

PAR TECHNOLOGY CORP
Form 10-Q
May 15, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2017.

OR

TRANSITION REPORT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _____ to _____
Commission File Number 1-09720

PAR TECHNOLOGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	16-1434688
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
PAR Technology Park	
8383 Seneca Turnpike	
New Hartford, New York	13413-4991
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (315) 738-0600

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

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

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

Large Accelerated Filer	Accelerated Filer
Non Accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company
	Emerging Growth Company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of May 11, 2017 15,797,861 shares of the registrant's common stock, \$0.02 par value, were outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

PAR TECHNOLOGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	For the three months ended	
	March 31,	
	2017	2016
Net revenues:		
Product	\$ 37,206	\$ 22,084
Service	14,343	11,704
Contract	14,316	21,517
	65,865	55,305
Costs of sales:		
Product	27,572	16,442
Service	9,885	8,599
Contract	12,747	19,655
	50,204	44,696
Gross margin	15,661	10,609
Operating expenses:		
Selling, general and administrative	9,610	7,542
Research and development	3,569	2,762
Amortization of identifiable intangible assets	241	241
	13,420	10,545
Operating income from continuing operations	2,241	64
Other expense, net	(248)	(70)
Interest (expense) income, net	(32)	29
Income from continuing operations before provision for income taxes	1,961	23
Provision for income taxes	(697)	(8)
Income from continuing operations	1,264	15
Discontinued operation		
Income from discontinued operations (net of tax)	183	-
Net income	\$ 1,447	\$ 15
Basic Earnings per Share:		
Income from continuing operations	0.08	0.00
Income from discontinued operations	0.01	0.00
Net income	\$ 0.09	\$ 0.00
Diluted Earnings per Share:		
Income from continuing operations	0.08	0.00
Income from discontinued operations	0.01	0.00
Net income	\$ 0.09	\$ 0.00
Weighted average shares outstanding		
Basic	15,781	15,646
Diluted	15,978	15,723

See accompanying notes to unaudited interim consolidated financial statements

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PAR TECHNOLOGY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(Unaudited)

	For the three months ended March 31,	
	2017	2016
Net income	\$ 1,447	\$ 15
Other comprehensive loss, net of applicable tax:		
Foreign currency translation adjustments	41	(122)
Comprehensive income (loss)	\$ 1,488	\$ (107)

See accompanying notes to unaudited interim consolidated financial statements

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PAR TECHNOLOGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

(Unaudited)

	March 31, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,470	\$ 9,055
Accounts receivable-net	34,241	30,705
Inventories-net	24,800	26,237
Note receivable	3,794	3,510
Income taxes receivable	-	261
Other current assets	4,350	4,027
Assets of discontinued operations	462	462
Total current assets	73,117	74,257
Property, plant and equipment - net	9,042	7,035
Deferred income taxes	17,056	17,417
Goodwill	11,051	11,051
Intangible assets - net	11,411	10,966
Other assets	3,861	3,785
Total Assets	\$ 125,538	\$ 124,511
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 189	\$ 187
Borrowings of line of credit	1,000	-
Accounts payable	17,460	16,687
Accrued salaries and benefits	5,297	5,470
Accrued expenses	4,492	4,682
Customer deposits and deferred service revenue	17,807	19,814
Total current liabilities	46,245	46,840
Long-term debt	331	379
Other long-term liabilities	7,705	7,712
Total liabilities	54,281	54,931
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock, \$.02 par value, 1,000,000 shares authorized	-	-
Common stock, \$.02 par value, 29,000,000 shares authorized; 17,493,293 and 17,479,454 shares issued, 15,785,184 and 15,771,345 outstanding at March 31, 2017 and December 31, 2016, respectively	350	350
Capital in excess of par value	46,392	46,203
Retained earnings	33,804	32,357
Accumulated other comprehensive loss	(3,453)	(3,494)
Treasury stock, at cost, 1,708,109 shares	(5,836)	(5,836)
Total shareholders' equity	71,257	69,580
Total Liabilities and Shareholders' Equity	\$ 125,538	\$ 124,511

See accompanying notes to unaudited interim consolidated financial statements

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PAR TECHNOLOGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the three months ended	
	March 31,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 1,264	\$ 15
Income from discontinued operations	183	-
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation, amortization and accretion	898	777
Provision for bad debts	112	185
Provision for obsolete inventory	958	395
Equity based compensation	177	66
Deferred income tax	361	(69)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(3,932)	(4,627)
Inventories	479	(1,272)
Income tax receivable/(payable)	261	(352)
Other current assets	(323)	226
Other assets	(76)	(93)
Accounts payable	773	3,527
Accrued salaries and benefits	(173)	(442)
Accrued expenses	(190)	205
Customer deposits and deferred service revenue	(2,007)	659
Other long-term liabilities	(7)	(182)
Deferred tax equity based compensation	12	37
Net cash used in operating activities-continuing operations	(1,230)	(945)
Net cash used in operating activities-discontinued operations	-	(161)
Net cash used in operating activities	(1,230)	(1,106)
Cash flows from investing activities:		
Capital expenditures	(2,344)	(322)
Capitalization of software costs	(1,006)	(659)
Net cash used in investing activities	(3,350)	(981)
Cash flows from financing activities:		
Payments of long-term debt	(46)	(44)
Payments of other borrowings	(5,000)	(53,812)
Proceeds from other borrowings	6,000	53,812
Repurchase of common stock	-	(1)
Net cash provided by (used in) financing activities	954	(45)
Effect of exchange rate changes on cash and cash equivalents	41	(122)
Net decrease in cash and cash equivalents	(3,585)	(2,254)
Cash and cash equivalents at beginning of period	9,055	8,024
Cash and equivalents at end of period	5,470	5,770
Less cash and cash equivalents of discontinued operations at end of period	-	-
Cash and cash equivalents of continuing operations at end of period	\$ 5,470	\$ 5,770

Supplemental disclosures of cash flow information:

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Cash paid during the period for:

Interest	6	8
Income taxes, net of refunds	39	420

See accompanying notes to unaudited interim consolidated financial statements

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PAR TECHNOLOGY CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Basis of presentation

The accompanying unaudited interim consolidated financial statements of PAR Technology Corporation (the “Company” or “PAR”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial statements and the instructions to Form 10-Q and Regulation S-X pertaining to interim financial statements. Accordingly, they do not include all information and footnotes required by GAAP for annual financial statements. In the opinion of the management, such unaudited interim consolidated financial statements include all normal and recurring adjustments necessary for a fair presentation of the results for the interim periods included in this Quarterly Report on Form 10-Q (“Quarterly Report”). Operating results for the three months ended March 31, 2017 are not necessarily indicative of the results of operations that may be expected for any future period. Certain amounts for prior periods have been reclassified to conform to the current period classification.

The preparation of consolidated financial statements requires management of the Company to make a number of estimates, judgements and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the period. Significant items subject to such estimates, judgements and assumptions include: the carrying amount of property, plant and equipment, identifiable intangible assets and goodwill, equity based compensation, and valuation allowances for receivables, inventories and deferred income taxes. Actual results could differ from those estimates.

The unaudited interim consolidated financial statements and related notes should be read in conjunction with the Company’s audited Consolidated Financial Statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016, which has been filed with the Securities and Exchange Commission (“SEC”).

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Note 2 — Divestiture and Discontinued Operations

On November 4, 2015, ParTech, Inc. (“PTI”), a wholly owned subsidiary of PAR Technology Corporation, PAR Springer-Miller Systems, Inc. (“PSMS”), Springer-Miller International, LLC (“SMI”), and Springer-Miller Canada, ULC (“SMC”) (PTI, PSMS, SMI and SMC are collectively referred to herein as the “Group”), entered into an asset purchase agreement (the “APA”) with Gary Jonas Computing Ltd., SMS Software Holdings LLC, and Jonas Computing (UK) Ltd. (the “Purchasers”), for the sale of substantially all of the assets of PSMS. Accordingly, the results of operations of PSMS have been classified as discontinued operations in the Consolidated Statements of Operations (unaudited) and Consolidated Statements of Cash Flows (unaudited) in accordance with Accounting Standards Codification (“ASC”) ASC 205-20 (Presentation of Financial Statements – Discontinued Operations). Additionally, the assets and associated liabilities have been classified as discontinued operations in the Consolidated Balance Sheets (unaudited). Total consideration to be received from the sale is \$16.6 million in cash (the “Base Purchase Price”), with \$12.1 million received at the time of closing and \$4.5 million receivable eighteen months after the closing date, a portion of such amount to be available for the payment of certain indemnification obligations of the Group and/or adjusted based on the net tangible asset calculation, as defined in the APA. The estimated fair value of the remaining portion of the note receivable, less any estimated working capital adjustments, due on May 5, 2017 was approximately \$3.8 million and is included in current assets in the Company’s Consolidated Balance Sheets (unaudited). During 2017, the Company increased the receivable by \$284,000 based on the terms of the net tangible asset calculation as the working capital shortfall was less than previously estimated.

In addition to the Base Purchase Price, contingent consideration of up to \$1.5 million could be received by the Company based on the achievement of certain agreed-upon revenue and earnings targets for calendar years 2016 through 2018, as set forth in the APA. As of March 31, 2017, the Company had not recorded any amount associated with this contingent consideration as we do not believe achievement of the related targets is probable.

Summarized financial information for the Company’s discontinued operations is as follows (in thousands):

	March 31, December, 31 (in thousands)	
	2017	2016
Assets		
Other current assets	\$ 462	\$ 462
Assets of discontinued operation	\$ 462	\$ 462
Liabilities		
Accrued salaries and benefits	\$ -	\$ -
Liabilities of discontinued operation	\$ -	\$ -

Summarized financial information for the Company’s discontinued operations is as follows (in thousands):

	March 31, (in thousands)	
	2017	2016
Total revenues	\$ -	\$ -
Income from discontinued operations before income taxes	\$ 284	\$ -
Income taxes	(101)	-
Income from discontinued operations, net of taxes	\$ 183	\$ -

During the three months ended March 31, 2017, the Company recognized income on discontinued operations of \$0.2 million (net of tax) mainly due to an increase of the note receivable. The increase of the note receivable is reflected in the Company's earnings for 2017 and will be increased by the amount the Company received on May 5, 2017.

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Note 3 — Accounts Receivable

The Company's net accounts receivable consist of:

	(in thousands)	
	March	
	31,	December 31,
	2017	2016
Government segment:		
Billed	\$7,821	\$ 6,779
Advanced billings	(2,239)	(1,599)
	5,582	5,180
Restaurant/Retail segment:		
Accounts receivable - net	28,659	25,525
	\$34,241	\$ 30,705

At March 31, 2017 and December 31, 2016, the Company had recorded allowances for doubtful accounts of \$0.9 million and \$0.9 million, respectively, against Restaurant/Retail segment accounts receivables.

Note 4 — Inventories

Inventories are primarily used in the manufacture, maintenance and service of Restaurant/Retail products. The components of inventories (net) consist of the following:

	(in thousands)	
	March	
	31,	December 31,
	2017	2016
Finished goods	\$9,159	\$ 9,423
Work in process	1,027	443
Component parts	8,355	10,386
Service parts	6,259	5,985
	\$24,800	\$ 26,237

At March 31, 2017 and December 31, 2016, the Company had recorded inventory reserves of \$7.0 million and \$9.2 million, respectively, against Restaurant/Retail inventories, which relates primarily to service parts.

Note 5 — Identifiable intangible assets and Goodwill

The Company's identifiable intangible assets represent intangible assets in connection with the Brink Software Inc. acquisition in 2014 and internally developed software costs. The Company capitalizes certain costs related to the development of computer software used in its Restaurant/Retail segment. Software development costs incurred prior to establishing technological feasibility are charged to operations and included in research and development costs. The technological feasibility of a computer software product is established when the Company has completed all planning, designing, coding, and testing activities that are necessary to establish that the product meets its design specifications including functions, features, and technical performance requirements. Software development costs incurred after establishing feasibility for software sold as a perpetual license, as defined within ASC 985-20 (Software – Costs of Software to be sold, Leased, or Marketed) and for software sold as a service ("SAAS"), as defined within ASC-350-40 (Intangibles – Goodwill and Other – Internal – Use Software) are capitalized and amortized on a product-by-product basis when the product is available for general release to customers. Software costs capitalized

within continuing operations during the three months ended March 31, 2017 and 2016 were \$1.0 million and \$0.7 million, respectively.

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Annual amortization, charged to cost of sales when a product is available for general release to customers, is computed using the greater of (a) the straight-line method over the remaining estimated economic life of the product, generally three to seven years or (b) the ratio that current gross revenues for the product bear to the total of current and anticipated future gross revenues for the product. Amortization of capitalized software costs from continuing operations amounted to \$0.3 million for the three months ended March 31, 2017 and 2016.

In 2014, the Company acquired identifiable intangible assets in connection with its acquisition of Brink Software Inc. Amortization of intangible assets acquired from the Brink Software Inc. acquisition amounted to \$0.2 million for the three months ended March 31, 2017 and 2016.

