PERFORMANCE TECHNOLOGIES INC \DE\
Form 10-Q
August 07, 2009

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, 2009

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

(Exact name of registrant as specified in its charter)

Delaware	**16-1158413**
(State or other jurisdiction of incorporation or organization)	***(I.R.S. Employer Identification No.)***

205 Indigo Creek Drive
Rochester, New York 14626
(Address of principal executive offices) (zip code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company: Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X] Small reporting company [ ]

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

The number of shares outstanding of the registrant's common stock was 11,116,397 as of July 31, 2009.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

ASSETS

	June 30, 2009	December 31, 2008
Current assets:		
Cash and cash equivalents	$ 21,755,000	$ 29,218,000
Investments	7,010,000	2,450,000
Accounts receivable, net	4,279,000	6,677,000
Inventories	5,392,000	5,303,000
Prepaid income taxes	100,000	299,000
Prepaid expenses and other assets	628,000	796,000
Deferred income taxes	209,000	1,841,000
Fair value of foreign currency hedge contracts	293,000	107,000
Total current assets	39,666,000	46,691,000
Investments	3,031,000	1,797,000
Property, equipment and improvements, net	1,954,000	2,069,000
Software development costs, net	4,132,000	3,840,000
Deferred income taxes		778,000
Goodwill	4,143,000	4,143,000
Total assets	$ 52,926,000	$ 59,318,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 813,000	$ 922,000
Accrued expenses	3,805,000	4,549,000
Total current liabilities	4,618,000	5,471,000
Income taxes payable	275,000	400,000
Deferred income taxes	533,000	
Total liabilities	5,426,000	5,871,000
Stockholders' equity:		

Preferred stock - $.01 par value; 1,000,000 shares authorized; none issued		
Common stock - $.01 par value; 50,000,000 shares authorized; 13,304,596 shares issued,		
11,116,397 and 11,216,397 shares outstanding, respectively	133,000	133,000
Additional paid-in capital	16,358,000	16,052,000
Retained earnings	40,534,000	46,689,000
Accumulated other comprehensive income	293,000	73,000
Treasury stock - at cost; 2,188,199 and 2,088,199 shares, respectively	(9,818,000)	(9,500,000)
Total stockholders' equity	47,500,000	53,447,000
Total liabilities and stockholders' equity	$ 52,926,000	$ 59,318,000

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

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PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Sales	$ 6,356,000	$ 11,225,000	$ 13,283,000	$ 22,206,000
Cost of goods sold	3,154,000	4,857,000	6,345,000	9,702,000
Gross profit	3,202,000	6,368,000	6,938,000	12,504,000
Operating expenses:				
Selling and marketing	1,698,000	2,135,000	3,614,000	4,239,000
Research and development	1,986,000	2,272,000	4,102,000	4,684,000
General and administrative	1,181,000	1,313,000	2,319,000	2,495,000
Restructuring charges			445,000	
Total operating expenses	4,865,000	5,720,000	10,480,000	11,418,000
(Loss) income from operations	(1,663,000)	648,000	(3,542,000)	1,086,000
Other income, net	177,000	268,000	256,000	657,000
(Loss) income before income taxes	(1,486,000)	916,000	(3,286,000)	1,743,000
Income tax provision	3,245,000	280,000	2,871,000	516,000
Net (loss) income	$ (4,731,000)	$ 636,000	$ (6,157,000)	$ 1,227,000
Basic (loss) earnings per share	$ (.43)	$ 0.05	$ (.55)	$ 0.10
Diluted earnings per share		$ 0.05		$ 0.10
Weighted average number of common shares used in basic earnings per share	11,116,397	11,687,010	11,142,916	11,691,179
Potential common shares		5,703		19,656
Weighted average number of common shares used in diluted earnings per share		11,692,713		11,710,835

