

American Reprographics CO  
Form 10-Q  
November 08, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from            to

Commission File Number: 001-32407

**AMERICAN REPROGRAPHICS COMPANY**

(Exact name of Registrant as specified in its Charter)

Edgar Filing: American Reprographics CO - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-1700361**  
(I.R.S. Employer  
Identification No.)

**1981 N. Broadway, Suite 385**  
**Walnut Creek, California 94596**  
**(925) 949-5100**

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of November 3, 2012, there were 46,285,092 shares of the issuer's common stock outstanding.

**Table of Contents**

**AMERICAN REPROGRAPHICS COMPANY**

**Form 10-Q**

**For the Quarter Ended September 30, 2012**

**Table of Contents**

**PART I FINANCIAL INFORMATION**

Item 1.	<u>Condensed Consolidated Financial Statements</u>	4
	<u>Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011</u>	4
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011</u>	5
	<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2012 and 2011</u>	6
	<u>Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2012 and 2011</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 4.	<u>Controls and Procedures</u>	41

**PART II OTHER INFORMATION**

Item 1.	<u>Legal Proceedings</u>	42
Item 1A.	<u>Risk Factors</u>	42
Item 6.	<u>Exhibits</u>	43
	<u>Signatures</u>	44
	<u>Exhibit Index</u>	45
	Exhibit 31.1	
	Exhibit 31.2	
	Exhibit 32.1	
	Exhibit 32.2	
	EX-101 INSTANCE DOCUMENT	
	EX-101 SCHEMA DOCUMENT	
	EX-101 CALCULATION LINKBASE DOCUMENT	
	EX-101 LABELS LINKBASE DOCUMENT	
	EX-101 PRESENTATION LINKBASE DOCUMENT	

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains statements that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Form 10-Q, the words believe, expect, anticipate, estimate, intend, plan, project, target, likely, will, variations of such words and similar expressions as they relate to our management or to American Reprographics Company ( the Company ) are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those contemplated herein. We have described in Part II, Item 1A- Risk Factors a number of factors that could cause our actual results to differ from our projections or estimates. These factors and other risk factors described in this Form 10-Q are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. Consequently, there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, us. Given these uncertainties, you are cautioned not to place undue reliance on such forward-looking statements.

Except where otherwise indicated, the statements made in this Form 10-Q are made as of the date we filed this report with the United States Securities and Exchange Commission ( SEC ) and should not be relied upon as of any subsequent date. All future written and verbal forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We undertake no obligation, and specifically disclaim any obligation, to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You should, however, consult further disclosures we make in future filings of our Forms 10-K, Forms 10-Q, and Forms 8-K, and any amendments thereto, as well as our proxy statements.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements  
AMERICAN REPROGRAPHICS COMPANY****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

<b>(In thousands, except per share amounts)</b>	<b>September 30, 2012</b>	<b>December 31, 2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 30,534	\$ 25,437
Accounts receivable, net of allowances for accounts receivable of \$3,050 and \$3,309	57,698	54,713
Inventories, net	14,450	12,107
Prepaid expenses	4,699	3,999
Other current assets	8,080	7,541
<b>Total current assets</b>	<b>115,461</b>	<b>103,797</b>
Property and equipment, net of accumulated depreciation of \$199,871 and \$191,598	56,408	55,084
Goodwill	212,608	229,315
Other intangible assets, net	36,308	45,127
Deferred financing costs, net	4,495	4,574
Deferred income taxes	1,293	1,368
Other assets	2,196	2,092
<b>Total assets</b>	<b>\$ 428,769</b>	<b>\$ 441,357</b>
<b>Liabilities and Equity</b>		
Current liabilities:		
Accounts payable	\$ 21,335	\$ 21,787
Accrued payroll and payroll-related expenses	9,906	7,292
Accrued expenses	26,440	19,308
Current portion of long-term debt and capital leases	13,987	15,005
<b>Total current liabilities</b>	<b>71,668</b>	<b>63,392</b>
Long-term debt and capital leases	210,245	211,259
Deferred income taxes	28,114	26,447
Other long-term liabilities	3,107	3,194
<b>Total liabilities</b>	<b>313,134</b>	<b>304,292</b>
Commitments and contingencies (Note 6)		
Stockholders' equity:		
American Reprographics Company stockholders' equity:		
Preferred stock, \$0.001 par value, 25,000 shares authorized; 0 shares issued and outstanding		
Common stock, \$0.001 par value, 150,000 shares authorized; 46,285 and 46,235 shares issued and outstanding	46	46
Additional paid-in capital	101,968	99,728
Retained earnings	6,591	32,663

## Edgar Filing: American Reprographics CO - Form 10-Q

Accumulated other comprehensive income (loss)	437	(1,760)
Total American Reprographics Company stockholders equity	<b>109,042</b>	130,677
Noncontrolling interest	<b>6,593</b>	6,388
Total equity	<b>115,635</b>	137,065
Total liabilities and equity	<b>\$ 428,769</b>	<b>\$ 441,357</b>

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

Table of Contents

**AMERICAN REPROGRAPHICS COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Reprographics services	\$ 58,720	\$ 65,529	\$ 186,029	\$ 206,011
Facilities management	27,116	25,505	81,262	75,304
Equipment and supplies sales	13,590	13,758	41,936	39,571
Total net sales	99,426	104,792	309,227	320,886
Cost of sales	70,178	70,868	214,348	217,881
Gross profit	29,248	33,924	94,879	103,005
Selling, general and administrative expenses	23,916	23,533	71,346	78,169
Amortization of intangible assets	1,846	4,654	9,244	14,119
Goodwill impairment	16,707	42,109	16,707	65,444
Loss from operations	(13,221)	(36,372)	(2,418)	(54,727)
Other income	(25)	(27)	(79)	(88)
Interest expense, net	6,982	7,743	21,675	23,609
Loss before income tax (benefit) provision	(20,178)	(44,088)	(24,014)	(78,248)
Income tax (benefit) provision	(84)	(2,392)	1,845	51,872
Net loss	(20,094)	(41,696)	(25,859)	(130,120)
(Income) loss attributable to noncontrolling interest	(18)	(61)	(213)	90
Net loss attributable to American Reprographics Company	\$ (20,112)	\$ (41,757)	\$ (26,072)	\$ (130,030)
Loss per share attributable to American Reprographics Company shareholders:				
Basic	\$ (0.44)	\$ (0.92)	\$ (0.57)	\$ (2.87)
Diluted	\$ (0.44)	\$ (0.92)	\$ (0.57)	\$ (2.87)
Weighted average common shares outstanding:				
Basic	45,716	45,416	45,641	45,366
Diluted	45,716	45,416	45,641	45,366

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

Table of Contents

## AMERICAN REPROGRAPHICS COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net loss	\$ (20,094)	\$ (41,696)	\$ (25,859)	\$ (130,120)
Other comprehensive income, net of tax				
Foreign currency translation adjustments, net of tax effect of \$(52) and \$(48) for the three and nine months ended September 30, 2012, respectively, and \$79 and \$19 for the three and nine months ended September 30, 2011, respectively.	270	(308)	281	275
Amortization of derivative, net of tax effect of \$289 and \$1,138 for the three and nine months ended September 30, 2012, respectively, and \$519 and \$1,633 for the three and nine months ended September 30, 2011, respectively.	486	871	1,908	2,737
Other comprehensive income, net of tax	756	563	2,189	3,012
Comprehensive loss	(19,338)	(41,133)	(23,670)	(127,108)
Comprehensive (loss) income attributable to noncontrolling interest	(9)	127	205	103
Comprehensive loss attributable to American Reprographics Company	\$ (19,329)	\$ (41,260)	\$ (23,875)	\$ (127,211)

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

**Table of Contents****AMERICAN REPROGRAPHICS COMPANY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

<b>(In thousands)</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>				
Net loss	\$ (20,094)	\$ (41,696)	\$ (25,859)	\$ (130,120)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Allowance for accounts receivable	128	329	532	746
Depreciation	7,143	7,057	21,266	22,244
Amortization of intangible assets	1,846	4,654	9,244	14,119
Amortization of deferred financing costs	276	225	812	662
Amortization of bond discount	156	140	453	407
Goodwill impairment	16,707	42,109	16,707	65,444
Stock-based compensation	554	517	1,457	3,775
Excess tax benefit related to stock-based compensation				(31)
Deferred income taxes	(3,797)	(5,009)	(4,301)	3,506
Deferred tax valuation allowance	3,854	1,379	6,766	65,719
Amortization of derivative, net of tax effect	486	871	1,908	2,737
Other non-cash items, net	(123)	(463)	(216)	(640)
Changes in operating assets and liabilities, net of effect of business acquisitions:				
Accounts receivable	2,796	206	(3,331)	(8,499)
Inventory	(1,081)	1,084	(2,666)	36
Prepaid expenses and other assets	(795)	942	(1,201)	(13,105)
Accounts payable and accrued expenses	5,973	5,272	9,308	2,490
<b>Net cash provided by operating activities</b>	<b>14,029</b>	<b>17,617</b>	<b>30,879</b>	<b>29,490</b>
<b>Cash flows from investing activities</b>				
Capital expenditures	(4,932)	(4,316)	(14,194)	(11,938)
Payment for swap transaction				(9,729)
Other	317	278	133	925
<b>Net cash used in investing activities</b>	<b>(4,615)</b>	<b>(4,038)</b>	<b>(14,061)</b>	<b>(20,742)</b>
<b>Cash flows from financing activities</b>				
Proceeds from stock option exercises			79	108
Proceeds from issuance of common stock under Employee Stock Purchase Plan		8	28	31
Excess tax benefit related to stock-based compensation				31
Payments on long-term debt agreements and capital leases	(3,575)	(5,618)	(12,041)	(19,719)
Net borrowings (repayments) under revolving credit facilities	1,424	(3,798)	1,041	10,822
Payment of deferred financing fees		(127)	(839)	(668)
<b>Net cash used in financing activities</b>	<b>(2,151)</b>	<b>(9,535)</b>	<b>(11,732)</b>	<b>(9,395)</b>
Effect of foreign currency translation on cash balances	(47)	3	11	308
<b>Net change in cash and cash equivalents</b>	<b>7,216</b>	<b>4,047</b>	<b>5,097</b>	<b>(339)</b>
Cash and cash equivalents at beginning of period	23,318	21,907	25,437	26,293

Edgar Filing: American Reprographics CO - Form 10-Q

Cash and cash equivalents at end of period	\$ 30,534	\$ 25,954	\$ 30,534	\$ 25,954
--------------------------------------------	-----------	-----------	-----------	-----------

**Supplemental disclosure of cash flow information**

**Noncash investing and financing activities**

Noncash transactions include the following:

Capital lease obligations incurred	\$ 1,781	\$ 2,023	\$ 8,511	\$ 7,476
Liabilities in connection with the acquisition of businesses	\$	\$ 1,371	\$	\$ 1,371

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

**Table of Contents**

**AMERICAN REPROGRAPHICS COMPANY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Description of Business and Basis of Presentation**

American Reprographics Company ( ARC or the Company ) is the nation's leading document solutions company for the architecture, engineering, and construction ( AEC ) industry. ARC is the largest company of its kind in the United States and offers managed print services, digital color printing, proprietary document management technology products and services, and conventional reprographic services. The Company conducts its operations through its wholly-owned operating subsidiary, American Reprographics Company, L.L.C., a California limited liability company, and its subsidiaries.

*Basis of Presentation*

The accompanying interim Condensed Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and in conformity with the requirements of the SEC. As permitted under those rules, certain footnotes or other financial information required by GAAP for complete financial statements have been condensed or omitted. In management's opinion, the accompanying interim Condensed Consolidated Financial Statements presented reflect all adjustments of a normal and recurring nature that are necessary to fairly present the interim Condensed Consolidated Financial Statements. All material intercompany accounts and transactions have been eliminated in consolidation. The operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the interim Condensed Consolidated Financial Statements and accompanying notes. The Company evaluates its estimates and assumptions on an ongoing basis and relies on historical experience and various other factors that it believes to be reasonable under the circumstances to determine such estimates. Actual results could differ from those estimates, and such differences may be material to the interim Condensed Consolidated Financial Statements.