The components of identifiable intangible assets, excluding discontinued operations, are:

	(in thousands)		
	March 31, 2017	December 31, 2016	Estimated Useful Life
Acquired and internally developed software costs	\$15,621	\$ 15,884	3 - 7 years
Customer relationships	160	160	7 years
Non-competition agreements	30	30	1 year
	15,811	16,074	
Less accumulated amortization	(4,800)	(5,508)	
	\$11,011	\$ 10,566	
Trademarks, trade names (non-amortizable)	400	400	N/A
	\$11,411	\$ 10,966	

The expected future amortization of these intangible assets, assuming straight-line amortization of capitalized software costs and acquisition related intangibles, is as follows (in thousands):

2017	\$1,657
2018	2,054
2019	1,616
2020	1,396
2021	1,031
Thereafter	3,257
Total	\$11,011

The Company tests goodwill for impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment. The Company operates in two reportable business segments, Restaurant/Retail and Government. Goodwill impairment testing is performed at the segment level. Goodwill is assigned to a specific segment at the date the goodwill is initially recorded. Once goodwill has been assigned to a specific segment, it no longer retains its association with a particular acquisition, and all of the activities within a segment, whether acquired or organically grown, are available to support the value of the goodwill. The amount of goodwill carried by the Restaurant/Retail and Government reporting segments is \$10.3 million and \$0.7 million, respectively, at March 31, 2017 and December 31, 2016.

Note 6 — Stock Based Compensation

The Company applies the fair value recognition provisions of ASC Topic 718 Stock-Based Compensation. The Company recorded stock based compensation of \$0.2 million and \$0.1 million for the three months ended March 31, 2017 and 2016, respectively. The amount recorded for the three months ended March 31, 2017 and 2016 was

recorded net of (expense) benefits of \$13,000 and \$26,000, respectively, as a result of forfeitures of unvested stock awards prior to the completion of the requisite service period. At March 31, 2017, the aggregate unrecognized compensation expense related to unvested equity awards was \$0.4 million (net of estimated forfeitures), which is expected to be recognized as compensation expense in fiscal years 2017 through 2019.

For the three month period ended March 31, 2017, the Company recognized compensation expense related to performance awards based on its estimate of the probability of achievement in accordance with ASC Topic 718.

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Note 7 — Net Income (loss) per share

Earnings per share are calculated in accordance with ASC Topic 260, which specifies the computation, presentation and disclosure requirements for earnings per share (EPS). It requires the presentation of basic and diluted EPS. Basic EPS excludes all dilution and is based upon the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the three months ended March 31, 2017 there were no anti-dilutive stock options outstanding, and there were 16,000 anti-dilutive stock options outstanding for the three months ended March 31, 2016.

The following is a reconciliation of the weighted average of shares outstanding for the basic and diluted EPS computations (in thousands, except share and per share data):

	For the three months ended March 31,	
	2017	2016
Income from continuing operations	\$ 1,264	\$ 15
Basic:		
Shares outstanding at beginning of period	15,771	15,645
Weighted average shares issued during the period, net	10	1
Weighted average common shares, basic	15,781	15,646
Income from continuing operations per common share, basic	\$ 0.08	\$ 0.00
Diluted:		
Weighted average common shares, basic	15,781	15,646
Dilutive impact of stock options and restricted stock awards	197	77
Weighted average common shares, diluted	15,978	15,723
Income from continuing operations per common share, diluted	\$ 0.08	\$ 0.00

Note 8 — Contingencies

The Company is subject to legal proceedings, which arise in the ordinary course of business. Additionally, U.S. Government contract costs are subject to periodic audit and adjustment. The Company is investigating whether certain import/export and/or documentation of sales activities at the Company's China and Singapore offices were improper and in possible violation of the U.S. Foreign Corrupt Practices Act ("FCPA") and other applicable laws and certain Company policies. The Company voluntarily notified, and is fully cooperating with, the SEC and the U.S. Department of Justice ("DOJ") of these activities. On May 1, 2017, the Company received a subpoena for documents from the SEC relating to the Company's investigation. The SEC's investigation is a non-public, fact-finding inquiry and it is not clear what action, if any, the SEC intends to take with respect to the information it gathers. If the SEC, DOJ, or other governmental agencies (including foreign governmental agencies) determine that violations of certain laws or regulations occurred, the Company could be exposed to a broad range of civil and criminal sanctions. The potential liability arising out of the China and Singapore matters or the SEC investigation cannot currently be reasonably estimated; however, the imposition of sanctions, fines or remedial measures could have a material adverse effect on the Company's business, prospects, reputation, financial condition, liquidity, results of operations or cash flows.

Note 9 — Segment and Related Information

The Company is organized in two reportable business segments, Restaurant/Retail and Government. The Company's chief operating decision maker is the Company's Chief Executive Officer. Management views the Restaurant/Retail and Government segments separately in operating its business, as the products and services are different for each

segment. The Restaurant/Retail segment offers integrated solutions to the restaurant and retail industry consisting of restaurants, grocery stores and specialty retail outlets. These offerings include industry leading hardware and software applications utilized at the point-of-sale, back of store and corporate office and includes the acquisition of Brink Software. This segment also offers customer support including field service, installation, and twenty-four-hour telephone support and depot repair. With our SureCheck solution, we continue to expand our business into retail, big box retailers, grocery stores, and contract food management organizations. The Government segment performs complex technical studies, analysis, and experiments, develops innovative solutions, and provides on-site engineering in support of advanced defense, security, and aerospace systems. This segment also provides expert on-site services for operating and maintaining U.S. Government-owned communication assets.

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Information noted as “Other” primarily relates to the Company’s corporate, home office operations.

Information as to the Company’s segments is set forth below. Amounts below exclude discontinued operations.

	(in thousands)	
	For the three months ended March 31,	
	2017	2016
Revenues:		
Restaurant/Retail	\$ 51,549	\$ 33,788
Government	14,316	21,517
Total	\$ 65,865	\$ 55,305
Operating income (loss):		
Restaurant/Retail	\$ 2,362	\$ (500)
Government	1,511	1,807
Other	(1,632)	(1,243)
	2,241	64
Other income, net	(248)	(70)
Interest (expense) income	(32)	29
Income before provision for income taxes	\$ 1,961	\$ 23
Depreciation, amortization and accretion:		
Restaurant/Retail	\$ 774	\$ 732
Government	7	9
Other	117	36
Total	\$ 898	\$ 777
Capital expenditures including software costs:		
Restaurant/Retail	\$ 1,075	\$ 948
Government	-	7
Other	2,274	26
Total	\$ 3,349	\$ 981
Revenues by country:		
United States	\$ 61,567	\$ 50,219
Other Countries	4,298	5,086
Total	\$ 65,865	\$ 55,305

The following table represents identifiable assets by business segment. Amounts below exclude discontinued operations.

	(in thousands)	
	March	
	31, 2017	December 31, 2016
Restaurant/Retail	\$ 90,024	\$ 87,672
Government	7,333	6,504
Other	27,719	29,873

Total	\$125,076	\$ 124,049
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The following table represents assets by country based on the location of the assets. Amounts below exclude discontinued operations.

	(in thousands)	
	March	
	31,	December 31,
	2017	2016
United States	\$ 110,447	\$ 110,369
Other Countries	14,629	13,680
Total	\$ 125,076	\$ 124,049

The following table represents Goodwill by business segment. Amounts below exclude discontinued operations.

	(in thousands)	
	March	
	31,	December 31,
	2017	2016
Restaurant/Retail	\$ 10,315	\$ 10,315
Government	736	736
Total	\$ 11,051	\$ 11,051

Customers comprising 10% or more of the Company's total revenues, excluding discontinued operations, are summarized as follows:

	For the three months ended			
	March 31,			
	2017		2016	
Restaurant/Retail segment:				
McDonald's Corporation	44	%	17	%
Yum! Brands, Inc.	12	%	12	%
Government segment:				
U.S. Department of Defense	22	%	39	%
All Others	22	%	32	%
	100	%	100	%

No other customer within All Others represented more than 10% of the Company's total revenue for the three months ended March 31, 2017 or 2016.

Note 10 — Fair Value of Financial Instruments

The Company's financial instruments have been recorded at fair value using available market information and valuation techniques. The fair value hierarchy is based upon three levels of input, which are:

Level 1 – quoted prices in active markets for identical assets or liabilities (observable)

Level 2 – inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in inactive markets, or other inputs that are observable market data for essentially the full term of the asset or liability (observable)

Level 3 – unobservable inputs that are supported by little or no market activity, but are significant to determining the fair value of the asset or liability (unobservable)

The Company's financial instruments consist primarily of cash and cash equivalents, trade receivables, trade payables, debt instruments and deferred compensation assets and liabilities. For cash and cash equivalents, trade receivables and trade payables, the carrying amounts of these financial instruments as of March 31, 2017 and December 31, 2016 were considered representative of their fair values. The estimated fair value of the Company's long-term debt and line of credit at March 31, 2017 and December 31, 2016 was based on variable and fixed interest rates at March 31, 2017 and December 31, 2016, respectively, for new issues with similar remaining maturities and approximates the respective carrying values at March 31, 2017 and December 31, 2016.

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The deferred compensation assets and liabilities primarily relate to the Company's deferred compensation plan, which allows for pre-tax salary deferrals for certain key employees. Changes in the fair value of the deferred compensation liabilities are derived using quoted prices in active markets of the asset selections made by the participants. The deferred compensation liabilities are classified within Level 2, as defined under U.S. GAAP, because their inputs are derived principally from observable market data by correlation to the hypothetical investments. The Company holds insurance investments to partially offset the Company's liabilities under the Deferred Compensation Plan, which are recorded at fair value each period using the cash surrender value of the insurance investments.

The Company has obligations, to be paid in cash, to the former owners of Brink Software Inc., based on the achievement of certain conditions defined in the September 18, 2014 stock purchase agreement governing the Brink Software, Inc. acquisition. The fair value of this contingent consideration payable was estimated using a discounted cash flow method, with significant inputs that are not observable in the market and thus represents a Level 3 fair value measurement as defined in ASC 820, Fair Value Measurements and Disclosures. The significant inputs in the Level 3 measurement not supported by market activity included the Company's probability assessments of expected future cash flows related to the Company's acquisition of Brink Software Inc. during the contingent consideration period, appropriately discounted considering the uncertainties associated with the obligation, and calculated in accordance with the terms of the definitive agreement. Any change in the fair value adjustment is recorded in the earnings of that period. Changes in the fair value of the contingent consideration obligations may result from changes in probability assumptions with respect to the likelihood of achieving the various contingent payment obligations. Significant increases or decreases in the inputs noted above in isolation would result in a significantly lower or higher fair value measurement.

The following table presents a summary of changes in fair value of the Company's Level 3 assets and liabilities that are measured at fair value on a recurring basis (in thousands):

	Level 3 Inputs Liabilities
Balance at December 31, 2016	\$ 4,000
New level 3 liability	-
Total gains (losses) reported in earnings	-
Transfers into or out of Level 3	-
Balance at March 31, 2017	\$ 4,000

Note 11 — Related Party Transactions

The Company leases its corporate wellness facility to related parties at a current rate of \$9,775 per month. The Company receives a complimentary membership to this facility which is provided to all employees. During the quarters ended March 31, 2017 and March 31, 2016 the Company received rental income amounting to \$29,325 for the lease of the facility in each year.

Our director, Paul D. Eurek, is President of Xpanxion LLC. In October 2016, Par Tech, Inc. entered into a statement of work ("SOW") with Xpanxion LLC for software development services. In the quarter ended March 31, 2017 we paid approximately \$0.3 million to Xpanxion under the SOW. Mr. Eurek's successor has been announced, and he will be fully retired from Xpanxion on June 30, 2017.

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

When used in this Quarterly Report on Form 10-Q (“Quarterly Report”), the terms “PAR Technology Corporation,” “Company,” “we,” “us” and “our” mean PAR Technology Corporation and all entities included in our unaudited interim consolidated financial statements. The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited interim Consolidated Financial Statements and the Notes thereto included under Part I, Item 1 of this Quarterly Report. See also, “Forward-Looking Statements” below.

Forward-Looking Statements

This Quarterly Report contains “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”), and the Private Litigation Reform Act of 1995. Forward-looking statements are not historical in nature, but rather are predictive of our future operations, financial condition, business strategies and prospects. Forward-looking statements are generally identified by words such as “anticipate,” “believe,” “belief,” “continue,” “could,” “expect,” “estimate,” “intend,” “may,” “opportunity,” “plan,” “should,” “will,” “would,” “will li similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those expressed in, or implied by, the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, delays in new product development and/or product introduction, changes in customer product and service demands, concentration of revenues from a small group of customers, product and service competition, risks associated with the ongoing investigation into possible violations of the U.S. Foreign Corrupt Practices Act (“FCPA”) and similar laws, including sanctions, fines or remedial measures that may be imposed by the U.S. Department of Justice (“DOJ”) or the U.S. Securities and Exchange Commission (“SEC”), additional expenses related to remedial measures, risks associated with our identified material weaknesses in internal control over financial reporting and any other failure to maintain effective internal controls, and the other factors discussed in our most recent Annual Report on Form 10-K and other filings with the SEC. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as may be required under applicable securities law.

Overview

Our management technology solutions for the Restaurant/Retail segment features cloud and on-premise software applications, hardware platforms, and related installation, technical, and maintenance support services tailored for the needs of restaurants and retailers. Our Government segment provides technical expertise in contract development of advanced systems and software solutions for the U.S. Department of Defense and other federal agencies, as well as management technology and communications support services to the U.S. Department of Defense.

Our products sold in the Restaurant/Retail segment are utilized in a wide range of applications by customers worldwide. We face competition across all categories in the Restaurant/Retail segment in which we compete based on product design, innovative features and functionality, quality and reliability, price, customer service, and delivery capability. Our strategy is to provide complete integrated management technology solutions, supported by industry leading customer service. Our research and development efforts are focused on timely identifying changes in customer needs and/or relevant technologies, to rapidly and effectively develop innovative new products and enhancements to our existing products that meet and exceed customer requirements.