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

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

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities:		
Net (loss) income	$ (6,157,000)	$ 1,227,000
Non-cash adjustments:		
Depreciation and amortization	1,257,000	1,089,000
Deferred income taxes	2,977,000	155,000
Stock-based compensation expense	306,000	319,000
Tax benefit from stock option exercises		27,000
Gain on disposal of assets		(13,000)
Changes in operating assets and liabilities:		
Accounts receivable	2,398,000	(12,000)
Inventories	(89,000)	(323,000)
Prepaid expenses and other assets	168,000	241,000
Accounts payable and accrued expenses	(853,000)	320,000
Prepaid income taxes and income taxes payable	74,000	910,000
Net cash provided by operating activities	81,000	3,940,000
Cash flows from investing activities:		
Purchases of property, equipment and improvements	(297,000)	(348,000)
Capitalized software development costs	(1,120,000)	(941,000)
Proceeds from disposal of assets		17,000
Purchases of investments	(9,009,000)	(5,064,000)
Proceeds from sales of investments	3,200,000	18,200,000
Net cash (used) provided by investing activities	(7,226,000)	11,844,000
Cash flows from financing activities:		
Purchases of treasury stock	(318,000)	(1,063,000)
Exercise of stock options		549,000
Net cash used by financing activities	(318,000)	(514,000)
Net (decrease) increase in cash and cash equivalents	(7,463,000)	15,270,000

Cash and cash equivalents at beginning of period	29,218,000	15,592,000
Cash and cash equivalents at end of period	$ 21,755,000	$ 30,862,000

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

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PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note A Basis of Presentation

The unaudited Consolidated Financial Statements of Performance Technologies, Incorporated and Subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles in the United States of America 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, 2008, as reported in its Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The Company evaluated all events or transactions that occurred after June 30, 2009 through August 6, 2009, the date on which these financial statements were issued. During this period there were no material subsequent events that impacted the consolidated financial statements.

Note B Fair Value Measurements

Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157) defines fai value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and requires certain disclosures about fair value measurements. SFAS No. 157 establishes a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted prices included in Level 1 that are directly or indirectly observable for the asset or liability. Such inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs derived principally from or corroborated by observable market data by correlation or other means. Level 3 inputs are unobservable inputs for the asset or liability. Such inputs are used to measure fair value when observable inputs are not available.

At June 30, 2009, the Company held $7.0 million of investments in certificates of deposit, guaranteed investment contracts and commercial paper (Note G) that are measured at fair value in the accompanying financial statements. The fair value of these assets has been estimated using Level 2 inputs. In addition, the Company is a party to foreign currency hedge contracts (Note L), the fair value of which is estimated to be an asset in the amount of $293,000 at June 30, 2009. The fair value of these contracts is also estimated using Level 2 inputs.

Note C Stock-Based Compensation

The Company has stock options outstanding from two stock-based employee compensation plans: the 2001 Incentive Stock Option Plan and the 2003 Omnibus Incentive Plan.

The Company recognizes compensation expense in the financial statements for stock option awards based on the grant-date fair value of those awards, estimated using the Black-Scholes-Merton option pricing model. The table below summarizes the impact of outstanding stock options on the results of operations for the three and six month periods ended June 30, 2009 and 2008, respectively, under the provisions of Statement of Financial Accounting

Standards (SFAS) No. 123R, Share-Based Payment :

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	Three Months Ended June 30, 2009	2008	Six Months Ended June 30, 2009	2008
Stock-based compensation expense stock options	$ 158,000	$ 152,000	$ 306,000	$ 319,000
Income tax benefit		(48,000)		(100,000)
Net decrease in net income	$ 158,000	$ 104,000	$ 306,000	$ 219,000
Per share increase in loss or decrease in earnings:				
Basic	$ 0.01	$ 0.01	$ 0.03	$ 0.02
Diluted		$ 0.01		$ 0.02

The following table summarizes stock option activity for the six months ended June 30, 2009:

	Number of shares	Weighted Average Exercise Price
Outstanding at January 1, 2009	1,594,608	$ 7.33
Granted	275,000	2.61
Exercised	-	-
Expired	(289,925)	15.64
Outstanding at June 30, 2009	1,579,683	4.99
Exercisable at June 30, 2009	400,353	$6.00

The weighted average fair value of option grants was estimated using the Black-Scholes-Merton option pricing method. At June 30, 2009, the Company had approximately $817,000 of unrecognized stock compensation expense which will be recognized over a weighted average period of approximately 1.8 years.

Note D Earnings Per Share

Basic (loss) earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding for the period. Diluted earnings per share calculations reflect the assumed exercise and conversion of dilutive stock options, using the treasury stock method. Due to the net loss incurred in the three and six months ended June 30, 2009, there were no dilutive options considered for either period. The diluted earnings per share calculation excluded the effect of approximately 1,306,000 and 1,389,000 options for the three and six months ended June 30, 2008, since such options had an exercise price in excess of the average market price of the Company s common stock for that period and therefore are considered to be anti-dilutive.