These interim Condensed Consolidated Financial Statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes included in the Company's 2011 Form 10-K.

*Recent Accounting Pronouncements*

In September 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-08. The new guidance provides an entity the option, when testing for goodwill impairment, to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after performing a qualitative assessment, an entity determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment, and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). The adoption of ASU 2011-08 will have no impact to the Company's Condensed Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or present net income and other comprehensive income in two separate but consecutive statements. The Company adopted provisions of ASU 2011-05 effective January 1, 2012, and has presented a new statement titled Condensed Consolidated Statements of Comprehensive Income (Loss).

In May 2011, the FASB issued ASU 2011-04 which amends the accounting and disclosure requirements on fair value measurements. The new guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured at a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the new guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. The Company adopted provisions of ASU 2011-04 effective January 1, 2012, which did not have a material effect on its Condensed Consolidated Financial Statements.

*Segment Reporting*

The provisions of Accounting Standards Codification ( ASC ) 280, *Disclosures about Segments of an Enterprise and Related Information*, require public companies to report financial and descriptive information about their reportable operating segments. The Company identifies operating segments based on the various business activities that earn revenue and incur expense, whose operating results are reviewed by the chief operating decision maker. Based on the fact that operating segments have similar products and services, classes of customers, production processes and performance objectives, the Company is deemed to operate as a single reportable segment.

**Table of Contents***Risk and Uncertainties*

The Company generates the majority of its revenue from sales of products and services provided to the AEC industry. As a result, the Company's operating results and financial condition can be significantly affected by economic factors that influence the AEC industry, such as non-residential construction spending, GDP growth, interest rates, unemployment rates, and office vacancy rates. The effects of the current economic environment in the United States have resulted in a significant reduction of activity in the non-residential portions of the AEC industry, as compared to periods prior to the recent recession. The AEC industry generally experiences downturns several months after a downturn in the general economy, and there may be a similar delay in the recovery of the AEC industry following a recovery in the general economy. Similar to the AEC industry, the reprographics industry typically lags a recovery in the broader economy. A continued downturn in the AEC industry and the reprographics industry would further diminish demand for some of ARC's products and services, and would therefore negatively impact revenues and have a material adverse impact on its business, operating results and financial condition.

As technology continues to improve, this trend toward printing on an as needed basis could result in a continued decrease in printing volumes and declining revenues in the future. Failure to offset these declines in printing volumes by changing how the Company charges for its services and develops additional revenue sources could significantly affect its business and reduce its long term revenue, resulting in an adverse effect on its results of operations and financial condition.

**2. Earnings per Share**

The Company accounts for earnings per share in accordance with ASC 260, *Earnings Per Share*. Basic earnings per share is computed by dividing net income attributable to ARC by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if common shares subject to outstanding options and acquisition rights had been issued and if the additional common shares were dilutive. Common stock equivalents are excluded from the computation if their effect is anti-dilutive. For the three and nine months ended September 30, 2012, stock options for 2.3 million common shares were excluded from the calculation of diluted net income attributable to ARC per common share because they were anti-dilutive. For the three and nine months ended September 30, 2011, stock options for 2.2 million common shares were excluded from the calculation of diluted net income attributable to ARC per common share because they were anti-dilutive.

Basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 were calculated using the following common shares:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Weighted average common shares outstanding - basic	45,716	45,416	45,641	45,366
Effect of dilutive impact on equity-based compensation awards				
Weighted average common shares outstanding - diluted	45,716	45,416	45,641	45,366

**3. Goodwill and Other Intangibles Resulting from Business Acquisitions***Goodwill*

In connection with acquisitions, the Company applies the provisions of ASC 805, *Business Combinations*, using the acquisition method of accounting. The excess purchase price over the assessed fair value of net tangible assets and identifiable intangible assets acquired is recorded as goodwill.

In accordance with ASC 350, *Intangibles - Goodwill and Other*, the Company assesses goodwill for impairment annually as of September 30, and more frequently if events and circumstances indicate that goodwill might be impaired.

At September 30, 2012, absent the fact that the Company assesses goodwill for impairment annually as of September 30, the Company determined that there were sufficient indicators to trigger a goodwill impairment analysis. The indicators included, among other factors: (1) the Company's underperformance relative to its plan in the third quarter of 2012 (2) the performance against plan of reporting units which previously

## Edgar Filing: American Reprographics CO - Form 10-Q

had goodwill impairment (3) the economic environment, and (4) the continued decrease in large and small format printing at the Company's service centers, which the Company management believes is partly due to customers' increasing adoption of technology (refer to footnote 11 Subsequent Events for further information). The Company's analysis indicated that seven of its 27 reporting units, six in the United States and one in Canada, had a goodwill impairment as of September 30, 2012. Accordingly, the Company recorded a pretax, non-cash charge for the three months ended September 30, 2012 to reduce the carrying value of goodwill by \$16.7 million.

**Table of Contents**

At September 30, 2011, the results of the Company's analysis indicated that nine of its 37 reporting units, eight in the United States and one in Canada, had a goodwill impairment as of September 30, 2011. Accordingly, the Company recorded a pretax, non-cash charge for the three months ended September 30, 2011 to reduce the carrying value of goodwill by \$42.1 million. Given the increased uncertainty in the timing of the recovery of the construction industry, and the increased uncertainty in the economy as a whole, as well as the significant decline in the price of the Company's senior notes (resulting in a higher yield) and a decline of the Company's stock price during the third quarter of 2011, the Company concluded that it was appropriate to increase the estimated weighted average cost of capital ( WACC ) of its reporting units as of September 30, 2011. The increase in the Company's WACC was the main driver in the decrease in the estimated fair value of reporting units during the third quarter of 2011, which in turn resulted in the goodwill impairment.

At June 30, 2011, the Company determined that there were sufficient indicators to trigger an interim goodwill impairment analysis. The indicators included, among other factors: (1) the economic environment, (2) the performance against plan of reporting units which previously had goodwill impairment, and (3) revised forecasted future earnings. The Company's analysis indicated that six of its 36 reporting units, all of which are located in the United States, had a goodwill impairment as of June 30, 2011. Accordingly, the Company recorded a pretax, non-cash charge for the three and six months ended June 30, 2011 to reduce the carrying value of goodwill by \$23.3 million.

Goodwill impairment testing is performed at the reporting unit level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill.

Goodwill impairment testing is a two-step process. Step one involves comparing the fair value of the reporting units to its carrying amount. If the carrying amount of a reporting unit is greater than zero and its fair value is greater than its carrying amount, there is no impairment. If the reporting unit's carrying amount is greater than the fair value, the second step must be completed to measure the amount of impairment, if any. Step two involves calculating the implied fair value of goodwill by deducting the fair value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the fair value of the reporting unit as determined in step one. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference.

The Company determines the fair value of its reporting units using an income approach. Under the income approach, the Company determined fair value based on estimated discounted future cash flows of each reporting unit. The cash flows are discounted by an estimated weighted-average cost of capital, which is intended to reflect the overall level of inherent risk of a reporting unit. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and EBITDA margins, discount rates and future market conditions, among others. The Company considered market information in assessing the reasonableness of the fair value under the income approach outlined above.

Given the current economic environment, the changing document and printing needs of the Company's customers, and the uncertainties regarding the related impact on the Company's business, there can be no assurance that the estimates and assumptions made for purposes of the Company's goodwill impairment testing in 2012 will prove to be accurate predictions of the future. If the Company's assumptions, including forecasted EBITDA of certain reporting units, are not achieved, the Company may be required to record additional goodwill impairment charges in future periods, whether in connection with the Company's next annual impairment testing in the third quarter of 2013, or on an interim basis, if any such change constitutes a triggering event (as defined under ASC 350) outside of the quarter when the Company regularly performs its annual goodwill impairment test. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.

The changes in the carrying amount of goodwill from January 1, 2011 through September 30, 2012 are summarized as follows:

(In thousands)	Gross Goodwill	Accumulated Impairment Loss	Net Carrying Amount
January 1, 2011	\$ 405,558	\$ 110,799	\$ 294,759
Additions			
Goodwill impairment		65,444	(65,444)
December 31, 2011	405,558	176,243	229,315
Additions			

Edgar Filing: American Reprographics CO - Form 10-Q

Goodwill impairment		16,707	(16,707)
September 30, 2012	<b>\$ 405,558</b>	<b>\$ 192,950</b>	<b>\$ 212,608</b>

**Table of Contents**

See Critical Accounting Policies in Management's Discussion and Analysis of Financial Condition and Results of Operations for further information regarding the process and assumptions used in the goodwill impairment analysis.

*Long-lived Assets*

The Company periodically assesses potential impairments of its long-lived assets in accordance with the provisions of ASC 360, *Accounting for the Impairment or Disposal of Long-lived Assets*. An impairment review is performed whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The Company groups its assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of the other assets and liabilities. The Company has determined that the lowest level for which identifiable cash flows are available is the divisional level.

Factors considered by the Company include, but are not limited to, significant underperformance relative to historical or projected operating results; significant changes in the manner of use of the acquired assets or the strategy for the overall business; and significant negative industry or economic trends. When the carrying value of a long-lived asset may not be recoverable based upon the existence of one or more of the above indicators of impairment, the Company estimates the future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future undiscounted cash flows and eventual disposition is less than the carrying amount of the asset, the Company recognizes an impairment loss. An impairment loss is reflected as the amount by which the carrying amount of the asset exceeds the fair value of the asset, based on the fair value if available, or discounted cash flows, if fair value is not available.

The reporting units of the Company have been negatively impacted by the decline in commercial and residential construction, as well as the shift of customer demand from project-related printing to digital document management solutions. Before assessing the Company's goodwill for impairment, the Company evaluated, as described above, the long-lived assets in its reporting units for impairment. Based on these assessments, there was no impairment in 2012.

Other intangible assets that have finite lives are amortized over their useful lives. Customer relationships are amortized using the accelerated method, based on customer attrition rates, over their estimated useful lives of 13 (weighted average) years.

During the fourth quarter of 2010, the Company decided to consolidate the various brands that previously represented the Company's market presence in North America. Beginning in January 2011, each of the Company's operating segments and their respective locations began to adopt ARC, the Company's overall brand name. Original brand names were used in conjunction with the new ARC brand name to reinforce the Company's continuing presence in the business communities it serves, and ongoing relationships with its customers. Accordingly, the remaining estimated useful lives of the trade name intangible assets were revised down to 18 months. This change in estimate is accounted for on a prospective basis, resulting in increased amortization expense over the revised useful life of each trade name. The impact of this change in the nine months ended September 30, 2012 was an increase in amortization expense of approximately \$3.2 million. There was no related impact for the three months ended September 30, 2012. The impact of this change in the three and nine months ended September 30, 2011 was an increase in amortization expense of approximately \$2.4 million and \$7.1 million, respectively. Trade names were amortized using the straight-line method. The Company retired the original trade names in April 2012.