Our strategy is to expand our Restaurant/Retail business by continuing to invest in our existing products - Brink and SureCheck - including the development of enhancements to our existing software applications and hardware platforms and the development of new and innovative cloud based software applications. To support the growth of our products, we continue to expand our direct sales force and third-party channel partners.

Currently, PAR's primary market is the quick serve restaurant category and hardware sales to tier 1 customers in that category. Our strategy continues to focus on growth of our software offerings, including our cloud software as a service (SaaS) and related hardware and support services, consistent with our strategy to expand our product offerings beyond restaurant and retail markets. As we implement our strategies, we continuously monitor the trends in the markets we currently operate and the markets we intend to operate in the future. We know POS hardware is becoming a commodity, as more POS devices (tablets, kiosks and bring your own device) are introduced, competition will increase, driven by pricing, scalability, functionality, and economies of scale, resulting in smaller margins. Our strategy acknowledges this trend, and we intend to grow our recurring revenues from software contracts, specifically SaaS, reducing the impact of this eventual commoditization of POS hardware.

The strategy for our PAR Government segment is to build on our sustained outstanding performance of existing service contracts, coupled with investments in enhanced business development capabilities. We believe we are well positioned to realize continued renewals of expiring contracts and extensions of existing contracts, and secure service and solution contracts in expanded areas within the U.S. Department of Defense and other federal agencies. We believe our highly relevant technical competencies, intellectual property, and investments in new technologies provide opportunities to offer systems integration, products, and highly-specialized service solutions to the U.S. Department of Defense and other federal agencies. The general uncertainty in U.S. defense total workforce policies (military, civilian, and contract), procurement cycles, and spending levels for the next several years are factors we monitor as we develop and implement our business strategy for the PAR Government segment.

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Internal Investigation; Update.

As previously disclosed, our Audit Committee has been overseeing an internal investigation by outside counsel into import/export and sales documentation activities at our China and Singapore offices. The investigation is focused on whether certain import/export and sales documentation activities at our China and Singapore offices were improper and in possible violation of the FCPA and other applicable laws, and certain of our policies, including our Code of Business Conduct and Ethics. We voluntarily notified, and we are fully cooperating with, the SEC and the DOJ of these activities. On May 1, 2017, we received a subpoena for documents from the SEC relating to our investigation. The SEC's investigation is a non-public, fact-finding inquiry. While the fact-finding phase of our internal investigation is substantially complete, it is not clear what action, if any, the SEC intends to take with respect to the information it gathers. During the three months ended March 31, 2017, we recorded \$1.0 million of expenses relating to our internal investigation, including expenses of outside legal counsel and forensic accountants, and we expect to incur additional expenses relating to its completion and responding to the SEC's subpoena, as well as in connection with remedial measures being taken and to be taken by us to correct the material weaknesses identified in our internal control over financial reporting. It is not clear what action, if any, the SEC intends to take with respect to the information it gathers pursuant to its subpoena. If the SEC, or the DOJ or other governmental agency (including foreign governmental agencies) determine that violations of certain laws or regulations occurred, then we could be exposed to a broad range of civil and criminal sanctions, including injunctive relief, disgorgement, fines, penalties, modifications to our business practices, including the termination or modification of existing business relationships, the imposition of compliance programs and the retention of a monitor to oversee our future compliance. While we cannot currently reasonably estimate the potential liability arising out of the China and Singapore matters or the SEC investigation, the imposition of sanctions, fines or remedial measures could have a material adverse effect on our business, prospects, reputation, financial condition, liquidity, results of operations or cash flows.

Results of Operations —

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

We reported revenues of \$65.9 million for the quarter ended March 31, 2017, an increase of 19.0% from the \$55.3 million reported for the quarter ended March 31, 2016. Our net income from continuing operations was \$1.3 million or \$0.08 per diluted share for the first quarter of 2017 versus \$15,000 or \$0.00 per diluted share for the same period in 2016.

Product revenues were \$37.2 million for the quarter ended March 31, 2017, an increase of 68.5% from the \$22.1 million recorded for the same period in 2016. This increase was primarily driven by demand for our hardware solutions due to the timing of major project installations with a tier 1 customer in our Restaurant/Retail segment. Also, contributing to the growth in the quarter was continued deployments of hardware sold with our Brink POS software.

Service revenues were \$14.3 million for the quarter ended March 31, 2017, an increase of 22.5% from the \$11.7 million reported for the same period in 2016. During the quarter, we experienced an increase in installation services driven mostly by an increase in product revenue, and an increase in continued deployments of our Brink POS software. Additionally, there was an increase associated with our depot repair operation resulting from new service contracts.

Contract revenues were \$14.3 million for the quarter ended March 31, 2017, compared to \$21.5 million reported for the same period in 2016, a decrease of 33.5%. This decrease was driven by the wind down of a large multi-year contract within our Program Management Office ("PMO") product offering.

Product margins for the quarter ended March 31, 2017 were 25.9%, compared to 25.5% for the same period in 2016.

Service margins were 31.1% for the quarter ended March 31, 2017; an increase from the 26.5% recorded for the same period in 2016. Our favorable margin rates are primarily driven by growth in our software as a service platforms, depot repair, and call center product offerings.

Contract margins were 11.0% for the quarter ended March 31, 2017, compared to 8.7% for the same period in 2016. This favorable variance is the result of a shift in revenue mix from PMO to the higher value added product offerings of Intelligence, Surveillance, and Reconnaissance ("ISR") and Mission Support.

Selling, general and administrative (SG&A) expenses were \$9.6 million, an increase of 27.4%, compared to the \$7.5 million for the period ending March 31, 2016. The increase is primarily due to costs related to favorable year-over-year financial performance such as commissions and bonus accrual.

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Research and development (R&D) expenses were \$3.6 million for the quarter ended March 31, 2017, up from \$2.8 million recorded for the same period in 2016. This increase was primarily due to an increase in software development costs for products within the Restaurant/Retail segment, primarily associated with our Brink POS Software and SureCheck software applications.

During each of the quarters ended March 31, 2017 and March 31, 2016, we recorded \$0.2 million of amortization expense associated with acquired identifiable intangible assets from the acquisition of Brink Software Inc.

Other expense, net, was \$0.2 million for the quarter ended March 31, 2017 compared to \$0.1 million for the same period in 2016. Other income/expense primarily includes, fair market value fluctuations of our deferred compensation plan, rental income, and foreign currency fair value adjustments.

Interest (expense) income, was \$(32,000) for quarter ended March 31, 2017 and \$29,000 for quarter ended March 31, 2016. The 2016 interest income represents interest recorded on the note receivable in the amount of \$67,000 related to the sale of PSMS in November 2015, offset by interest charged on our short-term borrowings and from long-term debt of \$38,000.

For the three months ended March 31, 2017, our effective income tax expense was 35.5%, compared to 34.8% for the same period in 2016.

Liquidity and Capital Resources

Our primary sources of liquidity have been cash flow from operations and a line of credit with our bank. Cash used in operating activities from continuing operations was \$1.2 million for the three months ended March 31, 2017, compared to cash used in operating activities of \$1.0 million for the same period in 2016. This increase was primarily driven by first quarter hardware deployments associated with customer deposits from one of our Tier 1 accounts in the fourth quarter of 2016. For the three months ended March 31, 2016 cash used in operations was mostly due to changes in working capital requirements, primarily associated with increases in accounts receivable based on timing of product sales and contract billings partially offset by increases in accrued expenses and accounts payable from timing of payments made to vendors, specifically inventory purchases.

Cash used in investing activities from continuing operations was \$3.3 million for the three months ended March 31, 2017 versus \$1.0 million used in investing activities for the three months ended March 31, 2016. In the three months ended March 31, 2017, our capital expenditures of \$2.3 million were primarily related to the implementation of our enterprise resource planning system and capital improvements made to our owned and leased properties. We capitalized \$1.0 million in costs associated with investments in our Restaurant/Retail software platforms. In the three months ended March 31, 2016, our capital expenditures of \$1.0 million were primarily related to capital improvements to leased properties as well as purchases of computer equipment associated with our software support service offerings. We capitalized \$0.7 million in costs associated with investments in our Restaurant/Retail software platforms.

Cash provided by financing activities from continuing operations was \$1.0 million for the three months ended March 31, 2017 versus cash used of \$45,000 for the three months ended March 31, 2016. This change was a result of borrowings on the Credit Facility.

On November 29, 2016, we, together with certain of our U.S. subsidiaries, as “Loan Guarantors” (together, the “Loan Parties”) entered into a Credit Agreement (the “Credit Agreement”) with JPMorgan Chase Bank, N.A., as the “Lender”. The Credit Agreement provides for revolving loans in an aggregate principal amount of up to \$15.0 million to be made available to the Company; availability at any time being equal to the lesser of (i) \$15.0 million and (ii) a borrowing base (equal to the sum of 80% eligible accounts, 50% eligible raw materials inventory and 35% eligible

finished goods inventory, with no more than 50% of total eligible inventory included in the borrowing base), less the aggregate principal amount outstanding (the "Credit Facility"). Interest accrues on outstanding principal balances at an applicable rate per annum determined, as of the end of each fiscal quarter, by reference to the CBFR Spread or the Eurodollar Spread based on the Company's consolidated indebtedness ratio as at the determination date.

The Credit Facility matures three (3) years from the date of the Credit Agreement and is guaranteed by the Loan Guarantors. The Credit Facility is secured by substantially all of the assets of the Company and of the other Loan Parties; provided, that the Credit Facility is not secured by any liens on more than 65% of the voting stock of the Company's foreign subsidiaries. The Credit Agreement contains representations and warranties and affirmative and negative covenants that are usual and customary, including representations, warranties and covenants that, among other things, restrict the ability of the Company and its subsidiaries to incur additional indebtedness, incur or permit to exist liens on assets, make investments, loans, advances, guarantees and acquisitions, consolidate or merge with or into any other company, engage in asset sales and pay dividends and make distributions. The Credit Agreement requires that the Company's consolidated indebtedness ratio at the end of each of its fiscal quarters to be greater than 3.0 to 1.0 and 1.25 to 1.0 for the quarter ending March 31, 2017 and each quarter thereafter. Obligations under the Credit Agreement may be accelerated upon certain customary events of default (subject to grace periods, as appropriate), including among others: nonpayment of principal, interest or fees; breach of the affirmative or negative covenants; breach of the representations or warranties in any material respect; event of default under, or acceleration of, other material indebtedness; bankruptcy or insolvency; material judgments entered against the Company or any of its subsidiaries; invalidity or unenforceability of any collateral documentation associated with the Credit Facility; and a change of control of the Company. We were in compliance with these covenants as of March 31, 2017.

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On March 31, 2017, the applicable rate under the Credit Facility was 3.25% plus the CBF Spread or LIBOR plus the Eurodollar Spread based on the Company's consolidated indebtedness ratio. There was a \$1.0 million outstanding balance under the Credit Facility as of March 31, 2017, as such we had borrowing availability of up to \$14.0 million.

In addition to the Credit Facility, the Company has a mortgage loan, collateralized by certain real estate, with a balance of \$0.5 million and \$0.7 million as of March 31, 2017 and 2016, respectively. This mortgage matures on November 1, 2019. Interest is fixed at 4.00% through maturity. The annual mortgage payment, including interest through November 1, 2019, is \$0.2 million.

We expect our operating cash flows and available capacity under our Credit Facility will be sufficient to meet our operating needs for the next 12 months. Our actual cash needs will depend on many factors, including our rate of revenue growth, including growth of our SaaS revenues, the timing and extent of spending to support our product development efforts, the timing of introductions of new products and enhancements to existing products, market acceptance of our products, and potential fines and penalties that, while currently inestimable, could be material (see Item 1A – "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 for further discussion about the potential adverse effect of such fines and penalties on our business). If we are required or otherwise elect to seek additional funding, we cannot be certain that such additional funding will be available on terms and conditions acceptable to us, if at all.

Critical Accounting Policies and Estimates

Our Consolidated Financial Statements are based on the application of U.S. generally accepted accounting principles ("GAAP"). GAAP requires the use of estimates, assumptions, judgments and subjective interpretations of accounting principles that have an impact on the assets, liabilities, revenue and expense amounts reported. We believe our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently applied. Valuations based on estimates are reviewed for reasonableness and adequacy on a consistent basis. Primary areas where financial information is subject to the use of estimates, assumptions and the application of judgment include revenue recognition, accounts receivable, inventories, accounting for business combinations, contingent consideration, goodwill and intangible assets, and taxes. Our critical accounting policies have not changed materially from the discussion of those policies included under "Critical Accounting Policies and Estimates" in our Annual Report on Form 10-K for the year ended December 31, 2016.

Recently Issued Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB amended the existing accounting standards for revenue recognition. The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. In July 2015, the FASB affirmed its proposal of a one-year deferral of the effective date of the new revenue standard. As a result, the new guidance will be effective for the Company beginning in the first quarter of 2018. The amendments may be applied retrospectively to each prior period presented or with the cumulative effect recognized as of the date of initial application. PAR is currently evaluating the impact of these amendments and plans to adopt in 2018. In the second quarter of 2017, we will commence a project to assess the potential impact of the new standard on our consolidated financial statements and related disclosures. This project will also include the assessment and enhancement of our internal processes and systems to address the new standard. At this time, we have not yet selected a transition method.