Note E Inventories, net

Inventories consisted of the following:

	June 30, 2009	December 31, 2008
Purchased parts and components	$ 3,445,000	$ 3,142,000
Work in process	1,296,000	1,642,000
Finished goods	651,000	519,000
Net	$ 5,392,000	$ 5,303,000

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Note F Software Development Costs

Software development costs consisted of the following:

	June 30, 2009	December 31, 2008
Capitalized software development costs	$ 16,704,000	$ 15,584,000
Less: accumulated amortization	(12,572,000)	(11,744,000)
Net	$ 4,132,000	$ 3,840,000

Amortization of software development costs included in cost of goods sold was $395,000 and $380,000 in the second quarter 2009 and 2008, respectively. Amortization of software development costs included in cost of goods sold was $827,000 and $705,000 for the six months ended June 30, 2009 and 2008, respectively.

Note G Investments

Investments consisted of the following:

	June 30, 2009	December 31, 2008
Municipal bond (1)	$ 1,032,000	$ 1,047,000
U.S. Treasury Note (1)	1,999,000	-
Certificates of deposit and bank guaranteed contracts (2)	5,020,000	-
Commercial paper (2)	1,990,000	-
U.S. Government-backed FNMA note (1)	-	750,000
Auction rate municipal security (2)	-	1,951,000
Put option on auction rate municipal security (2)	-	499,000
Total investments	$ 10,041,000	$ 4,247,000
Less-current investments	(7,010,000)	(2,450,000)
Non-current investments	$ 3,031,000	$ 1,797,000

(1) - at amortized cost

(2) - at fair value

At December 31, 2008, the Company held one auction rate municipal security with an original cost of $2,450,000, after having received a partial redemption of $50,000 at par in the first quarter 2008. This security was involved in a successful auction in January 2008, but subsequent 2008 auctions failed, and the Company was not able to sell this security. In November 2008, the Company entered into an agreement with the investment brokerage company which had sold this security to the Company, whereby the Company acquired an option to put the security to the brokerage company at any time during 2009 or 2010 at its full par value. In January 2009, the Company exercised its option and sold the security to the brokerage firm, receiving full par value of $2,450,000 as consideration.

Note H Comprehensive (Loss) Income

The components of comprehensive (loss) income for the three and six month periods ended June 30, 2009 and 2008, respectively, are as follows:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net (loss) income	$ (4,731,000)	$ 636,000	$ (6,157,000)	$ 1,227,000
Increase in unrealized gain on foreign currency				
hedge contracts, net of tax effect	283,000	-	220,000	-
Unrealized loss on investment, net of tax	-	(96,000)	-	(223,000)
Comprehensive (loss) income	$ (4,448,000)	$ 540,000	$ (5,937,000)	$ 1,004,000

Note I _Warranty Obligations

Warranty obligations are incurred in connection with the sale of certain products. The warranty period for the Company s products is generally one year from date of sale. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. Future warranty costs are estimated based on product-based historical performance rates and related costs to repair. Changes in accrued warranty obligations for the three and six month periods ended June 30, 2009 and 2008 were as follows:

	2009	2008
Accrued warranty obligations, January 1	$ 167,000	$ 215,000
Actual warranty experience	(26,000)	(23,000)
Warranty provisions	26,000	23,000
Accrued warranty obligations, March 31	167,000	215,000
Actual warranty experience	(34,000)	(32,000)
Warranty provisions	(32,000)	22,000
Accrued warranty obligations, June 30	$ 101,000	$ 205,000

Note J _Stock Repurchase Program

In October 2008, the Board of Directors authorized a new stock repurchase program, whereby the Company may repurchase shares of its Common Stock for an aggregate amount not to exceed $10,000,000. Under this program, shares of the Company's Common Stock may be repurchased through open market or private transactions, including block purchases. This program expires on October 23, 2009. Repurchased shares can be used for the Company's stock option plans, potential acquisition initiatives and general corporate purposes. Under this program, the Company repurchased 100,000 shares during the first half 2009 for an aggregate purchase price of $318,000. For the program-to-date through June 30, 2009, the Company has repurchased 497,000 shares for an aggregate purchase price of $1,597,000.

Note K _Income Taxes

The Company s effective tax rate for the three and six months ended June 30, 2009 differs from the statutory rate due to taxes on foreign income that differ from the U.S. tax rate, permanent tax differences including research activities and tax-exempt interest, and the resolution of tax uncertainties, offset by a valuation allowance against U.S. deferred income tax assets. The calculation of the valuation allowance considers deferred income tax liabilities related to indefinite-lived intangible assets, which cannot be considered as a source of future taxable income.

