L. Turrell
President and
Chief Executive Officer

May 8, 2003 By: /s/ Dorrance W. Lamb

Dorrance W. Lamb

Chief Financial Officer and
Vice President, Finance

CERTIFICATION OF CHIEF 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 quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

May 8, 2003

/s/ Donald L. Turrell

Donald L. Turrell
President and Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Dorrance W. Lamb, certify that:

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

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

May 8, 2003

/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer

Exhibit 99.1

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

I, Donald L. Turrell, the Chief Executive Officer of Performance Technologies, Incorporated, certify that (i) the Form 10-Q for the quarter ended March 31, 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 the Form 10-Q 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 on request.

By:/s/ Donald L. Turrell

Donald L. Turrell
Chief Executive Officer

May 8, 2003

Exhibit 99.2

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

I, Dorrance W. Lamb, the Chief Financial Officer of Performance Technologies, Incorporated, certify that (i) the Form 10-Q for the quarter ended March 31, 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 the Form 10-Q 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 on request.

By:/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer

May 8, 2003