In February 2016, the FASB issued ASU 2016-02 impacting the accounting for leases intending to increase transparency and comparability of organizations by requiring balance sheet presentation of leased assets and increased

financial statement disclosure of leasing arrangements. The revised standard will require entities to recognize a liability for its lease obligations and a corresponding asset representing the right to use the underlying asset over the lease term. Lease obligations are to be measured at the present value of lease payments and accounted for using the effective interest method. The accounting for the leased asset will differ slightly depending on whether the agreement is deemed to be a financing or operating lease. For finance leases, the leased asset is depreciated on a straight-line basis and recorded separately from the interest expense in the income statement resulting in higher expense in the earlier part of the lease term. For operating leases, the depreciation and interest expense components are combined, recognized evenly over the term of the lease, and presented as a reduction to operating income. The ASU requires that assets and liabilities be presented or disclosed separately and classified appropriately as current and noncurrent. The ASU further requires additional disclosure of certain qualitative and quantitative information related to lease agreements. The new standard is effective for the Company beginning in the first quarter of 2019. We are currently evaluating the impact of these amendments on our financial statements.

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In January 2017, the FASB issued ASU 2017-01 clarifying the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this Update affect all reporting entities that must determine whether they have acquired or sold a business. This guidance clarifies that to be a business there must also be at least one substantive process, and narrows the definition of outputs by more closely aligning it with how outputs are described in the new revenue recognition standard. The amendments in this Update should be applied prospectively on or after the annual periods beginning after December 15, 2017, including interim periods within those periods. The adoption of this standards update is not expected to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04 intended to simplify the subsequent measurement of goodwill. The amendments in this Update modify the concept of impairment from the condition that exists when the carrying amount of goodwill exceeds its implied fair value to the condition that exists when the carrying amount of a reporting unit exceeds its fair value. An entity no longer will determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. Because these amendments eliminate Step 2 from the goodwill impairment test, they should reduce the cost and complexity of evaluating goodwill for impairment. The standards update is effective on a prospective basis for annual and interim goodwill impairment testing performed in fiscal years beginning after December 15, 2019. The adoption of this standards update is not expected to have a material impact on our consolidated financial statements.

Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-09 to simplify several aspects of the accounting for employee share-based payment transactions standard, including the classification of excess tax benefits and deficiencies and the accounting for employee forfeitures. The guidance was effective for the Company beginning in the quarter ended March 31, 2017 at which time we adopted this new standard. The updates to the accounting standard include the following:

Excess tax benefits and deficiencies no longer are recognized as a change in additional paid-in-capital in the equity section of the balance sheet, instead they are recognized in the income statement as a tax expense or benefit. In the statement of cash flows, excess tax benefits and deficiencies are no longer classified as a financing activity, instead they are classified as an operating activity.

Entities have the option to continue to reduce share-based compensation expense during the vesting period of outstanding awards for estimated future employee forfeitures or they may elect to recognize the impact of forfeitures as they actually occur.

The ASU also provides new guidance to other areas of the standard including minimum statutory tax withholding rules and the calculation of diluted common shares outstanding.

The adoption of the new standard in the first quarter of 2017 did not have a significant impact on our unaudited interim consolidated financial statements.

In November 2015, the FASB issued new guidance related to the balance sheet classification of deferred taxes. This standard requires an entity to classify all deferred tax assets, along with any valuation allowance, as noncurrent on the balance sheet. As a result, each jurisdiction will have one net noncurrent deferred tax asset or liability. The Company adopted this standard in the first quarter of 2017, which resulted in the Company's reclassification of deferred tax assets from current assets to non-current assets in the amount of \$7.8 million for the quarters ended March 31, 2017 and December 31, 2016.

In July 2015, the FASB issued new guidance related to the measurement of inventory. This standard changes the inventory valuation method from the lower of cost or market to the lower of cost or net realizable value for inventory valued under the first-in, first-out or average cost methods. The implementation of the amended accounting guidance did not have a significant impact on our consolidated financial statements.

In August 2014, the FASB issued new guidance related to disclosures around going concern, including management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures when conditions or events raise substantial doubt about an entity's ability to continue as a going concern. The adoption of the new standard in the first quarter of 2017, did not have a significant impact on our consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act), which are designed to provide reasonable assurances that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer (Chief Executive Officer) and principal financial officer (Chief Financial Officer), as appropriate, to allow timely decisions regarding required disclosure.

Internal Investigation; Material Weaknesses

As previously disclosed, our Audit Committee has been overseeing an internal investigation by outside counsel focused on whether certain import/export and sales documentation activities at our China and Singapore offices were improper and in violation of the FCPA and other applicable laws, and certain of our policies, including our Code of Business Conduct and Ethics. Based on the investigation findings to date, we discovered that certain members of our China and Singapore staff participated in or were aware of improper activities in China and Singapore, involving the improper bypassing of applicable customs laws of various countries. Such activities in China and Singapore included the failure to properly label items for import into various non-U.S. countries and the failure to properly document the declared value of certain items exported to various non-U.S. countries, as well as questionable payments made to customs officials in China without sufficient documentation to evidence or confirm the legitimacy of their purpose. The investigation also revealed that certain members of upper management knew or should have known of the questionable conduct, but failed to take action to prevent or correct such conduct.

Evaluation Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2017. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of March 31, 2017, as a result of the material weaknesses in our internal control over financial reporting previously disclosed and described below. However, it has been determined that no material adjustments, restatements, or other amendments to our previously issued financial statements are required.

Based on the results of the internal investigation to date and remedial actions taken through March 31, 2017, we concluded that material weaknesses continued to exist as of March 31, 2017 because:

we did not maintain a control environment that effectively promoted, maintained, and/or supported the control consciousness of employees or a culture of adequate and prompt reporting of information internally;

we failed to maintain sufficient monitoring activities to ensure compliant and consistent global practices and procedures and timely detection of deviations, allowing for timely corrective action; and

our policies, procedures, and training were insufficient as to procurement and sales activities, including insufficient documentation involving arrangements with third parties, knowledge of, and compliance with, import/export, customs and similar laws and regulations of international jurisdictions and the FCPA, including deficiencies in our training.

Remediation Efforts to Address Material Weaknesses.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

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As we previously disclosed, we have developed and we have begun to implement changes in our internal control over financial reporting to remediate our identified material weaknesses; and, we are in the process of developing and implementing a comprehensive compliance program focused on applicable domestic and international anti-bribery, trade control, and other laws, rules, and regulations. These additional measures are intended to address the above deficiencies and ensure a continuous and effective control environment that not only encourages, but demands compliance and provides processes and procedures for the timely reporting of necessary and/or required information to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We caution that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Changes in Internal Controls Over Financial Reporting.

In evaluating whether there were any reportable changes in our internal control over financial reporting during the quarter ended March 31, 2017, we determined that, other than the changes described above under “Remediation Efforts to Address Material Weaknesses”, there were no changes in internal control over financial reporting during the quarter ended March 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, we do anticipate further changes will be implemented to remedy the material weaknesses identified above.

Part II - Other Information

Item 1. Legal Proceedings

The information in Note 8 - Contingencies to the unaudited interim consolidated financial statements is responsive to this Item and is incorporated by reference herein.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those described in Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of PAR’s common stock. As disclosed above under “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Internal Investigation; Update”, we have received a subpoena for documents from the SEC relating to our investigation. It is not clear what action, if any, the SEC intends to take with respect to the information it gathers pursuant to its subpoena. If the SEC, or the DOJ or other governmental agency (including foreign governmental agencies) determine that violations of certain laws or regulations occurred, then we could be exposed to a broad range of civil and criminal sanctions, including injunctive relief, disgorgement, fines, penalties, modifications to our business practices, including the termination or modification of existing business relationships, the imposition of compliance programs and the retention of a monitor to oversee our future compliance. The imposition of sanctions, fines or remedial measures could have a material adverse effect on our business, prospects, reputation, financial condition, liquidity, results of operations or cash flow.

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Item 2. Unregistered Sales of Equity Securities And Use Of Proceeds

Under our equity incentive plans, recipients of restricted stock grants must pay us par value for each share granted; if the vesting requirements are not satisfied, we will repurchase the forfeited shares at par value. In addition, employees may elect to have us withhold shares to satisfy minimum statutory federal, state and local tax withholding obligations arising from the vesting of restricted stock. When we withhold these shares, we are required to remit to the appropriate taxing authorities the market price of the shares withheld, which could be deemed a purchase of shares by us on the date of withholding. For the three months ended March 31, 2017, 1,039 shares were purchased at an average price of \$6.83 per share.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

List of Exhibits

Exhibit No.	Exhibit Description
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
32.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

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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.

PAR TECHNOLOGY CORPORATION
(Registrant)

Date: May 15, 2017 /s/ Bryan A. Menar
Bryan A. Menar
Chief Financial Officer

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Exhibit Index

Exhibit No.	Exhibit Description
<u>31.1</u>	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
<u>31.2</u>	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
<u>32.1</u>	Certification of Principal Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
<u>32.2</u>	Certification of Principal Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

23

ign:right;font-size:10pt;">107,935

\$
(2,436
)

\$
105,499

\$
838,465

Intersegment sales ⁽³⁾

502

37,666

—

—

—

38,168

Value-added sales

264,569

132,737

75,872

(3,112
)

72,760

470,066

Operating profit (loss)

23,346

25,520

6,722

(12,362
)

(5,640
)

43,226

Assets

434,181

150,374

130,265

51,988

182,253

766,808

The Other reportable segment includes the results of our Precision Optics and Large Area Coatings operating (1) segments, which do not meet the quantitative thresholds for separate disclosure and are collectively referred to as our Precision Coatings group.

(2) Costs associated with our unallocated corporate functions have been shown separately to better illustrate the financial information for the businesses within the Other reportable segment.

(3) Intersegment sales are eliminated in consolidation.

Note H — Stock-based Compensation Expense

Stock-based compensation expense was \$1.2 million in both the third quarter of 2015 and the third quarter of 2014.

Stock-based compensation expense was \$5.9 million and \$6.4 million in the first nine months of 2015 and 2014, respectively.

The Company granted approximately 56,000 stock-settled restricted stock units (RSUs) during the first nine months of 2015. These shares generally will be amortized over a vesting period of three years, or earlier if the employee is retirement

Materion Corporation and Subsidiaries
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eligible as defined in the Plan, using the weighted average fair value per share of \$37.25. Additionally, approximately 35,000 cash-settled RSUs were granted to employees during the first nine months of 2015. Because these shares are settled in cash, the liability and related expense were adjusted based on the closing price of Materion's common stock over the vesting period of three years.

The Company granted approximately 160,000 stock appreciation rights (SARs) to certain employees in the first nine months of 2015 at a strike price of \$36.81 per share. The fair value of the SARs, which was determined on the grant date using a Black-Scholes model, was \$13.27 per share. The SARs generally will be amortized over the vesting period of three years, or earlier if the employee is retirement eligible as defined in the Plan. The SARs expire seven years from the date of the grant.

Exercises of SARs totaled approximately 67,000 in the first nine months of 2015 and 50,000 in the first nine months of 2014.

The Company granted approximately 77,000 stock-settled performance-based restricted stock units (PRSUs) to certain employees in the first nine months of 2015 at a weighted-average fair value of \$33.31 per share. The fair value will be expensed over the vesting period of three years. In addition, approximately 39,000 cash-settled PRSUs were awarded to employees in the first quarter of 2015. The liability for cash-settled PRSUs is remeasured at fair value each reporting period, and the expense is recorded accordingly. The final payout to the employees for all PRSUs will be based upon the Company's return on invested capital and the total return to shareholders over the vesting period relative to a peer group's performance over the same period.

Note I — Other-net

Other-net (income) expense for the third quarter and first nine months of 2015 and 2014 is summarized as follows:

(Thousands)	Third Quarter Ended		Nine Months Ended	
	Oct. 2, 2015	Sept. 26, 2014	Oct. 2, 2015	Sept. 26, 2014
Foreign currency exchange/translation (gain) loss	\$(1,256)	\$(450)	\$(4,569)	\$25
Amortization of intangible assets	1,256	1,208	3,769	3,841
Metal consignment fees	1,686	1,770	5,554	5,481
Net (gain) loss on disposal of fixed assets	2	225	310	(2,384)
Recovery from insurance	—	—	(3,800)	(6,750)
Legal settlements	(500)	(4,000)	(1,825)	(4,000)
Other items	402	603	29	610
Total	\$1,590	\$(644)	\$(532)	\$(3,177)

Note J — Income Taxes

The Company recorded income tax expense of \$2.6 million in the third quarter of 2015, an effective tax rate of 27.5% against income before income taxes, and income tax expense of \$4.3 million in the third quarter of 2014, with an effective tax rate of 25.5% against income before income taxes.

In the first nine months of 2015, income tax expense was \$9.9 million, or 27.9% of income before income taxes, while income tax expense was \$11.2 million in the first nine months of 2014, or 27.3% of income before income taxes.

The differences between the statutory and effective rates in the third quarter and first nine months of both years were due to the impact of percentage depletion, the production deduction, foreign source income and deductions, executive compensation, state and local taxes, discrete events, and other factors.

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Note K - Depreciation and Amortization

The Company received an aggregate of \$63.5 million from the U.S. Department of Defense (DoD) in previous periods for reimbursement of the DoD's share of the cost of capital equipment acquired by the Company under a Title III contract. The Company recorded the cost of the equipment in property, plant, and equipment and the reimbursements as unearned income, a liability on the Consolidated Balance Sheets. The equipment was placed in service during the third quarter of 2012, and its full cost is being depreciated in accordance with Company policy. The unearned income liability is being reduced ratably with the depreciation expense recorded over the life of the equipment.