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The Company s effective tax rate for the three and six months ended June 30, 2008, differed from the statutory rate primarily due to taxes on foreign income that differ from the U.S. tax rate and permanent tax differences including tax-exempt interest.

The Company utilizes the asset and liability method of accounting for income taxes as set forth in SFAS 109, Accounting for Income Taxes. The Company records deferred tax assets to the extent it believes these assets will more likely than not be realized. In making this judgment, the Company considers all available positive and negative evidence, including projected future taxable income, scheduled reversals of deferred tax liabilities, tax planning strategies, and recent financial performance. As of June 30, 2009, the Company updated its projections of taxable income for 2009, and has projected that the Company will have a three year U.S. cumulative pre-tax book loss, calculated using 2007 and 2008 actual results combined with projected 2009 results. This is considered to be a significant negative factor that is difficult to overcome. Based upon the Company s review of all positive and negative evidence, including its projected three year cumulative jurisdictional pre-tax book loss for 2007 through 2009, the Company has concluded that a full valuation allowance should be recorded against its U.S. net deferred tax assets in the three month period ended June 30, 2009. This valuation allowance and corresponding non-cash charge to income tax provision amounts to $3,304,000, including the reversal of the income tax benefit that had been recorded in the three month period ended March 31, 2009. Included in this charge is $237,000 relating to the Company s determination that it will likely not execute a strategy to realize its capital loss carry-forward, which expires in 2010.

For the second quarter 2009, the income tax provision amounted to $3,245,000, which included the non-cash charge discussed in the preceding paragraph. This amount also included an income tax benefit relating to the release of a reserve for income tax uncertainties amounting to $134,000 including interest and penalties, relating to a settlement with the relevant tax authority.

In the future, if the Company determines that it is more likely than not that it will realize its U.S. net deferred tax assets, it will reverse the applicable portion of the valuation allowance and recognize an income tax benefit in the period in which such determination is made.

In certain other foreign jurisdictions, where the Company does not have cumulative losses or other negative evidence, the Company had net deferred tax assets of $119,000 at June 30, 2009 and December 31, 2008. In addition, the Company had deferred tax assets amounting to $90,000 at June 30, 2009 available to offset a portion of the unrecognized tax benefits liability if such uncertainties were to result in tax assessments.

The Company had unrecognized tax benefits of $275,000 and $400,000 at June 30, 2009 and December 31, 2008, respectively. Included in the balance of unrecognized tax benefits as of June 30, 2009 and December 31, 2008 are accrued interest and penalties in the amount of $59,000 and $91,000, respectively.

The Company files U.S. federal, U.S. state, and foreign tax returns. For federal tax returns, the Company is generally no longer subject to tax examinations for years prior to 2005. For state and foreign tax returns, the Company is generally no longer subject to tax examinations for years prior to 2004. It is reasonably possible that the liability associated with the Company s unrecognized tax benefits will increase or decrease within the next twelve months. These changes may be the result of new examinations by taxing authorities, ongoing examinations, or the expiration of statutes of limitations. Based upon the closing of the tax years in these various jurisdictions, as well as the conclusion of ongoing examinations by taxing authorities, the Company may adjust its liability for unrecognized tax benefits. Certain of the Company s unrecognized tax benefits are related to tax years that are expected to close in the next twelve months, or related to ongoing examinations which the Company expects to successfully conclude in that time period. The closure of these unrecognized tax benefits could increase earnings in an amount ranging from $0 to approximately $126,000, including interest and penalties.

Note L Derivative Instruments Foreign Currency Hedge Contracts

The Company is exposed to the impact of fluctuations in foreign currency exchange rates on the expenses incurred in its Canadian and United Kingdom operations. The Company s risk management program is designed to reduce the exposure and volatility arising from fluctuations in foreign currency exchange rates. The Company has hedged approximately 70% of its estimated foreign currency risk for the next nine months. The Company s derivative instruments are designated and qualify as cash flow hedges.

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At June 30, 2009, the Company is party to foreign currency forward contracts with JPMorgan Chase Bank, N.A. (the Bank) designed to fix in U.S. dollars a portion of the future cost of the Company s Canadian and United Kingdom operations, which are denominated in Canadian dollars and U.K. pounds sterling, respectively. The Company is party to monthly forward contracts for both Canadian dollars and U.K. pounds sterling through March 2010. The Canadian dollar contracts effectively fix the exchange rate on the first $360,000CDN of monthly expenses for the months July through December 2009 (and the first $350,000CDN for the months January through March 2010) at rates ranging from .785 to .787. The U.K. pounds sterling contracts effectively fix the exchange rate on the first £105,000 of quarterly expenses during 2009 and the first £100,000 of expenses in the first quarter 2010 at rates ranging from 1.3900 to 1.5005.