The following table sets forth the Company's other intangible assets resulting from business acquisitions as of September 30, 2012 and December 31, 2011 which continue to be amortized:

	September 30, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
<b>(In thousands)</b>						
Amortizable other intangible assets						
Customer relationships	\$ 97,956	\$ 62,248	\$ 35,708	\$ 97,509	\$ 56,478	\$ 41,031
Trade names and trademarks	20,348	19,748	600	20,320	16,231	4,089
Non-competition agreements				100	93	7
	<b>\$ 118,304</b>	<b>\$ 81,996</b>	<b>\$ 36,308</b>	<b>\$ 117,929</b>	<b>\$ 72,802</b>	<b>\$ 45,127</b>



**Table of Contents**

Based on current information, estimated future amortization expense of amortizable intangible assets for the remainder of the 2012 fiscal year, each of the subsequent four fiscal years and thereafter are as follows:

<b>(In thousands)</b>	
2012 (excluding the nine months ended September 30, 2012)	<b>\$ 1,793</b>
2013	<b>6,615</b>
2014	<b>5,766</b>
2015	<b>5,221</b>
2016	<b>4,521</b>
Thereafter	<b>12,392</b>
	<b>\$ 36,308</b>

**4. Income Taxes**

On a quarterly basis, the Company estimates its effective tax rate for the full fiscal year and records a quarterly income tax provision based on the anticipated rate in conjunction with the recognition of any discrete items within the quarter.

The Company recorded an income tax benefit of \$84 thousand dollars in relation to pretax loss of \$20.2 million for the three months ended September 30, 2012, and an income tax provision of \$1.8 million in relation to pretax loss of \$24.0 million for the nine months ended September 30, 2012. For the three months ended September 30, 2012, the low income tax benefit was primarily due to an additional valuation allowance against certain deferred tax assets as a result of the pretax loss of \$20.2 million, which included a stock-based goodwill impairment charge of \$6.3 million that is nondeductible for U.S. income tax purposes until the stock is fully disposed of. The income tax provision of \$1.8 million was primarily due to the impact of amortization of tax basis goodwill in a deferred tax liability position, which results in an additional valuation allowance.

In accordance with ASC 740-10, *Income Taxes*, the Company evaluates its deferred tax assets to determine if a valuation allowance is required based on the consideration of all available evidence using a more likely than not standard, with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability; the length of statutory carryover periods for operating losses and tax credit carryovers; and available tax planning alternatives. During 2011, and the nine months ended September 30, 2012, the Company determined that cumulative losses for the preceding twelve quarters constituted sufficient objective evidence (as defined by ASC 740-10) that a valuation allowance on certain deferred assets was needed. As of September 30, 2012, the Company has a \$75.3 million valuation allowance against certain of its deferred tax assets.

Based on the Company's assessment, the remaining net deferred tax assets of \$1.3 million as of September 30, 2012 are considered to be more likely than not to be realized. The valuation allowance of \$75.3 million may be increased or decreased as conditions change or if the Company is unable to implement certain available tax planning strategies. The realization of the Company's net deferred tax assets ultimately depend on future taxable income, reversals of existing taxable temporary differences or through a loss carry back. The Company has income tax receivables of \$4.2 million as of September 30, 2012 included in other current assets in its condensed consolidated balance sheet primarily related to income tax refunds for prior years under audit.

**5. Long-Term Debt**

Long-term debt consists of the following:

<b>(In thousands)</b>	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Borrowings from foreign revolving credit facility; <b>0.6%</b> interest rate at September 30, 2012 and December 31, 2011	<b>\$ 1,757</b>	<b>\$ 713</b>
10.5% senior notes due 2016, net of bond discount of <b>\$3,306</b> and \$3,759	<b>196,694</b>	196,241
Various subordinated notes payable; weighted average interest rate of <b>6.0%</b> and 6.2% at September 30, 2012 and December 31, 2011, respectively; principal and interest payable monthly through September	<b>371</b>	1,174

Edgar Filing: American Reprographics CO - Form 10-Q

2014		
Various capital leases; weighted average interest rate of <b>8.5%</b> at September 30, 2012 and December 31, 2011; principal and interest payable monthly through September 2017	<b>25,410</b>	28,136
	<b>224,232</b>	226,264
Less current portion	<b>(13,987)</b>	(15,005)
	<b>\$ 210,245</b>	\$ 211,259

---

## **Table of Contents**

### ***10.5% Senior Notes due 2016***

On December 1, 2010, the Company completed a private placement of 10.5% senior unsecured notes due 2016 (the "Notes").

The Notes have an aggregate principal amount of \$200 million. The Notes are general unsecured senior obligations of the Company and are subordinate to all existing and future senior secured debt of the Company to the extent of the assets securing such debt. The Company's obligations under the Notes are jointly and severally guaranteed by all of the Company's domestic subsidiaries. The issue price was 97.824% with a yield to maturity of 11.0%. Interest on the Notes accrues at a rate of 10.5% per annum and is payable semiannually in arrears on June 15 and December 15 of each year, commencing on June 15, 2011. The Company will make each interest payment to the holders of record of the Notes on the immediately preceding June 1 and December 1.

The Company received gross proceeds of \$195.6 million from the Notes offering. In connection with the issuance of the Notes, the Company entered into an indenture (the "Indenture"). The Notes were offered only to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), and outside the United States to non-U.S. persons pursuant to Regulation S under the Securities Act.

*Optional Redemption.* At any time prior to December 15, 2013, the Company may redeem all or part of the Notes upon not less than 30 nor more than 60 days' prior notice at a redemption price equal to the sum of (i) 100% of the principal amount thereof, plus (ii) a make-whole premium as of the date of redemption, plus (iii) accrued and unpaid interest, if any, to the date of redemption. In addition, the Company may redeem some or all of the Notes on or after December 15, 2013, at redemption prices set forth in the Indenture, together with accrued and unpaid interest, if any, to the date of redemption. At any time prior to December 15, 2013, the Company may use the proceeds of certain equity offerings to redeem up to 35% of the aggregate principal amount of the Notes, including any permitted additional notes, at a redemption price equal to 110.5% of the principal amount of the Notes redeemed, plus accrued and unpaid interest, if any, to the date of redemption.

*Repurchase upon Change of Control.* Upon the occurrence of a change in control (as defined in the Indenture), each holder of the Notes may require the Company to repurchase all of the then-outstanding Notes in cash at a price equal to 101% of the aggregate principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, to the date of repurchase.

*Other Covenants.* The Indenture contains covenants that limit, among other things, the Company's and certain of its subsidiaries' ability to (1) incur certain additional debt and issue preferred stock, (2) make certain restricted payments, (3) consummate specified asset sales, (4) enter into certain transactions with affiliates, (5) create liens, (6) declare or pay any dividend or make any other distributions, (7) make certain investments, and (8) merge or consolidate with another person.

*Events of Default.* The Indenture provides for customary events of default (subject in certain cases to customary grace and cure periods), which include non-payment, breach of covenants in the Indenture, cross default and acceleration of other indebtedness, failure to pay certain judgments and certain events of bankruptcy and insolvency. Generally, if an event of default occurs, the Trustee or holders of at least 25% in principal amount of the then outstanding Notes may declare the principal of and accrued but unpaid interest on all of the then-outstanding Notes to be due and payable.

*Exchange Offer.* Pursuant to a registered exchange offer in May 2011, the Company offered to exchange up to \$200 million aggregate principal amount of the Notes, for new notes that were registered under the Securities Act. The terms of the registered notes are the same as the terms of the Notes, except that they are registered under the Securities Act and the transfer restrictions, registration rights and additional interest provisions are not applicable. The Company accepted the exchange of \$200 million aggregate principal amounts of the Notes that were properly tendered in the exchange offer.

### ***2012 Credit Agreement***

On January 27, 2012, the Company entered into a new Credit Agreement (the "2012 Credit Agreement") and terminated its previous senior secured credit agreement. The 2012 Credit Agreement provides revolving loans in an aggregate principal amount not to exceed \$50.0 million with a Canadian sublimit of \$5.0 million, based on inventory, accounts receivable and unencumbered equipment of the Company's subsidiaries organized in the US and Canada ("Domestic Subsidiaries") that meet certain eligibility criteria. The 2012 Credit Agreement has a maturity date of June 15, 2016.

Amounts borrowed in US dollars under the 2012 Credit Agreement bear interest, in the case of LIBOR loans, at a per annum rate equal to LIBOR plus the LIBOR Margin, which may range from 1.75% to 2.25%, based on Average Daily Net Availability (as defined in the 2012 Credit Agreement). All other amounts borrowed in US dollars that are not LIBOR loans bear interest at a per annum rate equal to (i) the greatest

## Edgar Filing: American Reprographics CO - Form 10-Q

of (A) the Federal Funds rate plus 0.5%, (B) the LIBOR (calculated based upon an interest period of three months and determined on a daily basis), plus 1.0% per annum, and (C) the rate of interest announced, from time to time, within Wells Fargo Bank, National Association at its principal office in San Francisco as its prime rate, plus (ii) the Base Rate Margin (as defined in the 2012 Credit Agreement), which may range from 0.75% to 1.25%, based on Average Daily Net Availability (as defined in the 2012 Credit Agreement). Amounts borrowed in Canadian dollars bear interest at a per annum rate equal to the Canadian Base Rate (as defined in the 2012 Credit Agreement) plus the LIBOR Margin, which may range from 1.75% to 2.25%, based on Average Daily Net Availability.

## **Table of Contents**

The 2012 Credit Agreement contains various loan covenants that restrict the Company's ability to take certain actions, including restrictions on incurrence of indebtedness, creation of liens, mergers or consolidations, dispositions of assets, repurchase or redemption of capital stock, making certain investments, entering into certain transactions with affiliates or changing the nature of the Company's business. In addition, at any time when Excess Availability (as defined in the 2012 Credit Agreement) is less than \$10.0 million, the Company is required to maintain a Fixed Charge Coverage Ratio (as defined in the 2012 Credit Agreement) of at least 1.0. The Company's obligations under the 2012 Credit Agreement are secured by substantially all of its assets pursuant to a Guaranty and Security Agreement.

As of and during the nine months ended September 30, 2012, the Company did not have any outstanding debt under the 2012 Credit Agreement.

As of September 30, 2012, based on inventory, accounts receivable and unencumbered equipment of the Company's subsidiaries organized in the US and Canada, the Company's borrowing availability under the 2012 Credit Agreement was \$47.5 million. Standby letters of credit aggregating \$2.9 million reduced the Company's borrowing availability under the 2012 Credit Agreement to \$44.6 million as of September 30, 2012.

### ***Foreign Credit Facility***

In the third quarter of 2012, in conjunction with its Chinese operations, UNIS Document Solutions Co. Ltd. ( UDS ), the Company's Chinese business venture with Beijing-based Unisplendour, entered into a revolving credit facility that expires in August 2013. This facility provides for a maximum credit amount of 11.1 million Chinese Yuan Renminbi, which translates to U.S. \$1.8 million as of September 30, 2012. Draws on the facility are limited to 30 day periods and incur a fee of 0.05% of the amount drawn and no additional interest is charged.

## **6. Commitments and Contingencies**

*Operating Leases.* The Company has entered into various non-cancelable operating leases primarily related to facilities, equipment and vehicles used in the ordinary course of business.

*Contingent Transaction Consideration.* The Company is subject to earnout obligations entered into in connection with prior acquisitions. If the acquired businesses generate sales and/or operating profits in excess of predetermined targets, the Company is obligated to make additional cash payments in accordance with the terms of such earnout obligations. As of September 30, 2012, the Company has potential future earnout obligations for acquisitions consummated before the adoption of ASC 805, *Business Combinations*, of approximately \$1.5 million through 2014 if predetermined financial targets are met or exceeded, and earnout obligations of \$0.3 million through 2014 consummated subsequent to the adoption of ASC 805. Earnout payments prior to the adoption of ASC 805 are recorded as additional purchase price (as goodwill) when the contingent payments are earned and become payable.

*Legal Proceedings.* On October 21, 2010, a former employee, individually and on behalf of a purported class consisting of all non-exempt employees who work or worked for American Reprographics Company, L.L.C. and American Reprographics Company in the State of California at any time from October 21, 2006 through October 21, 2010, filed an action against the Company in the Superior Court of California for the County of Orange. The complaint alleges, among other things, that the Company violated the California Labor Code by failing to (i) provide meal and rest periods, or compensation in lieu thereof, (ii) timely pay wages due at termination, and (iii) that those practices also violate the California Business and Professions Code. The relief sought includes damages, restitution, penalties, interest, costs, and attorneys' fees and such other relief as the court deems proper. The Company has not accrued for any liability in its Consolidated Financial Statements in connection with this matter. The Company cannot reasonably estimate the amount or range of possible loss, if any, at this time.