In the first nine months of 2015, the depreciation expense reimbursed for this equipment was \$4.7 million. Unearned income was reduced by \$4.7 million, accordingly, with the offset recorded as a credit to cost of sales. Depreciation, depletion, and amortization expense on the Consolidated Statements of Cash Flows is shown net of the reduction in unearned income.

Note L — Fair Value of Financial Instruments

The Company measures and records financial instruments at fair value. A fair value hierarchy is used for those instruments measured at fair value that distinguishes between assumptions based on market data (observable inputs) and the Company's assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 — Quoted market prices in active markets for identical assets and liabilities;

Level 2 — Inputs other than Level 1 inputs that are either directly or indirectly observable; and

Level 3 — Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use.

The following table summarizes the financial instruments measured at fair value in the Consolidated Balance Sheet as of October 2, 2015:

(Thousands)	Total	Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Deferred compensation investments	\$2,429	\$2,407	\$22	\$—
Foreign currency forward contracts	1,001	—	1,001	—
Total	\$3,430	\$2,407	\$1,023	\$—
Financial Liabilities				
Deferred compensation liability	\$2,466	\$2,466	\$—	\$—
Foreign currency forward contracts	368	—	368	—
Total	\$2,834	\$2,466	\$368	\$—

The Company uses a market approach to value the assets and liabilities for financial instruments in the table above. Outstanding contracts are valued through models that utilize market observable inputs, including both spot and forward prices, for the same underlying currencies and metals. The carrying values of the other working capital items and debt in the Consolidated Balance Sheet approximate fair values as of October 2, 2015.

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Note M — Derivative Instruments and Hedging Activity

The Company uses derivative contracts to hedge portions of its foreign currency exposures and may also use derivatives to hedge a portion of its precious metal exposures. The objectives and strategies for using derivatives in these areas are as follows:

Foreign Currency. The Company sells a portion of its products to overseas customers in their local currencies, primarily the euro and yen. The Company secures foreign currency derivatives, mainly forward contracts and options, to hedge these anticipated sales transactions. The purpose of the hedge program is to protect against the reduction in the dollar value of foreign currency sales from adverse exchange rate movements. Should the dollar strengthen significantly, the decrease in the translated value of the foreign currency sales should be partially offset by gains on the hedge contracts. Depending upon the methods used, hedge contracts may limit the benefits from a weakening U.S. dollar.

The use of forward contracts locks in a firm rate and eliminates any downside from an adverse rate movement as well as any benefit from a favorable rate movement. The Company may from time to time choose to hedge with options or a tandem of options known as a collar. These hedging techniques can limit or eliminate the downside risk but can allow for some or all of the benefit from a favorable rate movement to be realized. Unlike a forward contract, a premium is paid for an option; collars, which are a combination of a put and call option, may have a net premium but can be structured to be cash neutral. The Company will primarily hedge with forward contracts due to the relationship between the cash outlay and the level of risk.

The use of foreign currency derivative contracts is governed by policies approved by the Audit Committee of the Board of Directors. A team consisting of senior financial managers reviews the estimated exposure levels, as defined by budgets, forecasts, and other internal data, and determines the timing, amounts, and instruments to use to hedge that exposure within the confines of the policy. Management analyzes the effective hedged rates and the actual and projected gains and losses on the hedging transactions against the program objectives, targeted rates, and levels of risk assumed. Hedge contracts are typically layered in at different times for a specified exposure period in order to minimize the impact of rate movements.

Precious Metals. The Company maintains the majority of its precious metal production requirements on consignment in order to reduce its working capital investment and the exposure to metal price movements. When a precious metal product is fabricated and ready for shipment to the customer, the metal is purchased out of consignment at the current market price. The price paid by the Company forms the basis for the price charged to the customer. This methodology allows for changes in either direction in the market prices of the precious metals used by the Company to be passed through to the customer and reduces the impact changes in prices could have on the Company's margins and operating profit. The consigned metal is owned by financial institutions who charge the Company a financing fee based upon the current value of the metal on hand.

In certain instances, a customer may want to establish the price for the precious metal at the time the sales order is placed rather than at the time of shipment. Setting the sales price at a different date than when the material would be purchased potentially creates an exposure to movements in the market price of the metal. Therefore, in these limited situations, the Company may elect to enter into a forward contract to purchase precious metal. The forward contract allows the Company to purchase metal at a fixed price on a specific future date. The price in the forward contract serves as the basis for the price to be charged to the customer. By doing so, the selling price and purchase price are matched, and the Company's price exposure is reduced.

The Company refines precious metal containing materials for its customers and typically will purchase the refined metal from the customer at current market prices. In limited circumstances, the customer may want to fix the price to be paid at the time of the order as opposed to when the material is refined. The customer may also want to fix the price for a set period of time. The Company may then elect to enter into a hedge contract, either a forward contract or a swap, to fix the price for the estimated quantity of metal to be purchased, thereby reducing the exposure to adverse

movements in the price of the metal.

The Company may from time to time elect to purchase precious metal and hold in inventory rather than on consignment due to potential credit line limitations or other factors. These purchases are typically held for a short duration. A forward contract will be secured at the time of the purchase to fix the price to be used when the metal is transferred back to the consignment line, thereby limiting any price exposure during the time when the metal was owned.

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The Company will only enter into a derivative contract if there is an underlying identified exposure. Contracts are typically held until maturity. The Company does not engage in derivative trading activities and does not use derivatives for speculative purposes. The Company only uses currency hedge contracts that are denominated in the same currency as the underlying exposure and precious metal hedge contracts denominated in the same metal as the underlying exposure.

All derivatives are recorded on the balance sheet at their fair values. If the derivative is designated and effective as a cash flow hedge, changes in the fair value of the derivative are recognized in other comprehensive income (OCI) until the hedged item is recognized in earnings. The ineffective portion of a derivative's fair value, if any, is recognized in earnings immediately. If a derivative is not a hedge, changes in the fair value are adjusted through income. The fair values of the outstanding derivatives are recorded on the balance sheet as assets (if the derivatives are in a gain position) or liabilities (if the derivatives are in a loss position). The fair values will also be classified as short-term or long-term depending upon their maturity dates.

The outstanding foreign currency forward contracts had a notional value of \$31.0 million as of October 2, 2015. All of these contracts were designated and effective as cash flow hedges. The net fair value of the outstanding contracts was \$0.6 million, with an asset recorded in prepaid expenses and other assets and a liability recorded in other liabilities and accrued items on the Consolidated Balance Sheet as of October 2, 2015.

No ineffective expense was recorded in the third quarter or first nine months of 2015 or 2014.

Changes in the fair value of outstanding cash flow hedges recorded in OCI for the first nine months of 2015 and 2014 totaled \$2.2 million and \$2.4 million, respectively. The Company expects to relieve substantially the entire balance in OCI as of October 2, 2015 to the Consolidated Statements of Income during the twelve-month period beginning October 3, 2015. Refer to Note N for additional OCI details.

Note N — Accumulated Other Comprehensive Income

Changes in the components of accumulated other comprehensive income, including the amounts reclassified out, for the third quarter and first nine months of 2015 and 2014 are as follows:

(Thousands)	Gains and Losses On Cash Flow Hedges			Pension and Post-Employment Benefits	Foreign Currency Translation	Total
	Foreign Currency	Precious Metals	Total			
Accumulated other comprehensive income, as of July 3, 2015						
Gross	\$2,503	\$—	\$2,503	\$ (106,276)	\$ (5,407)	\$(109,180)
Deferred tax expense (benefit)	(474)	—	(474)	(26,418)	—	(26,892)
Net	\$2,977	\$—	\$2,977	\$ (79,858)	\$ (5,407)	\$(82,288)
Third quarter 2015 activity						
Other comprehensive income (loss) before reclassifications	\$(447)	\$—	\$(447)	\$ —	\$359	\$(88)
Amounts reclassified from accumulated other comprehensive income	(1,423)	—	(1,423)	1,396	—	(27)
Net current period other comprehensive income (loss) before tax	(1,870)	—	(1,870)	1,396	359	(115)
	(693)	—	(693)	495	—	(198)

Deferred taxes on current period activity						
Net current period other comprehensive income (loss) after tax	\$(1,177)	\$—	\$(1,177)	\$ 901	\$359	\$83
Accumulated other comprehensive income, as of October 2, 2015						
Gross	\$633	\$—	\$633	\$ (104,880)	\$(5,048)	\$(109,295)
Deferred tax expense (benefit)	(1,167)	—	(1,167)	(25,923)	—	(27,090)
Net	\$1,800	\$—	\$1,800	\$ (78,957)	\$(5,048)	\$(82,205)

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(Thousands)	Gains and Losses On Cash Flow Hedges			Pension and Post-Employment Benefits	Foreign Currency Translation	Total
	Foreign Currency	Precious Metals	Total			
Accumulated other comprehensive income, as of December 31, 2014						
Gross	\$3,456	\$—	\$3,456	\$ (109,080)	\$(4,153)	\$(109,777)
Deferred tax expense (benefit)	(122)	—	(122)	(27,418)	—	(27,540)
Net	\$3,578	\$—	\$3,578	\$ (81,662)	\$(4,153)	\$(82,237)
First nine months of 2015 activity						
Other comprehensive income (loss) before reclassifications	\$2,198	\$—	\$2,198	\$ 14	\$(895)	\$1,317
Amounts reclassified from accumulated other comprehensive income	(5,021)	—	(5,021)	4,186	—	(835)
Net current period other comprehensive income (loss) before tax	(2,823)	—	(2,823)	4,200	(895)	482
Deferred taxes on current period activity	(1,045)	—	(1,045)	1,495	—	450
Net current period other comprehensive income (loss) after tax	\$(1,778)	\$—	\$(1,778)	\$ 2,705	\$(895)	\$32
Accumulated other comprehensive income, as of October 2, 2015						
Gross	\$633	\$—	\$633	\$ (104,880)	\$(5,048)	\$(109,295)
Deferred tax expense (benefit)	(1,167)	—	(1,167)	(25,923)	—	(27,090)
Net	\$1,800	\$—	\$1,800	\$ (78,957)	\$(5,048)	\$(82,205)
Accumulated other comprehensive income, as of June 27, 2014						
Gross	\$31	\$—	\$31	\$ (61,597)	\$1,002	\$(60,564)
Deferred tax expense (benefit)	(1,390)	—	(1,390)	(10,013)	—	(11,403)
Net	\$1,421	\$—	\$1,421	\$ (51,584)	\$1,002	\$(49,161)
Third quarter 2014 activity						
Other comprehensive income (loss) before reclassifications	\$2,365	\$—	\$2,365	\$ —	\$(2,170)	\$195
Amounts reclassified from accumulated other comprehensive income	(17)	—	(17)	833	—	816
Net current period other comprehensive income (loss) before	2,348	—	2,348	833	(2,170)	1,011

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tax						
Deferred taxes on current period activity	868	—	868	293	—	1,161
Net current period other comprehensive income (loss) after tax	\$1,480	\$—	\$1,480	\$ 540	\$(2,170)	\$(150)
Accumulated other comprehensive income, as of September 26, 2014						
Gross	\$2,379	\$—	\$2,379	\$ (60,764)	\$(1,168)	\$(59,553)
Deferred tax expense (benefit)	(522)	—	(522)	(9,720)	—	(10,242)
Net	\$2,901	\$—	\$2,901	\$ (51,044)	\$(1,168)	\$(49,311)

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(Thousands)	Gains and Losses On Cash Flow Hedges			Pension and Post-Employment Benefits	Foreign Currency Translation	Total
	Foreign Currency	Precious Metals	Total			
Accumulated other comprehensive income, as of December 31, 2013						
Gross	\$(87)	\$(19)	\$(106)	\$ (77,301)	\$287	\$(77,120)
Deferred tax expense (benefit)	(1,433)	(7)	(1,440)	(15,792)	—	(17,232)
Net	\$1,346	\$(12)	\$1,334	\$ (61,509)	\$287	\$(59,888)
First nine months of 2014 activity						
Other comprehensive income (loss) before reclassifications	\$2,357	\$—	\$2,357	\$ 14,034	\$(1,455)	\$14,936
Amounts reclassified from accumulated other comprehensive income	109	19	128	2,503	—	2,631
Net current period other comprehensive income (loss) before tax	2,466	19	2,485	16,537	(1,455)	17,567
Deferred taxes on current period activity	911	7	918	6,072	—	6,990
Net current period other comprehensive income (loss) after tax	\$1,555	\$12	\$1,567	\$ 10,465	\$(1,455)	\$10,577
Accumulated other comprehensive income, as of September 26, 2014						
Gross	\$2,379	\$—	\$2,379	\$ (60,764)	\$(1,168)	\$(59,553)
Deferred tax expense (benefit)	(522)	—	(522)	(9,720)	—	(10,242)
Net	\$2,901	\$—	\$2,901	\$ (51,044)	\$(1,168)	\$(49,311)

Reclassifications from accumulated other comprehensive income of gains and losses on foreign currency cash flow hedges are recorded in Other-net in the Consolidated Statements of Income. Gains and losses on precious metal cash flow hedges are recorded in Cost of sales in the Consolidated Statements of Income in order to offset the impact of precious metal price movements in Cost of sales. The Company has no precious metal hedges as of October 2, 2015. Refer to Note M for additional details on cash flow hedges.

Reclassifications from accumulated other comprehensive income for pension and post-employment benefits are included in the computation of the net periodic pension and post-employment benefit expense. Refer to Note E for additional details on pension and post-employment expenses.