The fair value of the Company s derivative instruments is estimated in accordance with the framework for measuring fair value contained in SFAS No. 157 and is recorded as either an asset or liability in the balance sheet based on changes in the current spot rate, as compared to the exchange rates specified in the contracts. For these instruments, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and is reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. The fair value measurement of the Company s derivative instruments is estimated using Level 2 inputs as defined in SFAS No. 157, which are inputs other than quoted prices that are directly or indirectly observable for the asset or liability.

The Company s contracts have been designated as effective cash flow hedges and any gains or losses resulting from changes in the fair value of these contracts are recorded in other comprehensive (loss) income. No portion of these derivative instruments is considered to be ineffective. The Company will receive, or be required to disburse, cash payments upon the expiration of each contract depending on fluctuations in the underlying exchange rates. Such payments are recorded as reductions to or increases in operating expense as they are determined.

The fair value of the Company's derivative instruments was as follows:

	Balance Sheet Location	**Fair value at June 30, 2009**	**Fair value at December 31, 2008**
Derivatives designated as hedging instruments under SFAS No. 133	Current assets	$ 293,000	$ 107,000

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

Location of gain recognized in	**Amount of gain reclassified from accumulated other comprehensive income to the statement of operations**	
	Three months ended	**Six months ended**

Derivatives in SFAS No. 133 fair value hedging relationships	**operations**		**June 30, 2009**		
Foreign exchange contracts	Operating expenses	$	85,000	$	98,000

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

	Amount of gain recognized in other comprehensive income	
	Three months ended	Six months ended
	June 30, 2009	
Net change in the fair value of foreign currency hedge contracts:	$ 279,000	$ 186,000

Note M Restructuring

In January 2009, the Company implemented a strategic reduction of its existing workforce in response to the challenging global economic environment. As a result of this action, the Company eliminated twenty positions, or approximately 8% of its global workforce. In connection with this reduction, the Company incurred first quarter 2009 pre-tax restructuring charges of $444,000, primarily for employee-related costs, of which $437,000 resulted in first quarter 2009 cash expenditures, and the remainder resulted in second quarter 2009 cash expenditures.

Note N Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, Business Combinations, a revision to SFAS No. 141, Business Combinations. SFAS No. 141R provides revised guidance for recognition and measurement of identifiable assets and goodwill acquired, liabilities assumed, and any non-controlling interest in the acquiree at fair value. The Statement also establishes disclosure requirements to enable the evaluation of the nature and financial effects of a business combination. The Company adopted SFAS No. 141R as of January 1, 2009. The adoption of this standard did not have a material impact on the Company s financial position or results of operations.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS Statement No. 133 (SFAS No. 161). SFAS3.0pt;"> OK. First question is how can we be confident that the standalone plan will be implemented? What is PSAM prepared to do?

I ll take that one. As you know, we made a request to the PCS board a while ago in a letter to delay the annual meeting and to establish a new window for nominations of board members. We expect that the board will view a turn-down of this deal as a vote of no confidence and agree to our suggestion, but we can t be sure.

PCS has a strong operating team, good management, but it lacks leadership and strategic direction from the board. You know, we suggested originally that Roger Linquist would want to stay on for a transition, but it would require a new CEO search.

If for some reason the board is obstructionist, our present plan would be to lead a campaign to withhold votes at the next board meeting to express our dissatisfaction. And as I m sure you re aware, the entire board can be replaced at the 2014 meeting if it becomes necessary. And, you know, we would likely pursue that.

OK, we have a second question. Would you walk us through the MetroPCS liquidation scenario?

Rich, would you take that, Rich Bilotti?

Rich Bilotti: Sure. First, there s $7 of cash on the balance sheet. That s obviously not a very controversial number. For the moment, let s use the original $3.7 billion of value paid for the spectrum from the MPC website based on the tax footnote and the 2012 10-K. It appears to be both NOLs and bases that would shelter the majority of that sale of spectrum if it was sold from taxes.

And lastly, we would assume that PCS would continue its emphasis on converting subscribers to LTE, loses some 3G subscribers, but by the end of 2015 they would have about 5 million LTE subscribers with high ARPU and low turn rates. Those are the components, and obviously the you ll see on the slide the value we place on the subscribers.