In addition to the matter described above, the Company is involved in various additional legal proceedings and other legal matters from time to time in the normal course of business. The Company does not believe that the outcome of any of these matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

## **7. Stock-Based Compensation**

The Company's 2005 Stock Plan (the "Stock Plan") provides for the grant of incentive and non-statutory stock options, stock appreciation rights, restricted stock purchase awards, restricted stock awards, and restricted stock units to employees, directors and consultants of the Company. The Stock Plan authorizes the Company to issue up to 5.0 million shares of common stock. This amount automatically increased annually on the first day of the Company's fiscal year, from 2006 through and including 2010, by the lesser of (i) 1.0% of the Company's outstanding shares on the date of the increase; (ii) 0.3 million shares; or (iii) such smaller number of shares determined by the Company's board of directors. As of September 30, 2012, 2.1 million shares remain available for issuance under the Stock Plan.

## Edgar Filing: American Reprographics CO - Form 10-Q

Stock options granted under the Stock Plan generally expire no later than ten years from the date of grant. Options generally vest and become fully exercisable over a period of two to five years from date of award, except that options granted to non-employee directors may vest over a shorter time period. The exercise price of options must be equal to at least 100% (110% in the case of an incentive stock option granted to a 10% stockholder) of the fair market value of the Company's common stock on the date of grant. The Company allows for cashless exercises of vested outstanding options.

**Table of Contents**

The impact of stock-based compensation before income taxes on the interim Condensed Consolidated Statements of Operations was \$0.6 million and \$0.5 million for the three months ended September 30, 2012 and 2011, respectively.

The impact of stock-based compensation before income taxes on the interim Condensed Consolidated Statements of Operations was \$1.5 million and \$3.8 million for the nine months ended September 30, 2012 and 2011, respectively.

As of September 30, 2012, total unrecognized compensation cost related to unvested stock-based payments totaled \$5.1 million and is expected to be recognized over a weighted-average period of 2.5 years.

**8. Derivatives and Hedging Transactions**

As of September 30, 2012, the Company was not party to any derivative or hedging transactions.

As of December 31, 2010, the Company was party to a swap transaction, in which the Company exchanged its floating-rate payments for fixed-rate payments. As of December 1, 2010, the swap transaction was de-designated upon issuance of the Notes and payoff of the Company's previous credit agreement. The swap transaction no longer qualified as a cash flow hedge under ASC 815, *Derivatives and Hedging*, as all the floating-rate debt was extinguished. The swap transaction qualified as a cash flow hedge up to November 30, 2010. On January 3, 2011, the Company terminated and settled the swap transaction.

As of September 30, 2012, \$0.4 million is deferred in Accumulated Other Comprehensive Loss ( AOCL ) and will be recognized in earnings over the remainder of the original term of the swap transaction which was scheduled to end in December 2012.

The following table summarizes the effect of the swap transaction on the interim Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011:

(In thousands)	Amount of Gain or (Loss) Reclassified from AOCL into Income							
	(effective portion)				(ineffective portion)			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,	
	2012	2011	2012	2011	2012	2011	2012	2011
<b>Location of Loss Reclassified from AOCL into Income</b>								
Interest expense	\$ (776)	\$ (1,389)	\$ (3,047)	\$ (4,369)	\$	\$	\$	\$

The following table summarizes the loss recognized in income of derivatives, not designated as hedging instruments under ASC 815 for the three and nine months ended September 30, 2012 and 2011:

(In thousands)	Amount of Loss Recognized in Income on Derivative			
	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2012	2011	2012	2011
<b>Derivative not designated as hedging instrument under ASC 815</b>				
Swap transaction	\$	\$	\$	\$ (120)
Tax effect				45
Swap transaction, net of tax effect	\$	\$	\$	\$ (75)

**9. Fair Value Measurements**

In accordance with ASC 820, the Company has categorized its assets and liabilities that are measured at fair value into a three-level fair value hierarchy as set forth below. If the inputs used to measure fair value fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement. The three levels of the hierarchy are defined as follows:

## Edgar Filing: American Reprographics CO - Form 10-Q

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

**Table of Contents**

The following table summarizes the bases used to measure certain assets and liabilities at fair value on a nonrecurring basis in the condensed consolidated financial statements as of and for the nine months ended September 30, 2012 and 2011:

Nonrecurring Fair Value Measure	Significant Other Unobservable Inputs September 30, 2012		September 30, 2011	
	Level 3	Total Losses	Level 3	Total Losses
Goodwill	\$ 212,608	\$ 16,707	\$ 229,315	\$ 65,444

In accordance with ASC 350, goodwill was written down to its implied fair value of \$212.6 million and \$229.3 million as of September 30, 2012 and 2011, respectively, resulting in an impairment charge of \$16.7 million and \$65.4 million during the nine months ended September 30, 2012 and 2011, respectively. See Note 3, Goodwill and other intangibles resulting from business acquisitions for further information regarding the process of determining the implied fair value of goodwill and change in goodwill.

*Fair Values of Financial Instruments.* The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments for disclosure purposes:

*Cash equivalents:* Cash equivalents are time deposits with maturity of three months or less when purchased, which are highly liquid and readily convertible to cash. Cash equivalents reported in the Company's Condensed Consolidated Balance Sheets were \$10.9 million and \$10.3 million as of September 30, 2012 and December 31, 2011, respectively, and are carried at cost and approximate fair value due to the relatively short period to maturity of these instruments.

*Short- and long-term debt:* The carrying amount of the Company's capital leases reported in the Condensed Consolidated Balance Sheets approximates fair value based on the Company's current incremental borrowing rate for similar types of borrowing arrangements. The carrying amount reported in the Company's Condensed Consolidated Balance Sheet as of September 30, 2012 for its Notes and its subordinated notes payable is \$200.0 million and \$0.4 million, respectively. Using a discounted cash flow technique that incorporates a market interest rate which assumes adjustments for duration, optionality, and risk profile, the Company has determined the fair value of its Notes and its subordinated notes payable is \$213.0 million and \$0.3 million, respectively, as of September 30, 2012.

**10. Condensed Consolidating Financial Statements**

The Notes are fully and unconditionally guaranteed, on a joint and several basis, by all of the Company's domestic subsidiaries (the Guarantor Subsidiaries). The Company's foreign subsidiaries have not guaranteed the Notes (the Non-Guarantor Subsidiaries). Each of the Guarantor Subsidiaries is 100% owned, directly or indirectly, by the Company. There are no significant restrictions on the ability of the Company to obtain funds from any of the Guarantor Subsidiaries by dividends or loans. In lieu of providing separate audited financial statements for the Guarantor Subsidiaries, condensed consolidating financial information is presented below.

The goodwill balance of guarantor subsidiaries has been decreased, and of non-guarantor subsidiaries has been increased, by \$1.5 million to correct an error as of December 31, 2011.

**Table of Contents****Condensed Consolidating Balance Sheet**

September 30, 2012

(Unaudited)

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$	\$ 16,222	\$ 14,312	\$	\$ 30,534
Accounts receivable, net		49,024	8,674		57,698
Intercompany operations	295	4,785	(5,080)		
Inventories, net		9,644	4,806		14,450
Prepaid expenses	14	3,085	1,600		4,699
Other current assets		5,920	2,160		8,080
<b>Total current assets</b>	<b>309</b>	<b>88,680</b>	<b>26,472</b>		<b>115,461</b>
Property and equipment, net		48,265	8,143		56,408
Goodwill		212,608			212,608
Investment in subsidiaries	150,406	13,899		(164,305)	
Other intangible assets, net		34,041	2,267		36,308
Deferred financing costs, net	4,495				4,495
Deferred income taxes			1,293		1,293
Other assets		1,870	326		2,196
<b>Total assets</b>	<b>\$ 155,210</b>	<b>\$ 399,363</b>	<b>\$ 38,501</b>	<b>\$ (164,305)</b>	<b>\$ 428,769</b>
<b>Liabilities and Equity</b>					
Current liabilities:					
Accounts payable	\$	\$ 17,840	\$ 3,495	\$	\$ 21,335
Accrued payroll and payroll-related expenses		9,809	97		9,906
Accrued expenses	6,205	15,515	4,720		26,440
Intercompany loans	(156,731)	154,001	2,730		
Current portion of long-term debt and capital leases		10,764	3,223		13,987
<b>Total current liabilities</b>	<b>(150,526)</b>	<b>207,929</b>	<b>14,265</b>		<b>71,668</b>
Long-term debt and capital leases	196,694	11,699	1,852		210,245
Deferred income taxes		28,114			28,114
Other long-term liabilities		1,215	1,892		3,107
<b>Total liabilities</b>	<b>46,168</b>	<b>248,957</b>	<b>18,009</b>		<b>313,134</b>
Commitments and contingencies					
Total equity	109,042	150,406	20,492	(164,305)	115,635
<b>Total liabilities and equity</b>	<b>\$ 155,210</b>	<b>\$ 399,363</b>	<b>\$ 38,501</b>	<b>\$ (164,305)</b>	<b>\$ 428,769</b>

**Table of Contents****Condensed Consolidating Balance Sheet****December 31, 2011****(Unaudited)**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$	\$ 11,706	\$ 13,731	\$	\$ 25,437
Accounts receivable, net		49,435	5,278		54,713
Intercompany operations	295	4,667	(4,962)		
Inventories, net		7,772	4,335		12,107
Prepaid expenses	77	3,145	777		3,999
Other current assets		6,637	904		7,541
<b>Total current assets</b>	<b>372</b>	<b>83,362</b>	<b>20,063</b>		<b>103,797</b>
Property and equipment, net		47,431	7,653		55,084
Goodwill		227,812	1,503		229,315
Investment in subsidiaries	154,813	14,476		(169,289)	
Other intangible assets, net		42,625	2,502		45,127
Deferred financing costs, net	4,574				4,574
Deferred income taxes			1,368		1,368
Other assets		1,850	242		2,092
<b>Total assets</b>	<b>\$ 159,759</b>	<b>\$ 417,556</b>	<b>\$ 33,331</b>	<b>\$ (169,289)</b>	<b>\$ 441,357</b>
<b>Liabilities and Equity</b>					
Current liabilities:					
Accounts payable	\$ 113	\$ 19,965	\$ 1,709	\$	\$ 21,787
Accrued payroll and payroll-related expenses		6,807	485		7,292
Accrued expenses	933	15,327	3,048		19,308
Intercompany loans	(168,206)	166,361	1,845		
Current portion of long-term debt and capital leases		13,078	1,927		15,005
<b>Total current liabilities</b>	<b>(167,160)</b>	<b>221,538</b>	<b>9,014</b>		<b>63,392</b>
Long-term debt and capital leases	196,241	13,496	1,522		211,259
Deferred income taxes		26,447			26,447
Other long-term liabilities		1,262	1,932		3,194
<b>Total liabilities</b>	<b>29,081</b>	<b>262,743</b>	<b>12,468</b>		<b>304,292</b>
Commitments and contingencies					
<b>Total equity</b>	<b>130,678</b>	<b>154,813</b>	<b>20,863</b>	<b>(169,289)</b>	<b>137,065</b>
<b>Total liabilities and equity</b>	<b>\$ 159,759</b>	<b>\$ 417,556</b>	<b>\$ 33,331</b>	<b>\$ (169,289)</b>	<b>\$ 441,357</b>