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

OUR BUSINESS

We are an integrated producer of high-performance advanced engineered materials used in a variety of electrical, electronic, thermal, and structural applications. Our products are sold into numerous end markets, including consumer electronics, industrial components, medical, automotive electronics, energy, telecommunications infrastructure, and defense.

EXECUTIVE OVERVIEW

For the third quarter and first nine months of 2015, the following key factors contributed to our overall results of operations, financial position, and cash flows:

Net sales in the third quarter of 2015 were \$244.4 million, a 16% decrease from net sales in the third quarter of 2014.

The decrease was due primarily to the impact of lower sales volume, lower pass-through precious metal and copper prices, and the negative impact of foreign exchange rates.

Value-added sales decreased 10% to \$148.8 million in the third quarter of 2015 compared to \$165.6 million in the third quarter of 2014. The impact of foreign exchange rate movements of \$2.4 million negatively impacted value-added sales in the third quarter of 2015 by 1% compared to the third quarter of 2014. Value-added sales is a non-GAAP measure that removes the impact of pass-through metal costs and allows for analysis without the distortion of the movement or volatility in pass-through metal prices. Internally, we manage our business on this basis, and a reconciliation of sales to value-added sales is included herein.

Gross margin was \$44.0 million in the third quarter of 2015 compared to \$54.8 million in the third quarter of 2014. The decrease is due to a combination of lower sales volume and unfavorable product mix. In the third quarter of 2015, we also recorded \$0.6 million of expense primarily for headcount reductions in our Precision Coatings group within our Other reportable segment to respond to weakening demand in the projector display segment of the consumer electronics end market.

Operating profit was \$10.2 million in the third quarter of 2015 compared to \$17.7 million in the third quarter of 2014. Operating profit for the third quarter of 2014 was adjusted to correct an error related to amortization of stock compensation expense (refer to Note B in the Consolidated Financial Statements for further details). The decrease in the third quarter of 2015 was due to lower gross margins of \$10.8 million and a \$2.2 million unfavorable change in Other-net, partially offset by lower selling, general, and administrative (SG&A) expense of \$4.8 million. The unfavorable change in Other-net was primarily driven by a \$4.0 million gain on a legal settlement recognized in the third quarter of 2014. The decrease in SG&A was due primarily to lower annual incentive compensation expense and lower selling expenses, partially offset by \$1.2 million of expense related to headcount reductions in our Precision Coatings group within our Other reportable segment and the elimination of executive positions in the third quarter of 2015.

As a result of the aforementioned factors, overall diluted earnings per share decreased to \$0.34 for the three months ended October 2, 2015 as compared to \$0.61 for the three months ended September 26, 2014. For the first nine months of 2015, the overall diluted earnings per share decreased to \$1.24 versus \$1.42 for the same period in 2014.

A total of 140,290 shares of common stock were repurchased in the third quarter of 2015 for \$4.4 million in the aggregate. Since the approval of a \$50.0 million common stock repurchase plan by our Board of Directors in January 2014, we have purchased 902,504 shares at a total cost of \$29.4 million.

RESULTS OF OPERATIONS

	Third Quarter Ended				Nine Months Ended			
	Oct. 2, 2015	Sept. 26, 2014	\$ Change	% Change	Oct. 2, 2015	Sept. 26, 2014	\$ Change	% Change
(Millions, except per share data)								
Net sales	\$244.4	\$291.6	\$(47.2)	(16)%	\$811.2	\$838.5	\$(27.3)	(3)%
Value-added sales	148.8	165.6	(16.8)	(10)%	473.8	470.1	3.7	1%
Gross margin	44.0	54.8	(10.8)	(20)%	147.7	150.1	(2.4)	(2)%
SG&A expense	29.7	34.5	(4.8)	(14)%	101.6	100.6	1.0	1%
R&D expense	2.5	3.2	(0.7)	(22)%	9.4	9.5	(0.1)	(1)%
Other—net	1.6	(0.6)	2.2	(367)%	(0.5)	(3.2)	2.7	(84)%
Operating profit	10.2	17.7	(7.5)	(42)%	37.2	43.2	(6.0)	(14)%
Interest expense—net	0.6	0.7	(0.1)	(14)%	1.9	2.1	(0.2)	(10)%
Income before income taxes	9.6	17.0	(7.4)	(44)%	35.3	41.1	(5.8)	(14)%
Income tax expense	2.7	4.4	(1.7)	(39)%	9.9	11.2	(1.3)	(12)%
Net income	\$6.9	\$12.6	\$(5.7)	(45)%	\$25.4	\$29.9	\$(4.5)	(15)%
Diluted earnings per share	\$0.34	\$0.61	\$(0.27)	(44)%	\$1.24	\$1.42	\$(0.18)	(13)%

Third Quarter

Net sales of \$244.4 million in the third quarter of 2015 were \$47.2 million lower than the \$291.6 million recorded in the third quarter of 2014. The decrease in net sales in the third quarter of 2015 was due to lower sales volume, lower pass-through precious metal and copper prices, and the negative impact of foreign exchange rates. Sales volume was lower due primarily to weaker demand in Asian markets and the oil and gas sector of the energy market. Changes in precious metal and copper prices negatively impacted net sales in the third quarter of 2015 by approximately \$17.6 million when compared to the third quarter of 2014. The strengthening of the U.S. dollar, primarily against the euro and yen, had an approximate \$3.9 million negative impact on net sales in the third quarter of 2015 versus the comparable period in 2014.

Value-added sales of \$148.8 million in the third quarter of 2015 decreased \$16.8 million, or 10% compared to the third quarter of 2014. The impact of foreign exchange rate movements of \$2.4 million negatively impacted value-added sales by 1% in the third quarter of 2015 versus the third quarter of 2014. The year-over-year decrease in value-added sales was primarily driven by lower sales in our consumer electronics, energy, and medical end markets, partially offset by increased sales to our defense and industrial components end markets. Value-added sales to the consumer electronics, energy, and medical end markets decreased year-over-year 17%, 43%, and 14%, respectively. Value-added sales to the defense and industrial components end markets increased year-over-year 34% and 10%, respectively.

Gross margin in the third quarter of 2015 was \$44.0 million, or \$10.8 million below the \$54.8 million in gross margin recorded during the third quarter of 2014. Expressed as a percentage of value-added sales, gross margin decreased 350 basis points from 33.1% in the third quarter of 2014 to 29.6% in the third quarter of 2015. The decrease in gross margin was primarily due to a combination of lower sales volume, unfavorable product mix, and the negative impact of foreign exchange. In addition, we recorded \$0.6 million of expense in 2015 primarily for headcount reductions in our Precision Coatings group within our Other reportable segment to respond to weakening demand in the projector display segment of the consumer electronics end market.

Selling, general, and administrative (SG&A) expense was \$29.7 million in the third quarter of 2015, or \$4.8 million lower than \$34.5 million in the third quarter of 2014. The decrease in SG&A expense was due primarily to a reduction in annual incentive compensation expense driven by a reduction in operating profit and lower selling expenses. We also recorded \$1.2 million of expense in the third quarter of 2015 for headcount reductions in our Precision Coatings group within our Other reportable segment and the elimination of executive positions, which partially offset these reductions.

Research and development (R&D) expense consists primarily of direct personnel costs for pre-production evaluation and testing of new products, prototypes, and applications. R&D expense was relatively flat as a percentage of value-added sales at approximately 2% in both the third quarter of 2015 and 2014.

Other-net was \$1.6 million of expense in the third quarter of 2015 as compared to \$0.6 million of income in the third quarter of 2014. The main factor impacting the movement in Other-net was the recognition of a \$4.0 million insurance gain in 2014 related to a settlement with a contractor for a dispute regarding construction of the Company's beryllium pebble facility. In addition, we recognized \$1.3 million of foreign currency exchange gains in the third quarter of 2015 versus \$0.5 million of foreign currency exchange gains in the third quarter of 2014. Refer to Note I to the Consolidated Financial Statements for details of the major components within Other-net.

Interest expense - net was \$0.6 million in the third quarter of 2015 and \$0.7 million in third quarter of 2014.

Income tax expense for the third quarter of 2015 was \$2.7 million versus \$4.4 million in the third quarter of 2014. The effective tax rates for the third quarter of 2015 and 2014 were 27.5% and 25.5%, respectively. The effects of percentage depletion, production deduction, foreign source income, and discrete items were the primary factors for the difference between the effective and statutory rates in the third quarter of 2015 and 2014.

Nine Months

Net sales of \$811.2 million in the first nine months of 2015 were \$27.3 million, or 3% below the \$838.5 million recorded in the first nine months of 2014. The decrease in net sales in the first nine months of 2015 was due to lower pass-through precious metal and copper prices and the negative impact of foreign exchange rates, partially offset by higher sales volume. Changes in precious metal and copper prices negatively impacted net sales in the first nine months of 2015 by approximately \$42.6 million when compared to the first nine months of 2014. The strengthening of the U.S. dollar, primarily against the euro and yen, had a negative impact of approximately \$12.4 million on net sales in the first nine months of 2015 versus the comparable period in 2014.

Value-added sales of \$473.8 million in the first nine months of 2015 increased \$3.7 million, or 1% compared to the first nine months of 2014. The impact of foreign exchange rate movements of \$8.2 million negatively impacted value-added sales by 2% in the first nine months of 2015 versus the same period in 2014. The year-over-year improvement in value-added sales was primarily driven by sales growth in our industrial components and defense end markets, partially offset by lower sales to the energy and consumer electronics end markets. Value-added sales to the industrial components and defense end markets increased year-over-year 15% and 27%, respectively. Value-added sales to the energy and consumer electronics end markets decreased year-over-year 23% and 6%, respectively.

Gross margin in the first nine months of 2015 was \$147.7 million, or \$2.4 million below the \$150.1 million in gross margin recorded during the first nine months of 2014. Expressed as a percentage of value-added sales, gross margin decreased 70 basis points from 31.9% in the first nine months of 2014 to 31.2% in the first nine months of 2015. The decrease in gross margin was primarily due to the negative impact of foreign exchange, partially offset by sales volume increases.

Selling, general, and administrative (SG&A) expense was \$101.6 million in the first nine months of 2015, relatively flat compared to \$100.6 million over the first nine months of 2014. SG&A expense increased primarily due to higher domestic pension expense and charges related to cost reduction initiatives, partially offset by a decrease in annual incentive compensation expense. Domestic pension expense increased in the first nine months of 2015 as compared to the same period in 2014 due to a lower discount rate used to measure the liability as of December 31, 2014, as well as new mortality rate assumptions that assume retirees are living longer. We also recorded \$1.2 million of expense in the first nine months of 2015 for headcount reductions in our Precision Coatings group within our Other reportable

segment and the elimination of executive positions. Annual incentive compensation expense was lower in the first nine months of 2015 versus the same period in 2014 due to a reduction in operating profit.

Research and development (R&D) expense consists primarily of direct personnel costs for pre-production evaluation and testing of new products, prototypes, and applications. R&D expense was flat as a percentage of value-added sales at approximately 2% in both the first nine months of 2015 and 2014.

Other-net totaled \$0.5 million of income in the first nine months of 2015 as compared to \$3.2 million of income in the first nine months of 2014. Other-net in the first nine months of 2015 included recognized gains of \$5.6 million from insurance and legal settlement agreements on claims in connection with the construction of our beryllium pebble facility in Elmore, Ohio, as well as \$4.6 million of foreign currency exchange gains. Other-net in the first nine months of 2014 included a \$6.8 million insurance recovery related to a theft claim associated with a precious metal inventory loss at our Albuquerque, New Mexico facility in 2012, a \$4.0 million gain related to a legal settlement with a contractor for a dispute regarding construction of the Company's beryllium pebble facility, and a net gain of \$2.4 million related to the sale of used equipment. Refer to Note I to the Consolidated Financial Statements for details of the major components within Other-net.

Interest expense - net was \$1.9 million in the first nine months of 2015 and \$2.1 million in the first nine months of 2014.

Income tax expense for the first nine months of 2015 was \$9.9 million versus \$11.2 million in the first nine months of 2014. The effective tax rates for the first nine months of 2015 and 2014 were comparable at 27.9% and 27.3%, respectively. The effects of percentage depletion, production deduction, and foreign source income were the primary factors for the difference between the effective and statutory rates in the first nine months of 2015 and 2014.

Value-Added Sales - Reconciliation of Non-GAAP Measure

A reconciliation of net sales to value-added sales, a non-GAAP measure, for each reportable segment and for the total Company for the third quarter and first nine months of 2015 and 2014 is as follows:

(Millions)	Third Quarter Ended		Nine Months Ended	
	Oct. 2, 2015	Sept. 26, 2014	Oct. 2, 2015	Sept. 26, 2014
Net sales				
Performance Alloys and Composites	\$93.6	\$114.2	\$304.5	\$321.0
Advanced Materials	113.6	137.6	394.9	412.0
Other	37.2	39.8	111.8	105.5
Total	\$244.4	\$291.6	\$811.2	\$838.5
Less: pass-through metal costs				
Performance Alloys and Composites	\$14.0	\$19.5	\$47.8	\$56.4
Advanced Materials	69.1	91.5	251.9	279.3
Other	12.5	15.0	37.7	32.7
Total	\$95.6	\$126.0	\$337.4	\$368.4
Value-added sales				
Performance Alloys and Composites	\$79.6	\$94.7	\$256.7	\$264.6
Advanced Materials	44.5	46.1	143.0	132.7
Other	24.7	24.8	74.1	72.8
Total	\$148.8	\$165.6	\$473.8	\$470.1

The cost of gold, silver, platinum, palladium, and copper can be quite volatile. Our pricing policy is to directly pass the cost of these metals to the customer in order to mitigate the impact of metal price volatility on our results from operations. Trends and comparisons of net sales are affected by movements in the market prices of these metals, but changes in net sales due to metal price movements may not have a proportionate impact on our profitability.