You know, we felt that was very conservative, because the lifetime value of the cash flows in an LTE subscriber could actually probably be twice that of a 3G subscriber, so there s upside in that subscriber valuation.

The other obvious area where there s upside is the spectrum. And I don t think there s any controversy that spectrum values have only gone up in the last, you know, 15 years. And for every 20 percent premium we put on the value of the spectrum, you get about $1.30 a share after taxes, but as the value goes up, obviously, the tax shield remains the same. The marginal dollars would be fully taxed.

Peter Schoenfeld: OK, the next question we received is, what do you think is the optimal leverage ratio at the combined Metro T-Mobile? Doug, would you take that one?

Doug Polley: Sure. You know, optimal is a bit of a loaded question, because I m not sure we re in a position to achieve the optimal leverage ratio. If I had to say what the optimal leverage ratio would be, I d say the company should be aligned with its national competitors, which are currently levered at about 1.2 to 2 times on net debt-to-EBITDA. Right now for us, this is really just about finding a capital structure that will allow the company to remain competitive, lower the cost of capital, you know, and raise additional capital if needed.

So the plan that we have suggested would well, actually, let me step back. The current capital structure as I mentioned is about 3.6 times, which leads to a 0.8 times EBITDA minus CAPEX to interest ratio, which is, in our view, completely inadequate, and about 29 percent equity contribution, all of which is just too tight in our view.

In our plan, with a $4 billion debt reduction, the EBITDA minus CAPEX to interest would be brought up to one times, so cash flow would be able to service interest, and net debt-to-EBITDA would be about three times, with the equity contribution of about 34 percent.

I would say despite the fact that this is the plan that we put forward, it s still very thin from an equity perspective. And just to give you some perspective, if you were to do a $6 billion reduction, that would be about 2.6 times levered with an EBITDA minus CAPEX to interest ratio of 1.2 times and a 36 percent equity contribution, which would obviously be better. But I think the company will be adequately capitalized at three times, if we can get these notes reduced by $4 billion.

Peter Schoenfeld: OK. We got another question here. Can you help us highlight the value of the C-block spectrum that PCS owns, and how Sprint would be able to combine it with their adjacent G block to deploy a better, deeper LTE experience?

Rich Bilotti: I ll take this one, and I ll try to go light on the engineering terms. As many of you know, LTE technology is optimized when you use a contiguous block of spectrum. It amplifies the capacity to a gain, and that s what I was referring to when I said gain more capacity. You double the spectrum, you get more than a doubling of the capacity.

What s interesting about the PCS spectrum is that both Sprint and T-Mobile rely on PCS and AWS band spectrum. The MetroPCS spectrum happens to reside in exactly those spectrum bands, as well, hence the name, by the way, MetroPCS, which means that both parties create contiguous spectrum blocks, which if you re an engineer is something you get really excited about.

Peter Schoenfeld: Thanks, Rich. One question, probably our last: What other combinations or revisions would PSAM be willing to explore for PCS holders?

I ll start on that. Anyone else can join in if they want to. Obviously to our presentation, this one and the white paper, we sort of demonstrated there are a lot of levers here that can be used in order to create value. You know, we think the most robust lever is the amount of debt on the combined company. We think that s the most important, as we ve indicated in this presentation.

But clearly, you know, bigger equity splits are possible. There is a possibility, as well, that Deutsche may decide to buy PCS and keep it private for a while and IPO it some other time and give shareholders either cash or cash and some of the notes that we think are totally mispriced and significantly more than par.

We did note in the first configuration of the negotiations that Metro was going to be in somewhat of a control position with DT only taking 49 percent of their equity in the voting stake. They have non-voting shares. That would clearly allow the new company to access the debt markets in the way Doug portrayed them, getting access to both secured financing and more attractive terms on the unsecured financing, as well, to create value, so there are just many permutations of we chose in this permutation to be sort of simplify the process, you know, and focus on the debt structure, but there are a lot of different permutations that we can deal with.

Well, thank you again for listening to our presentation. That sort of ends the Q&A period. And, remember, please, vote the **WHITE CARD AGAINST** the transaction on April 12th. Thank you all for attending.

Operator: A replay of this webcast will be available tomorrow and will remain accessible until July 1, 2013, at 5:00 p.m. Eastern Time. To access this information and other proxy materials and press releases published by PSAM to date, please go to www.innisfreema.com/pcs/. Once again, that s www.innisfreema.com/pcs/. You may now disconnect.

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