**Table of Contents****Condensed Consolidating Statement of Operations****Three Months Ended****September 30, 2012****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net sales	\$	\$ 86,714	\$ 12,712	\$	\$ 99,426
Cost of sales		59,988	10,190		70,178
Gross profit		26,726	2,522		29,248
Selling, general and administrative expenses	2	23,274	640		23,916
Amortization of intangible assets		1,760	86		1,846
Goodwill impairment		15,204	1,503		16,707
(Loss) income from operations	(2)	(13,512)	293		(13,221)
Other income		(25)			(25)
Interest expense (income), net	5,752	1,238	(8)		6,982
(Loss) income before equity earnings of subsidiaries and income tax (benefit) provision	(5,754)	(14,725)	301		(20,178)
Equity in earnings of subsidiaries	14,358	(200)		(14,158)	
Income tax (benefit) provision		(167)	83		(84)
Net (loss) income	(20,112)	(14,358)	218	14,158	(20,094)
Loss attributable to noncontrolling interest			(18)		(18)
Net (loss) income attributable to American Reprographics Company	\$ (20,112)	\$ (14,358)	\$ 200	\$ 14,158	\$ (20,112)

**Table of Contents****Condensed Consolidating Statement of Operations****Three Months Ended****September 30, 2011****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net sales	\$	\$ 93,365	\$ 11,427	\$	\$ 104,792
Cost of sales		61,895	8,973		70,868
Gross profit		31,470	2,454		33,924
Selling, general and administrative expenses		21,513	2,020		23,533
Amortization of intangible assets		4,581	73		4,654
Goodwill impairment		42,109			42,109
Loss from operations		(36,733)	361		(36,372)
Other income		(27)			(27)
Interest expense (income), net	5,788	1,999	(44)		7,743
Loss before equity earnings of subsidiaries and income tax benefit	(5,788)	(38,705)	405		(44,088)
Equity in earnings of subsidiaries	36,675	(527)		(36,148)	
Income tax benefit	(706)	(1,503)	(183)		(2,392)
Net (loss) income	(41,757)	(36,675)	588	36,148	(41,696)
Loss attributable to noncontrolling interest			(61)		(61)
Net (loss) income attributable to American Reprographics Company	\$ (41,757)	\$ (36,675)	\$ 527	\$ 36,148	\$ (41,757)

**Condensed Consolidating Statement of Operations****Nine Months Ended****September 30, 2012****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net sales	\$	\$ 270,645	\$ 38,582	\$	\$ 309,227
Cost of sales		184,274	30,074		214,348
Gross profit		86,371	8,508		94,879
Selling, general and administrative expenses	5	66,631	4,710		71,346
Amortization of intangible assets		8,961	283		9,244

Edgar Filing: American Reprographics CO - Form 10-Q

Goodwill impairment		15,204	1,503		16,707
(Loss) income from operations	(5)	(4,425)	2,012		(2,418)
Other income		(79)			(79)
Interest expense (income), net	17,219	4,514	(58)		21,675
(Loss) income before equity earnings of subsidiaries and income tax provision	(17,224)	(8,860)	2,070		(24,014)
Equity in earnings of subsidiaries	8,848	(1,527)		(7,321)	
Income tax provision		1,515	330		1,845
Net (loss) income	(26,072)	(8,848)	1,740	7,321	(25,859)
Loss attributable to noncontrolling interest			(213)		(213)
Net (loss) income attributable to American Reprographics Company	\$ (26,072)	\$ (8,848)	\$ 1,527	\$ 7,321	\$ (26,072)

**Table of Contents****Condensed Consolidating Statement of Operations****Nine Months Ended****September 30, 2011****(Unaudited)**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	\$	\$ 290,461	\$ 30,425	\$	\$ 320,886
Cost of sales		193,825	24,056		217,881
Gross profit		96,636	6,369		103,005
Selling, general and administrative expenses		72,086	6,083		78,169
Amortization of intangible assets		13,914	205		14,119
Goodwill impairment		65,444			65,444
Loss from operations		(54,808)	81		(54,727)
Other income		(88)			(88)
Interest expense (income), net	17,130	6,555	(76)		23,609
Loss before equity earnings of subsidiaries and income tax provision	(17,130)	(61,275)	157		(78,248)
Equity in earnings of subsidiaries	112,900	917		(113,817)	
Income tax provision		50,708	1,164		51,872
Net (loss) income	(130,030)	(112,900)	(1,007)	113,817	(130,120)
Loss attributable to noncontrolling interest			90		90
Net (loss) income attributable to American Reprographics Company	\$ (130,030)	\$ (112,900)	\$ (917)	\$ 113,817	\$ (130,030)

**Table of Contents****Condensed Consolidating Statement of Comprehensive Income (Loss)****Three Months Ended****September 30, 2012****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net (loss) income	\$ (20,112)	\$ (14,358)	\$ 218	\$ 14,158	\$ (20,094)
Other comprehensive income, net of tax:					
Foreign currency translation adjustments, net of tax			270		270
Amortization of derivative, net of tax		486			486
Other comprehensive income, net of tax		486	270		756
Comprehensive (loss) income	(20,112)	(13,872)	488	14,158	(19,338)
Comprehensive income attributable to noncontrolling interest			(9)		(9)
Comprehensive (loss) income attributable to American Reprographics Company	\$ (20,112)	\$ (13,872)	\$ 497	\$ 14,158	\$ (19,329)

**Condensed Consolidating Statement of Comprehensive Income (Loss)****Three Months Ended****September 30, 2011****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net (loss) income	\$ (41,757)	\$ (36,675)	\$ 588	\$ 36,148	\$ (41,696)
Other comprehensive income, net of tax:					
Foreign currency translation adjustments, net of tax			(308)		(308)
Amortization of derivative, net of tax		871			871
Other comprehensive income, net of tax		871	(308)		563
Comprehensive (loss) income	(41,757)	(35,804)	280	36,148	(41,133)
Comprehensive loss attributable to noncontrolling interest			127		127
Comprehensive (loss) income attributable to American Reprographics Company	\$ (41,757)	\$ (35,804)	\$ 153	\$ 36,148	\$ (41,260)



**Table of Contents****Condensed Consolidating Statement of Comprehensive Income (Loss)****Nine Months Ended****September 30, 2012****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net (loss) income	\$ (26,072)	\$ (8,848)	\$ 1,740	\$ 7,321	\$ (25,859)
Other comprehensive income, net of tax:					
Foreign currency translation adjustments, net of tax			281		281
Amortization of derivative, net of tax		1,908			1,908
Other comprehensive income, net of tax		1,908	281		2,189
Comprehensive (loss) income	(26,072)	(6,940)	2,021	7,321	(23,670)
Comprehensive income attributable to noncontrolling interest			205		205
Comprehensive (loss) income attributable to American Reprographics Company	\$ (26,072)	\$ (6,940)	\$ 1,816	\$ 7,321	\$ (23,875)

**Condensed Consolidating Statement of Comprehensive Income (Loss)****Nine Months Ended****September 30, 2011****(Unaudited)**

<b>(In thousands)</b>	<b>American Reprographics Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
Net (loss) income	\$ (130,030)	\$ (112,900)	\$ (1,007)	\$ 113,817	\$ (130,120)
Other comprehensive income, net of tax:					
Foreign currency translation adjustments, net of tax			275		275
Amortization of derivative, net of tax		2,737			2,737
Other comprehensive income, net of tax		2,737	275		3,012
Comprehensive (loss) income	(130,030)	(110,163)	(732)	113,817	(127,108)
Comprehensive loss attributable to noncontrolling interest			103		103
Comprehensive (loss) income attributable to American Reprographics Company	\$ (130,030)	\$ (110,163)	\$ (835)	\$ 113,817	\$ (127,211)



**Table of Contents****Condensed Consolidating Statement of Cash Flows****Three Months Ended****September 30, 2012****(Unaudited)**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Cash flows from operating activities</b>					
Net cash (used in) provided by operating activities	\$ (54)	\$ 13,893	\$ 190	\$	\$ 14,029
<b>Cash flows from investing activities</b>					
Capital expenditures		(4,588)	(344)		(4,932)
Other		350	(33)		317
Net cash used in investing activities		(4,238)	(377)		(4,615)
<b>Cash flows from financing activities</b>					
Payments on long-term debt agreements and capital leases		(3,125)	(450)		(3,575)
Net borrowings under revolving credit facilities			1,424		1,424
Payment of deferred financing fees					
Advances to/from subsidiaries	54	11	(65)		
Net cash provided by (used in) financing activities	54	(3,114)	909		(2,151)
Effect of foreign currency translation on cash balances			(47)		(47)
Net change in cash and cash equivalents		6,541	675		7,216
Cash and cash equivalents at beginning of period		9,681	13,637		23,318
Cash and cash equivalents at end of period	\$	\$ 16,222	\$ 14,312	\$	\$ 30,534

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Three Months Ended****September 30, 2011****(Unaudited)**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Cash flows from operating activities</b>					
Net cash (used in) provided by operating activities	\$ (131)	\$ 18,316	\$ (568)	\$	\$ 17,617
<b>Cash flows from investing activities</b>					
Capital expenditures		(3,798)	(518)		(4,316)
Payment for swap transaction					
Other		251	27		278
Net cash used in investing activities		(3,547)	(491)		(4,038)
<b>Cash flows from financing activities</b>					
Proceeds from issuance of common stock under Employee Stock Purchase Plan		8			8
Payments on long-term debt agreements and capital leases		(5,393)	(225)		(5,618)
Net (repayments) borrowings under revolving credit facility	(4,000)		202		(3,798)
Payment of deferred financing fees	(127)				(127)
Advances to/from subsidiaries	4,258	(4,580)	322		
Net cash provided by (used in) financing activities	131	(9,965)	299		(9,535)
Effect of foreign currency translation on cash balances			3		3
Net change in cash and cash equivalents		4,804	(757)		4,047
Cash and cash equivalents at beginning of period		9,527	12,380		21,907
Cash and cash equivalents at end of period	\$	\$ 14,331	\$ 11,623	\$	\$ 25,954

**Table of Contents****Condensed Consolidating Statement of Cash Flows****Nine Months Ended****September 30, 2012****(Unaudited)**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Cash flows from operating activities</b>					
Net cash (used in) provided by operating activities	\$ (10,636)	\$ 40,281	\$ 1,234	\$	\$ 30,879
<b>Cash flows from investing activities</b>					
Capital expenditures		(12,997)	(1,197)		(14,194)
Other		233	(100)		133
Net cash used in investing activities		(12,764)	(1,297)		(14,061)
<b>Cash flows from financing activities</b>					
Proceeds from stock option exercises		79			79
Proceeds from issuance of common stock under Employee Stock Purchase Plan		28			28
Payments on long-term debt agreements and capital leases		(10,866)	(1,175)		(12,041)
Net borrowings under revolving credit facilities			1,041		1,041
Payment of deferred financing fees	(839)				(839)
Advances to/from subsidiaries	11,475	(12,242)	767		
Net cash provided by (used in) financing activities	10,636	(23,001)	633		(11,732)
Effect of foreign currency translation on cash balances			11		11
Net change in cash and cash equivalents		4,516	581		5,097
Cash and cash equivalents at beginning of period		11,706	13,731		25,437
Cash and cash equivalents at end of period	\$	\$ 16,222	\$ 14,312	\$	\$ 30,534

**Table of Contents****Consolidating Condensed Statement of Cash Flows****Nine Months Ended****September 30, 2011**

(In thousands)	American Reprographics Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
<b>Cash flows from operating activities</b>					
Net cash (used in) provided by operating activities	\$ (10,881)	\$ 41,255	\$ (884)	\$	\$ 29,490
<b>Cash flows from investing activities</b>					
Capital expenditures		(10,766)	(1,172)		(11,938)
Payment for swap transaction		(9,729)			(9,729)
Other		1,054	(129)		925
Net cash used in investing activities		(19,441)	(1,301)		(20,742)
<b>Cash flows from financing activities</b>					
Proceeds from stock option exercises		108			108
Proceeds from issuance of common stock under Employee Stock Purchase Plan		31			31
Excess tax benefit related to stock-based compensation		31			31
Payments on long-term debt agreements and capital leases		(18,718)	(1,001)		(19,719)
Net borrowings under revolving credit facilities	9,800		1,022		10,822
Payment of deferred loan fees	(668)				(668)
Advances to/from subsidiaries	1,749	(1,522)	(227)		
Net cash provided by (used in) financing activities	10,881	(20,070)	(206)		(9,395)
Effect of foreign currency translation on cash balances			308		308
Net change in cash and cash equivalents		1,744	(2,083)		(339)
Cash and cash equivalents at beginning of period		12,587	13,706		26,293
Cash and cash equivalents at end of period	\$	\$ 14,331	\$ 11,623	\$	\$ 25,954

**11. Subsequent Events**

Management believes customers are increasingly (1) adopting technology and digital document management practices, and (2) changing their document and printing needs. Therefore, the Company's revenue in large and small format printing at its service centers continues to decline. As a result, the Company initiated a restructuring plan in October of 2012. Barring any additional changes that may result from the Company's ongoing analysis, the restructuring plan includes the closure of 27 of the Company's service centers, which represents over 10% of the Company's total number of service center locations. In addition, as part of the restructuring plan, the Company reduced headcount in and middle management associated with its service center locations, streamlined the upper management team, and allocated more resources into growing sales categories such as managed print services and digital services. The restructuring plan provides for a headcount reduction of approximately 300 full-time employees, which represents approximately 10% of the Company's total workforce.