Internally, management reviews net sales on a value-added basis. Value-added sales are a non-GAAP measure that deducts the value of the pass-through metal costs from net sales. The reporting of value-added sales allows management to assess the

impact of differences in net sales between periods, segments, or markets, and analyze the resulting margins and profitability without the distortion of movements in pass-through metal costs. The dollar amount of gross margin and operating profit is not affected by the value-added sales calculation. We sell other metals and materials that are not considered direct pass-throughs, and these costs are not deducted from net sales when calculating value-added sales. Our net sales are also affected by changes in the use of customer-supplied metal. When we manufacture a precious metal product, the customer may purchase metal from us or may elect to provide their own metal, in which case we process the metal on a toll basis and the metal value does not flow through net sales or cost of sales. In either case, we generally earn our margin based upon our fabrication efforts. The relationship of this margin to net sales can change depending upon whether or not the product was made from metal owned by us or the customer's metal. The use of value-added sales removes the potential distortion in the comparison of net sales caused by changes in the level of customer-supplied metal.

By presenting information for net sales and value-added sales, it is our intention to allow users of our financial statements to review our net sales with and without the impact of the pass-through metals.

Segment Results

The Company consists of three reportable segments: Performance Alloys and Composites, Advanced Materials, and Other. The Other reportable segment includes the results of our Precision Optics and Large Area Coatings operating segments, which do not meet the quantitative thresholds for separate disclosure and are collectively referred to as our Precision Coatings group. The Other reportable segment also includes unallocated corporate costs. Refer to Note G to the Consolidated Financial Statements for additional business segment information.

Performance Alloys and Composites

(Millions)	Third Quarter Ended		Nine Months Ended	
	Oct. 2, 2015	Sept. 26, 2014	Oct. 2, 2015	Sept. 26, 2014
Net sales	\$93.6	\$114.2	\$304.5	\$321.0
Value-added sales	79.6	94.7	256.7	264.6
Operating profit	4.5	10.8	20.7	23.3

Third Quarter

Net sales from the Performance Alloys and Composites segment of \$93.6 million in the third quarter of 2015 were 18% lower than net sales of \$114.2 million in the third quarter of 2014 due primarily to lower sales volume and the negative impact of foreign exchange rate movements of \$2.9 million, primarily related to the strengthening of the U.S. dollar versus the euro and yen. Net sales to the energy, medical, and consumer electronics end markets were the main drivers of lower sales, partially offset by higher sales to the defense and industrial components end markets. Net sales to the energy market were lower due to a significant decline in exploration in the oil and gas sector of the market. Medical end market sales were down due to discrete shipments made in the third quarter of 2014 related to the nuclear medicine segment of the market that did not recur in 2015. Net sales to the consumer electronics end market were lower due to weaker customer demand, particularly in Asia. Defense end market sales were higher due to the timing of government spending and related programs, and industrial components end market sales increased due to stronger sales of specialty metal alloys and products into the plastics segments of the market.

Value-added sales of \$79.6 million in the third quarter of 2015 were 16% lower than value-added sales of \$94.7 million in the third quarter of 2014 due to the aforementioned impacts on end market sales.

The Performance Alloys and Composites segment generated operating profit of \$4.5 million in the third quarter of 2015 compared to \$10.8 million in the third quarter of 2014. As a percentage of net sales, operating profit was 4.8% and 9.5% in the third quarter of 2015 and 2014, respectively. The decrease in operating profit in the third quarter of 2015 versus the comparable period of 2014 was due primarily to a reduction in gross margin from the negative impact of foreign currency and lower sales

volume. These decreases were partially offset by foreign currency hedge gains of \$1.4 million, which mitigated a portion of the negative impact of foreign exchange rate movements on net sales and gross margin.

Nine Months

Net sales from the Performance Alloys and Composites segment of \$304.5 million in the first nine months of 2015 were 5% lower than net sales of \$321.0 million in the first nine months of 2014 due primarily to the negative impact of foreign exchange rate movements of \$9.6 million, primarily related to the strengthening of the U.S. dollar versus the euro and yen, and lower copper prices on average in the first nine months of 2015 as compared to the comparable period of 2014, which lowered metal pass-through prices by an estimated \$5.1 million. From an end market perspective, net sales to the energy and medical end markets were weaker, partially offset by higher sales to the industrial components and defense end markets. Net sales to the energy end market were lower due to a significant decline in exploration in the oil and gas sector of the market. Medical end market sales were down primarily due to discrete shipments made in the first nine months of 2014 related to the nuclear medicine segment of the market. Increased sales to the industrial components end market were due to higher shipments to the plastics, foundry, and construction segments of the market. Defense end market sales were higher due to the timing of government spending and related programs.

Value-added sales of \$256.7 million in the first nine months of 2015 were 3% lower than value-added sales of \$264.6 million in the first nine months of 2014. The impact of foreign exchange rate movements negatively impacted value-added sales by 3% for the first nine months of 2015 as compared to the first nine months of 2014 due to the aforementioned impacts on end market sales.

The Performance Alloys and Composites segment generated operating profit of \$20.7 million in the first nine months of 2015 compared to \$23.3 million in the first nine months of 2014. As a percentage of net sales, operating profit was 6.8% and 7.3% in the first nine months of 2015 and 2014, respectively. The decrease in operating profit in the first nine months of 2015 versus the comparable period of 2014 was due primarily to the negative impact of foreign exchange rate movements of \$8.6 million. This decrease was partially offset by foreign currency hedge gains of \$4.6 million recorded in the first nine months of 2015, which partially offset the negative impact of foreign exchange rate movements on net sales and gross margin.

Advanced Materials

(Millions)	Third Quarter Ended		Nine Months Ended	
	Oct. 2, 2015	Sept. 26, 2014	Oct. 2, 2015	Sept. 26, 2014
Net sales	\$113.6	\$137.6	\$394.9	\$412.0
Value-added sales	44.5	46.1	143.0	132.7
Operating profit	7.0	7.8	23.3	25.5

Third Quarter

Net sales from the Advanced Materials segment of \$113.6 million in the third quarter of 2015 were 17% lower than net sales of \$137.6 million in the third quarter of 2014 due to the impact of lower pass-through metal prices of \$14.4 million in the third quarter of 2015 as compared to 2014 and lower sales volume.

Value-added sales of \$44.5 million in the third quarter of 2015 were 3% lower than value-added sales of \$46.1 million in the third quarter of 2014. The decrease in value-added sales was primarily driven by lower value-added sales to the consumer electronics end market, partially offset by smaller increases across several end markets. Value-added sales to the consumer electronics end market decreased \$2.3 million, or 10%, in the third quarter of 2015 versus the comparable period of 2014 due to weaker customer demand for handset devices.

The Advanced Materials segment generated operating profit of \$7.0 million in the third quarter of 2015 compared to \$7.8 million in the third quarter of 2014. As a percentage of value-added sales, operating profit was 15.7% and 16.9% in the third

quarter of 2015 and 2014, respectively. The decrease in operating profit in the third quarter of 2015 versus the comparable period of 2014 was due to lower sales volume.

Nine Months

Net sales from the Advanced Materials segment of \$394.9 million in the first nine months of 2015 were 4% lower than net sales of \$412.0 million in the first nine months of 2014 due to the impact lower pass-through metal prices of \$32.9 million in the first nine months of 2015 as compared to 2014, partially offset by higher sales volume.

Value-added sales of \$143.0 million in the first nine months of 2015 were 8% higher than value-added sales of \$132.7 million in the first nine months of 2014. Higher value-added sales were recorded across all end markets as compared to the prior year, led by growth in the industrial components and energy end markets. Value-added sales to the industrial components end market increased \$2.7 million, or 20%, in the first nine months of 2015 versus the comparable period of 2014 due primarily to strong demand in the display components segment of the market. Energy end market value-added sales increased \$2.4 million, or 26%, in the first nine months of 2015 as compared to the first nine months of 2014 as a result of stronger demand from the construction and solar segments of the market.

The Advanced Materials segment generated operating profit of \$23.3 million in the first nine months of 2015 compared to \$25.5 million in the first nine months of 2014. As a percentage of value-added sales, operating profit was 16.3% and 19.2% in the first nine months of 2015 and 2014, respectively. The decline in operating profit in the first nine months of 2015 versus the comparable period of 2014 was due to the recognition in 2014 of a \$6.8 million insurance recovery related to a theft claim associated with a precious metal inventory loss at our Albuquerque, New Mexico facility in 2012. Improved value-added sales growth partially offset this impact.

Other

(Millions)	Third Quarter Ended		Nine Months Ended	
	Oct. 2, 2015	Sept. 26, 2014	Oct. 2, 2015	Sept. 26, 2014
Net sales	\$37.2	\$39.8	\$111.8	\$105.5
Value-added sales	24.7	24.8	74.1	72.8
Operating profit (loss)	(1.3)	(0.9)	(6.8)	(5.6)

Third Quarter

The Other reportable segment in total includes the operating results of the Precision Coatings group and unallocated corporate costs.

Net sales for the Other reportable segment totaled \$37.2 million in the third quarter of 2015 and \$39.8 million in the third quarter of 2014. Including unallocated corporate costs, the Other reportable segment had an operating loss of \$1.3 million in the third quarter of 2015 compared to an operating loss of \$0.9 million in the third quarter of 2014.

Within the Other reportable segment, net sales for the Precision Coatings group were \$37.2 million in the third quarter of 2015 as compared to \$39.9 million in the third quarter of 2014, and value-added sales for the third quarter of 2015 and 2014 were \$25.7 million and \$27.0 million, respectively. The decrease in net sales and value-added sales was due to lower sales to the consumer electronics end market, partially offset by higher sales to all other end markets.

Consumer electronics end market sales were down due primarily to continued weakness in the projector display segment of the market.

Within the Other reportable segment, the Precision Coatings group reported an operating profit of \$2.3 million in the third quarter of 2015 as compared to \$2.1 million in the third quarter of 2014. Operating profit increased due to improved product mix, which more than offset \$1.3 million of expense recorded primarily for headcount reductions to respond to weakening demand in the projector display segment of the consumer electronics end market.

Within the Other reportable segment, corporate reported operating expense of \$3.6 million and \$3.0 million in the third quarter of 2015 and 2014, respectively. Operating expense in 2015 included \$0.5 million for the elimination of executive positions.

Nine Months

Net sales for the Other reportable segment totaled \$111.8 million in the first nine months of 2015 and \$105.5 million in the first nine months of 2014. Including unallocated corporate costs, the Other reportable segment had an operating loss of \$6.8 million in the first nine months of 2015 compared to an operating loss of \$5.6 million in the first nine months of 2014.

Within the Other reportable segment, net sales for the Precision Coatings group were \$112.0 million in the first nine months of 2015 as compared to \$107.9 million in the first nine months of 2014, and value-added sales for the first nine months of 2015 and 2014 were \$75.4 million and \$75.9 million, respectively. From an end market perspective, significant changes were recorded in the medical and consumer electronics end markets. Medical end market sales were up due to an increase in sales of precision precious metal-coated polymer films for blood glucose test strip applications. Lower sales to the consumer electronics end market were due to weakness in the projector display segment of the market.

Within the Other reportable segment, the Precision Coatings group reported an operating profit of \$4.5 million in the first nine months of 2015 as compared to \$6.7 million in the first nine months of 2014. The decrease in operating profit was primarily attributed to a \$2.6 million gain on the sale of used equipment in the first nine months of 2014. Operating profit in 2015 also included \$1.3 million of expense recorded primarily for headcount reductions to respond to weakening demand in the projector display segment of the consumer electronics end market. Improved sales volume and product mix in 2015 offset these unfavorable changes.

Within the Other reportable segment, corporate reported operating expense of \$11.3 million and \$12.3 million in the first nine months of 2015 and 2014, respectively. The reduction in operating expense was due to the recognition of insurance and legal settlement gains in 2015 of \$5.6 million mentioned previously, as compared to a legal settlement gain of \$4.0 million in 2014. This gain was partially offset by higher domestic pension expense, and \$0.5 million of severance costs associated with cost reduction initiatives.

LEGAL

One of our subsidiaries, Materion Brush Inc., is a defendant from time to time in proceedings in various state and federal courts brought by plaintiffs alleging that they have contracted chronic beryllium disease or other lung conditions as a result of exposure to beryllium. Plaintiffs in beryllium cases generally seek recovery under negligence and various other legal theories and seek compensatory and punitive damages, in many cases of an unspecified sum. Spouses, if any, often claim loss of consortium.

There was one chronic beryllium disease (CBD) case outstanding as of the end of the third quarter of 2015. This case was filed in 2013. The Company does not expect the resolution of this matter to have a material impact on the consolidated financial statements. During the third quarter, in one case, which was filed during the second quarter of 2015, the court granted the demurrer filed by the Company, and dismissed all claims against the Company, without leave to amend the complaint. The case is subject to appeal.

Additional beryllium claims may arise. Employee cases, in which plaintiffs have a high burden of proof, have historically involved relatively small losses to us. Third-party plaintiffs (typically employees of customers or contractors) face a lower burden of proof than do employees or former employees, but these cases are generally covered by varying levels of insurance.