## **Table of Contents**

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

*The following discussion should be read in conjunction with our interim Condensed Consolidated Financial Statements and the related notes and other financial information appearing elsewhere in this report as well as Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2011 Form 10-K and our Quarterly Report on Form 10-Q for the quarters ended March 31, 2012 and June 30, 2012.*

#### **Business Summary**

ARC provides specialized document solutions to businesses of all types, and is the leading document solutions company for the non-residential segment of the architecture, engineering and construction ( AEC ) industry. ARC is the largest company of its kind in the United States and offers managed print services, digital color printing, proprietary document management technology products and services as well as conventional reprographic services.

Our products and services rely on our technology and expertise to enhance our customers' document workflow, reduce costs, shorten their document processing and distribution time, improve the quality of their document management tasks, and provide a secure, controlled environment in which to manage, distribute and produce their documents.

ARC offers three general categories of service which are reported as Reprographics Services, Facilities Management, and Equipment and Supplies.

*Reprographics Services* sales include operational activities provided at Company locations such as document management services, document logistics, large- and small-format print-on-demand services in color and black and white, and digital document management services.

*Facilities Management* sales are primarily composed of services executed at the customer's location ( on-site services) where we provide document production equipment and sometimes staff in our customers' offices. These services include both (i) reprographics services or facilities management ( FM ), as well as (ii) managed print services ( MPS ). Under an MPS contract, we supply, maintain and manage a customer's entire print network, including office printing equipment, on an outsourced basis. In each case, ARC assumes all costs related to print, and issues a single invoice to its customers based on a contracted cost-per-printed page rate.

*Equipment and Supplies* sales involve the resale of printing and imaging equipment from a wide variety of suppliers.

We are diversifying our business beyond the services we have traditionally provided to the AEC industry, and we are expanding into managed print services, digital color printing to the non-AEC market, and technology-based document management services. We deliver both our traditional and newer services through a nationwide network of service centers, locally-based sales executives, technical specialists, and a national/regional sales force known as Global Solutions, which is managed from our corporate offices in Walnut Creek, California. Based on our analysis of our operating results, we estimate that sales to the AEC industry accounted for approximately 75% of our net sales for the nine months ended September 30, 2012, with the remaining 25% consisting of sales to non-AEC industries.

Acquisition activity during the last three years has been minimal and did not materially affect our overall business.

Historically, our local production facilities have operated under their acquired brand. In response to changes in our markets, consisting primarily of the consolidation of our larger customers and prospects, we branded all of our operations ARC in 2011 to highlight the scope and scale of our services. Our non-AEC digital color printing business is branded separately as Riot Creative Imaging to facilitate marketing to a specialized customer base.

We identify operating segments based on the various business activities that earn revenue and incur expense. Since operating segments have similar products and services, classes of customers, production processes and economic characteristics, we are deemed to operate as a single reportable segment. See Note 1 Description of Business and Basis of Presentation for further information.

**Costs and Expenses.** Our cost of sales consists primarily of paper, toner and other consumables, labor, and expenses for facilities and equipment. Facilities and equipment expenses include maintenance, repairs, rents, insurance, and depreciation. Paper is the largest component of our material cost. However, paper pricing typically does not significantly affect our operating margins due, in part, to our efforts to pass increased costs on to our customers. We closely monitor material cost as a percentage of net sales to measure volume and waste. We also track labor utilization, or net sales per employee, to measure productivity and determine staffing levels.

## Edgar Filing: American Reprographics CO - Form 10-Q

We maintain low levels of inventory and other working capital. Our capital expenditure requirements are changing slightly as we are more frequently electing to purchase equipment for our facilities and on-site service installations rather than lease it. This practice reflects an increase of cash available to fund capital expenditures, and the lower cost of capital under our revolving credit facilities versus current capital lease rates.

Research and development costs consist mainly of the salaries, leased building space, and computer equipment that comprise our data storage and development centers in Fremont, California and Kolkata, India. Such costs are primarily recorded to cost of sales.

---

## **Table of Contents**

One of the primary methods we have used to maintain our margins during periods of economic or industry decline has been to quickly and aggressively reduce our variable operating costs. The largest portions of our variable costs are labor-related. Given that we manage production capacity primarily through labor utilization during a given daily production schedule or shift, we achieve cost containment objectives through the reduction of full-time employees, and the close management of hourly schedules.

During the recent past we have seen customers increasingly adopt technology to manage construction documents and print fewer documents as a result. We believe this trend will continue in future periods, and therefore we initiated a restructuring plan in October of 2012 in order to position the Company to better serve the evolving document management needs of our customers to digital document management solutions, and away from traditional project-related printing. As part of the restructuring plan, we reduced headcount in our service centers and middle management, streamlined the upper management team, and allocated more resources into growing sales categories such as managed print services, and digital services.

Barring any additional changes that may result from the Company's ongoing analysis, our restructuring plan includes the closure of 27 of our service centers, which represents over 10% of our total number of service center locations. In addition, the restructuring plan provides for a headcount reduction of approximately 300 full-time employees, which represents approximately 10% of our total workforce. We are still assessing the anticipated impact of the restructuring charges on the Company's results for the fourth quarter of 2012. We believe that the implementation of the restructuring plan will lead to margin expansion in future periods.

### ***Non-GAAP Financial Measures.***

EBIT, EBITDA and related ratios presented in this report are supplemental measures of our performance that are not required by or presented in accordance with accounting principles generally accepted in the United States of America ( GAAP ). These measures are not measurements of our financial performance under GAAP and should not be considered as alternatives to net income, income from operations, or any other performance measures derived in accordance with GAAP or as an alternative to cash flows from operating, investing or financing activities as a measure of our liquidity.

EBIT represents net income before interest and taxes. EBITDA represents net income before interest, taxes, depreciation and amortization. EBIT margin is a non-GAAP measure calculated by dividing EBIT by net sales. EBITDA margin is a non-GAAP measure calculated by dividing EBITDA by net sales.

We present EBIT, EBITDA and related ratios because we consider them important supplemental measures of our performance and liquidity. We believe investors may also find these measures meaningful, given how our management makes use of them. The following is a discussion of our use of these measures.

We use EBIT and EBITDA to measure and compare the performance of our operating segments. Our operating segments' financial performance includes all of the operating activities except debt and taxation which are managed at the corporate level for U.S. operating segments. As a result, we believe EBIT is the best measure of operating segment profitability and the most useful metric by which to measure and compare the performance of our operating segments. We also use EBIT to measure performance for determining operating segment-level compensation and we use EBITDA to measure performance for determining consolidated-level compensation. In addition, we use EBIT and EBITDA to evaluate potential acquisitions and potential capital expenditures.

EBIT, EBITDA and related ratios have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are as follows:

They do not reflect our cash expenditures, or future requirements for capital expenditures and contractual commitments;

They do not reflect changes in, or cash requirements for, our working capital needs;

They do not reflect the significant interest expense, or the cash requirements necessary, to service interest or principal payments on our debt;

## Edgar Filing: American Reprographics CO - Form 10-Q

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements; and

Other companies, including companies in our industry, may calculate these measures differently than we do, limiting their usefulness as comparative measures.

Because of these limitations, EBIT, EBITDA, and related ratios should not be considered as measures of discretionary cash available to us to invest in business growth or to reduce our indebtedness. We compensate for these limitations by relying primarily on our GAAP results and using EBIT, EBITDA and related ratios only as supplements.

Our presentation of adjusted net income and adjusted EBITDA over certain periods is an attempt to provide meaningful comparisons to our historical performance for our existing and future investors. The unprecedented changes in our end markets over the past several years have required us to take measures that are unique in our history and specific to individual circumstances. Comparisons inclusive of these actions make normal financial and other performance patterns difficult to discern under a strict GAAP presentation. Each non-GAAP presentation, however, is explained in detail in the reconciliation tables below.

**Table of Contents**

Specifically, we have presented adjusted net (loss) income attributable to ARC and adjusted (loss) earnings per share attributable to ARC shareholders for the three and nine months ended September 30, 2012 and 2011 to reflect the exclusion of goodwill impairment charge, the amortization impact related specifically to the change in useful lives of trade names, interest rate swap related costs, the valuation allowance related to certain deferred tax assets and other discrete tax items. This presentation facilitates a meaningful comparison of our operating results for the three and nine months ended September 30, 2012 and 2011. We believe these charges were the result of our capital restructuring, or other items which are not indicative of our actual operating performance.

We presented adjusted EBITDA in the three and nine months ended September 30, 2012 to exclude the non-cash goodwill impairment charge of \$16.7 million and stock-based compensation expense of \$0.6 million and \$1.5 million, respectively. We presented adjusted EBITDA in the three and nine months ended September 30, 2011 to exclude the non-cash goodwill impairment charge of \$42.1 million and \$65.4 million, respectively, and stock-based compensation expense of \$0.5 million and \$3.8 million, respectively. This presentation is consistent with the definition of adjusted EBITDA in our credit agreement; therefore, we believe this information is useful to investors in assessing our financial performance.

The following is a reconciliation of cash flows provided by operating activities to EBIT, EBITDA, and net loss attributable to ARC:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cash flows provided by operating activities	\$ 14,029	\$ 17,617	\$ 30,879	\$ 29,490
Changes in operating assets and liabilities, net of effect of business acquisitions	(6,893)	(7,504)	(2,110)	19,078
Non-cash expenses, including depreciation and amortization	(27,230)	(51,809)	(54,628)	(178,688)
Income tax (benefit) provision	(84)	(2,392)	1,845	51,872
Interest expense, net	6,982	7,743	21,675	23,609
(Income) loss attributable to the noncontrolling interest	(18)	(61)	(213)	90
<b>EBIT</b>	<b>(13,214)</b>	<b>(36,406)</b>	<b>(2,552)</b>	<b>(54,549)</b>
Depreciation and amortization	8,989	11,711	30,510	36,363
<b>EBITDA</b>	<b>(4,225)</b>	<b>(24,695)</b>	<b>27,958</b>	<b>(18,186)</b>
Interest expense, net	(6,982)	(7,743)	(21,675)	(23,609)
Income tax benefit (provision)	84	2,392	(1,845)	(51,872)
Depreciation and amortization	(8,989)	(11,711)	(30,510)	(36,363)
<b>Net loss attributable to ARC</b>	<b>\$ (20,112)</b>	<b>\$ (41,757)</b>	<b>\$ (26,072)</b>	<b>\$ (130,030)</b>

The following is a reconciliation of net loss attributable to ARC to EBIT, EBITDA and adjusted EBITDA:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net loss attributable to ARC	\$ (20,112)	\$ (41,757)	\$ (26,072)	\$ (130,030)
Interest expense, net	6,982	7,743	21,675	23,609
Income tax (benefit) provision	(84)	(2,392)	1,845	51,872
<b>EBIT</b>	<b>(13,214)</b>	<b>(36,406)</b>	<b>(2,552)</b>	<b>(54,549)</b>
Depreciation and amortization	8,989	11,711	30,510	36,363
<b>EBITDA</b>	<b>(4,225)</b>	<b>(24,695)</b>	<b>27,958</b>	<b>(18,186)</b>
Goodwill impairment	16,707	42,109	16,707	65,444
Stock-based compensation	554	517	1,457	3,775

## Edgar Filing: American Reprographics CO - Form 10-Q

Adjusted EBITDA	\$	<b>13,036</b>	\$	17,931	\$	<b>46,122</b>	\$	51,033
-----------------	----	---------------	----	--------	----	---------------	----	--------

The following is a reconciliation of net loss margin attributable to ARC to EBIT margin, EBITDA margin and adjusted EBITDA margin:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012(1)	2011(1)	2012(1)	2011(1)
Net loss margin attributable to ARC	(20.2)%	(39.8)%	(8.4)%	(40.5)%
Interest expense, net	7.0	7.4	7.0	7.4
Income tax (benefit) provision	(0.1)	(2.3)	0.6	16.2
EBIT margin	(13.3)	(34.7)	(0.8)	(17.0)
Depreciation and amortization	9.0	11.2	9.9	11.3
EBITDA margin	(4.2)	(23.6)	9.0	(5.7)
Goodwill impairment	16.8	40.2	5.4	20.4
Stock-based compensation	0.6	0.5	0.5	1.2
Adjusted EBITDA margin	13.1%	17.1%	14.9%	15.9%

**Table of Contents**

(1) Column does not foot due to rounding

The following is a reconciliation of net loss attributable to ARC to unaudited adjusted net income (loss) attributable to ARC:

(In thousands, except per share amounts)	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	2012	2011	2012	2011
Net loss attributable to ARC	\$ (20,112)	\$ (41,757)	\$ (26,072)	\$ (130,030)
Goodwill impairment	16,707	42,109	16,707	65,444
Change in trade name impact to amortization		2,368	3,158	7,106
Interest rate swap related costs	776	1,389	3,047	4,369
Income tax benefit related to above items	(4,230)	(6,866)	(6,279)	(14,745)
Deferred tax valuation allowance and other discrete tax items	5,142	3,832	8,575	67,040
Unaudited adjusted net (loss) income attributable to ARC	\$ (1,717)	\$ 1,075	\$ (864)	\$ (816)

**Actual:**

Loss per share attributable to ARC shareholders:

Basic	\$ (0.44)	\$ (0.92)	\$ (0.57)	\$ (2.87)
Diluted	\$ (0.44)	\$ (0.92)	\$ (0.57)	\$ (2.87)

Weighted average common shares outstanding:

Basic	45,716	45,416	45,641	45,366
Diluted	45,716	45,416	45,641	45,366

**Adjusted:**

(Loss) earnings per share attributable to ARC shareholders:

Basic	\$ (0.04)	\$ 0.02	\$ (0.02)	\$ (0.02)
Diluted	\$ (0.04)	\$ 0.02	\$ (0.02)	\$ (0.02)

Weighted average common shares outstanding:

Basic	45,716	45,416	45,641	45,366
Diluted	45,716	45,448	45,641	45,366

*Free Cash Flows*

Free Cash Flows ( FCF ) is defined as cash flows from operating activities less capital expenditures. FCF is a useful measure in determining our ability to generate excess cash flows for reinvestment in the business in a variety of ways including acquisition opportunities, the potential return of value to shareholders through stock repurchases or the purchase of our own debt instruments. As such, we believe this measure provides relevant and useful information to our current and potential investors.

The following is reconciliation of cash flows provided by operating activities to FCF:

(In thousands)	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	2012	2011	2012	2011
Cash flows provided by operating activities	\$ 14,029	\$ 17,617	\$ 30,879	\$ 29,490
Capital expenditures	(4,932)	(4,316)	(14,194)	(11,938)
Free Cash Flows	\$ 9,097	\$ 13,301	\$ 16,685	\$ 17,552

Cash flows provided by operating activities for the nine months ended September 30, 2012 and 2011 includes a \$10.5 million semi-annual interest payment on the Company's 10.5% senior notes.



**Table of Contents****Results of Operations**

(In millions, except percentages)	Three Months Ended				Nine Months Ended			
	September 30,		Increase (decrease)		September 30,		Increase (decrease)	
	2012	2011	\$	%	2012	2011	\$ (1)	%
Reprographics services	\$ 58.7	\$ 65.5	\$ (6.8)	(10.4)%	\$ 186.0	\$ 206.0	\$ (20.0)	(9.7)%
Facilities management	27.1	25.5	1.6	6.3%	81.3	75.3	6.0	7.9%
Equipment and supplies sales	13.6	13.8	(0.2)	(1.2)%	41.9	39.6	2.4	6.0%
Total net sales	\$ 99.4	\$ 104.8	\$ (5.4)	(5.1)%	\$ 309.2	\$ 320.9	\$ (11.7)	(3.6)%
Gross profit	\$ 29.2	\$ 33.9	\$ (4.7)	(13.8)%	\$ 94.9	\$ 103.0	\$ (8.1)	(7.9)%
Selling, general and administrative expenses	\$ 23.9	\$ 23.5	\$ 0.4	1.6%	\$ 71.3	\$ 78.2	\$ (6.8)	(8.7)%
Amortization of intangibles	\$ 1.8	\$ 4.7	\$ (2.8)	(60.3)%	\$ 9.2	\$ 14.1	\$ (4.9)	(34.5)%
Goodwill impairment	\$ 16.7	\$ 42.1	\$ (25.4)	(60.3)%	\$ 16.7	\$ 65.4	\$ (48.7)	(74.5)%
Interest expense, net	\$ 7.0	\$ 7.7	\$ (0.8)	(9.8)%	\$ 21.7	\$ 23.6	\$ (1.9)	(8.2)%
Income tax (benefit) provision	\$ (0.1)	\$ (2.4)	\$ 2.3	(96.5)%	\$ 1.8	\$ 51.9	\$ (50.0)	(96.4)%
Net loss attributable to ARC	\$ (20.1)	\$ (41.8)	\$ 21.6	(51.8)%	\$ (26.1)	\$ (130.0)	\$ 104.0	(79.9)%
EBITDA	\$ (4.2)	\$ (24.7)	\$ 20.5	(82.9)%	\$ 28.0	\$ (18.2)	\$ 46.1	(253.7)%
Adjusted EBITDA	\$ 13.0	\$ 17.9	\$ (4.9)	(27.3)%	\$ 46.1	\$ 51.0	\$ (4.9)	(9.6)%

(1) Column does not foot due to rounding

The following table provides information on the percentages of certain items of selected financial data compared to net sales for the periods indicated:

	As Percentage of Net Sales Three Months Ended September 30,		As Percentage of Net Sales Nine Months Ended September 30,	
	2012 (1)	2011 (1)	2012 (1)	2011 (1)
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	70.6	67.6	69.3	67.9
Gross profit	29.4	32.4	30.7	32.1
Selling, general and administrative expenses	24.1	22.5	23.1	24.4
Amortization of intangibles	1.9	4.4	3.0	4.4
Goodwill impairment	16.8	40.2	5.4	20.4
Loss from operations	(13.3)	(34.7)	(0.8)	(17.1)
Interest expense, net	7.0	7.4	7.0	7.4
Loss before income tax (benefit) provision	(20.3)	(42.1)	(7.8)	(24.4)
Income tax (benefit) provision	(0.1)	(2.3)	0.6	16.2
Net loss	(20.2)	(39.8)	(8.4)	(40.6)
Income attributable to the noncontrolling interest		(0.1)	(0.1)	
Net loss attributable to ARC	(20.2)%	(39.8)%	(8.4)%	(40.5)%
EBITDA	(4.2)%	(23.6)%	9.0%	(5.7)%
Adjusted EBITDA	13.1%	17.1%	14.9%	15.9%

## Edgar Filing: American Reprographics CO - Form 10-Q

(1) Column does not foot due to rounding

*Three and Nine Months Ended September 30, 2012 Compared to Three and Nine Months Ended September 30, 2011*

### *Net Sales*

Net sales for the three and nine months ended September 30, 2012 decreased by 5.1% and 3.6%, respectively. The decrease in net sales was due to a combination of (1) the decrease of private, non-residential construction activity, as compared to periods prior to the recent recession, and (2) our AEC customers are accelerating their adoption of technology and exerting greater central control over document production for their project teams

*Reprographics services.* Reprographics services sales decreased \$6.8 million, or 10.4%, and \$20.0 million, or 9.7%, during the three and nine months ended September 30, 2012, compared to the same periods in 2011, respectively.

Overall reprographics services sales nationwide were negatively affected by the lower volume of construction drawings produced through large-format black and white printing. Large-format black-and-white printing revenues represented approximately 31% of reprographics services for the three and nine months ended September 30, 2012, and decreased by approximately 15% compared to the same periods in 2011.

## Table of Contents

Digital color printing comprised approximately 31% and 29% of our overall reprographics services sales for the three and nine months ended September 30, 2012, respectively. Net sales of digital color printing services decreased approximately 3.0% and approximately 5.0% for the three and nine months ended September 30, 2012 compared to the same periods in 2011. We attribute this decrease, in part, to an overall decline in color printing in the AEC industry, and temporary disruptions as we expand and enhance our digital color printing operations and sales force.

Our customers in the AEC industry prefer to receive documents in both analog (printed) and digital forms, but we have noted a growing adoption of digital services. Despite the decline in AEC activity, during the three and nine months ended September 30, 2012, digital service revenue remained consistent as compared to the same periods in 2011. As a percentage of overall sales, digital service revenue was approximately 9% for the three and nine months ended September 30, 2012, which was consistent with the same periods in 2011.

*Facilities management.* On-site sales for the three and nine months ended September 30, 2012, increased \$1.6 million, or 6.3%, and \$6.0 million, or 7.9%, respectively, as compared to the same periods in 2011. FM revenue is derived from two sources: (1) an engagement with the customer to place reprographics equipment that we own or lease in our customers' offices, typically referred to as a traditional FM, and (2) an arrangement by which our customers outsource their entire printing network to us, including all office printing, copying, and reprographics printing, typically referred to as managed print services or MPS. In both cases, we are paid a single cost per unit of material used, often referred to as a click charge.

The number of onsite services locations has grown to approximately 6,700 as of September 30, 2012, an increase of more than 800 locations compared to September 30, 2011, due to growth in new MPS placements. We believe this is a high growth area for us as demonstrated by the adoption of our MPS services by large, multi-national firms in the AEC space over the past several years. Our intention is to continue the expansion of our on-site service offering through our regional sales force and through Global Services, our national accounts group.

*Equipment and supplies sales.* Equipment and supplies sales for the three months ended September 30, 2012 decreased \$0.2 million, or 1.2%, as compared to the same period in 2011. Equipment and supplies sales for the nine months ended September 30, 2012 increased \$2.4 million, or 6.0%, as compared to the same period in 2011. For the three months ended September 30, 2012, the decrease in equipment and supplies sales was driven by a slight decline in equipment and supplies sales in our US operations compared to the same period in 2011. For the nine months ended September 30, 2012 the increase in equipment and supplies sales was primarily due to increased sales in UNIS Document Solutions Co. Ltd ( UDS ), our Chinese business venture with Beijing-based Unisplendour. To date, the Chinese market has shown a preference for owning reprographics equipment as opposed to using equipment through an on-site services or FM arrangement. Chinese operations had sales of equipment and supplies of \$5.3 million and \$16.2 million for the three and nine months ended September 30, 2012, respectively, as compared to \$5.3 million and \$12.2 million for the three and nine months ended September 30, 2011, respectively.