Although it is not possible to predict the outcome of any litigation, we provide for costs related to these matters when a loss is probable, and the amount is reasonably estimable. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably in amounts exceeding our reserves. An unfavorable outcome or settlement of a beryllium case or adverse media coverage could encourage the commencement of additional similar litigation. We are unable to estimate our potential exposure to unasserted claims.

Based upon currently known facts and our experience with beryllium cases and assuming collectability of insurance, we do not believe that resolution of future beryllium proceedings will have a material adverse effect on our financial condition or cash flow. However, our results of operations could be materially affected by unfavorable results in one or more of these cases in the future.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are cash and cash equivalents, available lines of credit under the revolving credit facility, and cash flows from operating activities. We believe funds from operations plus the available borrowing capacity and the current cash balance are adequate to support operating requirements, capital expenditures, projected pension plan contributions, the payment of quarterly dividends, share repurchases, environmental remediation projects, and strategic acquisitions.

As of October 2, 2015, we had \$24.8 million of cash and cash equivalents, and the majority of our cash and cash equivalents reside outside the United States. Repatriation of these funds could result in potential foreign and domestic taxes. However, we do not intend or foresee a need to repatriate these funds to the United States.

The largest capital project during the first nine months of 2015 related to mine development activities. We commenced the opening of a new pit to mine proven reserves of beryllium-bearing bertrandite ore in Juab County, Utah. We expect total capital expenditures in 2015 related to this project to be in the range of \$20.0 to \$25.0 million. The remaining capital spending related to smaller projects includes future business opportunities, productivity, facility and equipment modernization, and other infrastructure projects.

The available and unused borrowing capacity under the existing lines of credit, which is subject to limitations set forth in our debt covenants, was \$319.8 million as of October 2, 2015. Our revolving line of credit matures in 2018.

Mandatory long-term debt payments in 2015 total \$0.7 million. We were in compliance with all of our debt covenants as of October 2, 2015.

The available and unused capacity under the off-balance sheet consignment lines and authorized limits established by our Board of Directors totaled \$222.6 million as of October 2, 2015.

In January 2014, our Board of Directors approved a plan to repurchase up to \$50.0 million of our common stock. The timing of the share purchases will depend on several factors, including market and business conditions, our cash flow, debt levels, and other investment opportunities. There is no minimum required purchase quantity for a given year, and the purchases may be discontinued at any time. We purchased 212,165 shares at a cost of \$7.1 million in the first nine months of 2015. Since the approval of the repurchase plan, we have purchased 902,504 shares at a total cost of \$29.4 million.

We paid dividends to our shareholders totaling \$5.3 million in the first nine months of 2015. Our Board of Directors increased the quarterly dividend from \$0.085 per share to \$0.09 per share in the second quarter of 2015. We intend to pay a quarterly dividend on an ongoing basis, subject to a determination that the dividend remains in the best interest of our shareholders.

CASH FLOWS

Summary of Cash flows for the nine months ended October 2, 2015 and September 26, 2014

(Millions)	Nine Months Ended		
	Oct. 2, 2015	Sept. 26, 2014	\$ Change
Net cash provided by operating activities	\$44.8	\$21.0	\$23.8
Net cash (used in) investing activities	(41.0)	(17.4)	(23.6)
Net cash provided by (used in) financing activities	8.8	(6.6)	15.4
Effects of exchange rate changes	(0.9)	(0.2)	(0.7)
Net change in cash and cash equivalents	\$11.7	\$(3.2)	\$14.9

Net cash provided by operating activities totaled \$44.8 million in the first nine months of 2015 versus \$21.0 million provided by operating activities in the comparable prior-year period. The difference between periods is due primarily to lower working capital requirements in 2015 as compared to 2014. For the first nine months of 2015, the decrease in inventory was due to working capital reduction initiatives, primarily in the Performance Alloys and Composites segment. The use of cash of \$19.3 million for accounts payable and accrued expenses in 2015 is due primarily to year-end incentive compensation payments and the timing of payments. Net income generated in the first nine months of 2015 more than offset working capital requirements.

Net cash used in investing activities was \$41.0 million in the first nine months of 2015 compared to \$17.4 million in the prior-year corresponding period. The increase in the first nine months of 2015 was due to a significant increase in mine development activities as previously mentioned. In addition, we received approximately \$3.1 million of cash proceeds in the first nine months of 2014 for the sale of used equipment, and there were no significant asset sales in the first nine months of 2015.

Net cash provided by financing activities totaled \$8.8 million in the first nine months of 2015 versus net cash used in financing activities of \$6.6 million in the prior-year corresponding period. There were higher borrowings in 2015 to fund mine development activities and a decrease in the amount of share repurchases in 2015 as compared to 2014.

DEBT

We ended the third quarter of 2015 with \$46.3 million in debt, an increase of \$22.0 million from the year-end 2014 balance of \$24.3 million. The increase in debt was used primarily to fund our capital expenditures and seasonal working capital requirements.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

We maintain the majority of the precious metals we use in production and a portion of our copper requirements on a consignment basis in order to reduce our exposure to metal price movements and to reduce our working capital investment. The notional value of off-balance sheet precious metals was \$231.2 million as of October 2, 2015 versus \$310.6 million as of December 31, 2014. We were in compliance with all of the covenants contained in the consignment agreements as of October 2, 2015 and December 31, 2014. For additional information on our contractual obligations, refer to page 35 of our Form 10-K for the year ended December 31, 2014.

CRITICAL ACCOUNTING POLICIES

For additional information regarding critical accounting policies, please refer to pages 38 to 41 of our Form 10-K for the year ended December 31, 2014. There have been no material changes in our critical accounting policies subsequent to the issuance of our Form 10-K.

OUTLOOK

We continue our focus on new product introductions and maintaining an active pipeline of new product development and technologies. We believe that these new products and applications will be key to sustaining our growth. We continue to manage headwinds related to a few end markets and global financial markets. As expected, our net sales to the energy end market, in particular oil and gas exploration, were lower in the third quarter of 2015 as compared to recent quarters, and we expect this market to remain weak the remainder of the year. In addition, from a macroeconomic perspective, the continued strength of the U.S. dollar, particularly against the euro and yen, negatively impacts our net sales and operating profit and provides for increased competitive pricing pressures. Global financial markets also remain volatile, and China continues to experience an economic slowdown. We are experiencing the pullback in demand related to the build out of the 4G telecommunications infrastructure, which was strong in the first half of 2015. We expect this demand slowdown to continue for the remainder of 2015.

Forward-looking Statements

Portions of the narrative set forth in this document that are not statements of historical or current facts are forward-looking statements. Our actual future performance may materially differ from that contemplated by the forward-looking statements as a result of a variety of factors. These factors include, in addition to those mentioned elsewhere herein:

Actual net sales, operating rates, and margins for 2015;

Our ability to strengthen our internal control over financial reporting and disclosure controls and procedures;

The global economy;

The impact of any U.S. Federal Government shutdowns and sequestrations;

The condition of the markets which we serve, whether defined geographically or by segment, with the major market segments being: consumer electronics, industrial components, medical, automotive electronics, energy, telecommunications infrastructure, defense, commercial aerospace and science;

Changes in product mix and the financial condition of customers;

Our success in developing and introducing new products and new product ramp-up rates;

Our success in passing through the costs of raw materials to customers or otherwise mitigating fluctuating prices for those materials, including the impact of fluctuating prices on inventory values;

Our success in integrating acquired businesses;

The impact of the results of acquisitions on our ability to achieve fully the strategic and financial objectives related to these acquisitions;

Our success in implementing our strategic plans and the timely and successful completion and start-up of any capital projects;

The availability of adequate lines of credit and the associated interest rates;

Other financial factors, including the cost and availability of raw materials (both base and precious metals), physical inventory valuations, metal financing fees, tax rates, exchange rates, pension costs and required cash contributions and other employee benefit costs, energy costs, regulatory compliance costs, the cost and availability of insurance, and the impact of the Company's stock price on the cost of incentive compensation plans;

The uncertainties related to the impact of war, terrorist activities, and acts of God;

Changes in government regulatory requirements and the enactment of new legislation that impacts our obligations and operations;

The conclusion of pending litigation matters in accordance with our expectation that there will be no material adverse effects;

•The success of the realignment of our businesses; and

•The risk factors set forth in Part 1, Item 1A of our Form 10-K for the year ended December 31, 2014.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For information regarding market risks, refer to pages 43 and 44 of our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes in our market risks since the inclusion of this discussion in our Annual Report on Form 10-K.

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures

The Company carried out an evaluation under the supervision and with participation of our management, including the chief executive officer and chief financial officer, of the effectiveness of the design and operation of disclosure controls and procedures as of October 2, 2015 pursuant to Rule 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). Based upon that evaluation, management, including the chief executive officer and chief financial officer, concluded that disclosure controls and procedures were not effective due to a material weakness in the Company's internal control over financial reporting that existed as of October 2, 2015, as described below.

b) Management's Report on Internal Control over Financial Reporting

During the third quarter 2015, the Company identified a deficiency in the Company's internal control over financial reporting that constitutes a material weakness as of October 2, 2015. Specifically, management's review controls were not designed properly to detect errors in the manner in which the Company had been amortizing stock compensation expense for retirement eligible employees. This deficiency allowed errors to go undetected, and management has assessed the potential magnitude and concluded this represents a material weakness in the Company's internal control over financial reporting (refer to Note B in the Consolidated Financial Statements for further details) as of October 2, 2015. Despite the existence of this material weakness, the Company believes the financial information presented herein is materially correct and in accordance with generally accepted accounting principles.

During the fourth quarter of 2015, specific actions are being implemented to remediate the above identified material weakness including: improving processes, implementing additional controls and strengthening management's review controls.

c) Changes in Internal Control over Financial Reporting

There has been no change in the Company's internal control over financial reporting that occurred during the most recent quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Our subsidiaries and our holding company are subject, from time to time, to a variety of civil and administrative proceedings arising out of our normal operations, including, without limitation, product liability claims, health, safety and environmental claims and employment-related actions. Among such proceedings are cases alleging that plaintiffs have contracted, or have been placed at risk of contracting, beryllium sensitization or chronic beryllium disease (CBD) or other lung conditions as a result of exposure to beryllium (“beryllium cases”). The plaintiffs in beryllium cases seek recovery under negligence and various other legal theories and demand compensatory and often punitive damages, in many cases of an unspecified sum. Spouses of some plaintiffs claim loss of consortium.

Beryllium Claims

As of October 2, 2015, our subsidiary, Materion Brush Inc., was a defendant in one beryllium case, as described more fully below.

The Company is one of five defendants in a case filed on October 4, 2013 in the Superior Court of the State of Arizona, Maricopa County, titled Parmar et al. v. Dolphin, Inc. et al., CV 2013-012980. One plaintiff alleges that he contracted CBD from exposures that resulted from his employment at manufacturing facilities of Karsten Manufacturing Corporation (Karsten) in Arizona, and asserts claims for negligence, strict liability, and fraudulent concealment. His wife claims a loss of consortium. Another plaintiff alleges that he has been diagnosed with beryllium sensitization that resulted from his employment at Karsten, and asserts a claim for medical monitoring. Plaintiffs seek compensatory and punitive damages and/or medical monitoring in unspecified sums.

The Company was one of six defendants in a case filed on April 7, 2015 in the Superior Court of the State of California, Los Angeles County, titled Godoy et al. v. The Argen Corporation et al., BC578085. This is a survival and wrongful death complaint. The complaint alleged that the decedent worked at H. Kramer & Co. in California and alleged that he worked as a dental lab technician at various dental labs in California, and that he suffered from CBD and other injuries as a result of grinding, melting and handling beryllium-containing products. The complaint alleged causes of action for negligence, strict liability - failure to warn, strict liability - design defect, fraudulent concealment, and breach of implied warranties. Plaintiffs sought punitive damages in connection with the strict liability and fraudulent concealment causes of action. The survival action sought all damages sustained by decedent that he would have been entitled to recover had he lived, including punitive damages. The Company filed a demurrer on May 29, 2015. At a hearing on September 29, 2015, the court granted the demurrer, dismissing all claims against the Company, without leave to amend the complaint. The case is subject to appeal.

The Company has some insurance coverage, subject to an annual deductible.

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

During the three months ended October 2, 2015, we repurchased 140,290 shares under our stock buyback program at an average price of \$31.23.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs (1)
July 4 through August 7, 2015	33,490	\$33.44	33,490	\$23,849,357
August 8 through September 4, 2015	48,000	30.66	48,000	22,377,645
September 5 through October 2, 2015	58,800	30.43	58,800	20,588,268
Total	140,290	\$31.23	140,290	\$20,588,268

(1) On January 14, 2014, we announced that our Board of Directors had authorized the repurchase of up to \$50.0 million of our common stock. As of October 2, 2015, \$20.6 million may still be purchased under the program.

Item 4. Mine Safety Disclosures

Information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K (17 CFR 229.104) is included in Exhibit 95 to this quarterly report on Form 10-Q.

Item 6. Exhibits

- 11 Statement regarding computation of per share earnings.
- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or 15d-14(a).
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or 15d-14(a).
- 32 Certifications of Chief Executive Officer and Chief Financial Officer required by 18 U.S.C. Section 1350.
- 95 Mine Safety Disclosure Pursuant to Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act for the period ended October 2, 2015.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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.

MATERION CORPORATION

Dated: November 2, 2015

/S/ JOSEPH P. KELLEY

Joseph P. Kelley
Vice President, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

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*	Submitted electronically herewith.