### *Gross Profit*

During the three months ended September 30, 2012, gross profit and gross profit margin decreased to \$29.2 million, or 29.4%, as compared to \$33.9 million, or 32.4%, during the same period in 2011, on a sales decline of \$5.4 million.

During the nine months ended September 30, 2012, gross profit and gross profit margin decreased to \$94.9 million, or 30.7%, as compared to \$103.0 million, or 32.1%, during the same period in 2011, on a sales decline of \$11.7 million.

The primary reason for the decrease in gross margins was a decline in sales of traditional reprographics. As a result, material costs as a percentage of consolidated sales for the three and nine months ended September 30, 2012 were 150 and 160 basis points higher as compared to the same periods in 2011. With the decrease in higher-margin reprographics sales, lower-margin equipment and supplies sales in China became a greater portion of consolidated sales. For the three months ended September 30, 2012, an additional contributor to the decrease in gross margins was an increase of 80 basis points in labor as a percentage of sales compared to the same period in 2011. The increase in labor as a percentage of sales was due to the continuing decline in traditional reprographics services sales leading to decreased utilization at our service centers.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased \$0.4 million, or 1.6%, during the three months ended September 30, 2012, compared to the same period in 2011.

Selling, general and administrative expenses decreased \$6.8 million, or 8.7%, during the nine months ended September 30, 2012, compared to the same period in 2011.

## Edgar Filing: American Reprographics CO - Form 10-Q

General and administrative expenses for the three and nine months ended September 30, 2012, decreased \$1.6 million, or 10.5%, and \$8.6 million, or 16.6% compared to the same periods in 2011. This decrease was primarily driven by the reconfiguration of our labor force to increase utilization in response to the decline in overall sales, and a decrease in stock-based compensation due to the vesting of awards in 2011.

**Table of Contents**

Selling expenses increased \$2.0 million and \$1.8 million for the three and nine months ended September 30, 2012, respectively, compared to the same periods in 2011. The increases were primarily due to the hiring and training of new sales personnel to support our new sales initiatives, such as color sales and our MPS offering.

*Amortization of Intangibles*

Amortization of intangibles of \$1.8 million and \$9.2 million for the three and nine months ended September 30, 2012, respectively, decreased by \$2.8 million or 60.3% and \$4.9 million or 34.5% compared to same periods in 2011 primarily due to the completion of the phasing out of local trade names in April 2012 described below.

During the fourth quarter of 2010, we decided to phase out the use of our local trade names in North America over the following 18 months and revised the remaining estimated useful lives of our trade name intangible assets accordingly. Effective January 1, 2011, all divisions began using the ARC name, though some of the original brand names remained in circulation to ensure business recognition and the retention of existing customers. In April 2012, the trade names were fully transitioned to the ARC name and removed from the marketplace. This change in estimate was accounted for on a prospective basis, resulting in increased amortization expense over the revised useful lives for each trade name. The remaining useful lives of trade names prior to this change ranged from 11 to 18 years.

*Goodwill Impairment*

We assess goodwill at least annually for impairment as of September 30 or more frequently if events and circumstances indicate that goodwill might be impaired. Goodwill impairment testing is performed at the reporting unit level.

At September 30, 2012, we performed our annual goodwill impairment analysis, which indicated that seven of our 27 reporting units, six in the United States and one in Canada, had a goodwill impairment as of September 30, 2012. Accordingly, we recorded a pretax, non-cash charge for the three months ended September 30, 2012 to reduce the carrying value of goodwill by \$16.7 million.

At September 30, 2011, our annual goodwill impairment analysis indicated that nine of our 37 reporting units, eight in the United States and one in Canada, had a goodwill impairment as of September 30, 2011. Accordingly, we recorded a pretax, non-cash charge for the three months ended September 30, 2011 to reduce the carrying value of goodwill by \$42.1 million.

At June 30, 2011, we determined that there were sufficient indicators to trigger an interim goodwill impairment analysis. The indicators included, among other factors, the current economic environment; the performance against plan of reporting units which previously had goodwill impairment; and revised forecasted future earnings. The results of our analysis indicated that six of our reporting units, all of which are located in the United States, had a goodwill impairment as of June 30, 2011. Accordingly, we recorded a pretax, non-cash charge for the three and six months ended June 30, 2011 to reduce the carrying value of goodwill by \$23.3 million.

See *Critical Accounting Policies* section for further information related to our goodwill impairment test.

*Interest Expense, Net*

Net interest expense was \$7.0 million and \$21.7 million during the three and nine months ended September 30, 2012, respectively, compared to \$7.7 and \$23.6 million in the same periods in 2011. The decrease in interest expense was driven by a reduction in the average debt balance of \$13.9 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 and a reduction in interest expense reclassified from accumulated other comprehensive income resulting from a previously terminated interest rate swap agreement (refer to Note 8 *Derivatives and Hedging Transactions* for further information).

*Income Taxes*

We recorded an income tax benefit of \$84 thousand in relation to pretax loss of \$20.2 million for the three months ended September 30, 2012, and an income tax provision of \$1.8 million in relation to pretax loss of \$24.0 million for the nine months ended September 30, 2012. We recorded an income tax benefit of \$2.4 million in relation to a pretax loss of \$44.1 million, and an income tax provision of \$51.9 million in relation to a pretax loss of \$78.2 million for the three and nine months ended September 30, 2011, respectively.

For the three months ended September 30, 2012, the low income tax benefit was primarily due to an additional valuation allowance against certain deferred tax assets as a result of the pretax loss of \$20.2 million, which included a stock-based goodwill impairment charge of \$6.3

## Edgar Filing: American Reprographics CO - Form 10-Q

million that is nondeductible for U.S. income tax purposes until the stock is fully disposed of. For the nine months ended September 30, 2012, the income tax provision of \$1.8 million was primarily due to the impact of amortization of tax basis goodwill in a deferred tax liability position which results in an additional valuation allowance.

For the three months ended September 30, 2011, the low income tax benefit was primarily due to the impact of a stock basis goodwill impairment charge of \$27.1 million, which is nondeductible for U.S. income tax purposes until the stock is disposed of, as well as an additional valuation allowance of \$1.4 million recorded against certain deferred tax assets recognized in the same period. For the nine months ended September 30, 2011, the income tax provision of \$51.9 million is primarily due to the establishment of a \$65.7 million non-cash valuation allowance against certain of our deferred tax assets. The deferred tax assets remain available to us for use in future profitable quarters.

**Table of Contents***Noncontrolling Interest*

Net loss attributable to noncontrolling interest represents 35% of the loss of UDS and its subsidiaries, which together comprise our Chinese operations, which commenced operations on August 1, 2008.

*Net Loss Attributable to ARC*

Net loss attributable to ARC was \$20.1 million and \$26.1 million during the three and nine months ended September 30, 2012, respectively, compared to net loss attributable to ARC of \$41.8 million and \$130.0 million in the same periods in 2011. The net loss attributable to ARC in 2012 is primarily due to the decrease in sales and gross margins and the goodwill impairment charge, partially offset by the decrease in selling, general and administrative expenses, as noted above. The net loss attributable to ARC in 2011 is primarily due to the establishment of a valuation allowance and the goodwill impairment charges, as described above.

*EBITDA*

EBITDA margin increased to (4.2)% and 9.0% during the three and nine months ended September 30, 2012, compared to (23.6)% and (5.7) % during the same periods in 2011 due to the impact of the goodwill impairment in 2012 and 2011. Excluding the impact of goodwill impairment and stock based compensation, our adjusted EBITDA margin was 13.1% and 14.9% for the three and nine months ended September 30, 2012, as compared to 17.1% and 15.9% during the same periods in 2011. The decrease in our adjusted EBITDA margins in 2012 is primarily due to the decrease in gross profit margins noted above.

*Impact of Inflation*

Inflation has not had a significant effect on our operations. Price increases for raw materials, such as paper and fuel charges, typically have been, and we expect will continue to be, passed on to customers in the ordinary course of business.

*Liquidity and Capital Resources*

Our principal sources of cash have been operations and borrowings under our debt agreements. Our historical uses of cash have been for acquisitions of reprographics businesses, payment of principal and interest on outstanding debt obligations, and capital expenditures. Total cash as of September 30, 2012 was \$30.5 million. Of this amount, \$14.3 million was held in foreign countries. Specifically, \$12.5 million was held in China and is considered a permanent investment in UDS.

Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our interim Condensed Consolidated Statements of Cash Flows and notes thereto included elsewhere in this report.

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net cash provided by operating activities	\$ 14,029	\$ 17,617	\$ 30,879	\$ 29,490
Net cash used in investing activities	\$ (4,615)	\$ (4,038)	\$ (14,061)	\$ (20,742)
Net cash used in financing activities	\$ (2,151)	\$ (9,535)	\$ (11,732)	\$ (9,395)

*Operating Activities*

Cash flows from operations are primarily driven by sales and net profit generated from these sales, excluding non-cash charges.

The overall increase in cash flows from operations during the nine months ended September 30, 2012 over the same period in 2011 was primarily due to the timing of trade payables and payroll, partially offset by our 2012 decline in operating results and an increase in inventory. The increase in inventory was primarily due to a build-up of inventory in our Chinese operations, as the fourth quarter is seasonally their strongest quarter. Days sales outstanding ( DSO ) remained consistent at 52 days as of September 30, 2012 compared to 52 days as of September 30, 2011. With the absence of significant growth in the construction industry, we will continue to focus on our accounts receivable collections and DSO. If the recent negative sales trends continue throughout 2012 and into 2013, it will significantly impact our cash flows from operations in future periods.

*Investing Activities*

Net cash used in investing activities of \$14.1 million for the nine months ended September 30, 2012 relates to capital expenditures of \$14.2 million and net cash inflows from other investing activities of \$0.1 million. Cash flows from other investing activities primarily relate cash proceeds generated from the sale of fixed assets, partially offset by the purchase of customer lists. Net cash used in investing activities for the nine months ended September 30, 2011 includes a \$9.7 million payment related to the termination our swap agreement.

**Table of Contents***Financing Activities*

Net cash of \$11.7 million used in financing activities during the nine months ended September 30, 2012 primarily relates to scheduled payments under capital leases and seller notes of \$12.0 million, deferred financing fee payments related to our new revolving credit facility of \$0.8, and net borrowings under our foreign revolving credit facility of \$1.0 million.

Our cash position, working capital, and debt obligations as of September 30, 2012 and December 31, 2011 are shown below and should be read in conjunction with our Condensed Consolidated Balance Sheets and notes thereto contained elsewhere in this report.

<b>(In thousands)</b>	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Cash and cash equivalents	\$ 30,534	\$ 25,437
Working capital	\$ 43,793	\$ 40,405
Borrowings from senior secured credit facility and Notes (1)	\$ 196,694	\$ 196,241
Other debt obligations	27,538	30,023
<b>Total debt obligations</b>	<b>\$ 224,232</b>	<b>\$ 226,264</b>

(1) Notes, net of discount of **\$3,306** and \$3,759 at September 30, 2012 and December 31, 2011, respectively.

The increase of \$3.4 million in working capital in 2012 was primarily due to an increase in cash of \$5.1 million, an increase in accounts receivable of \$3.0 million, and a \$2.3 million increase in inventory. The increase was partially offset by an increase in accrued expenses of \$7.1 million. To manage our working capital, we focus on our number of days sales outstanding and monitor the aging of our accounts receivable, as receivables are the most significant element of our working capital.

We believe that our current cash balance of \$30.5 million, availability under our revolving credit facility and additional cash flows provided by operations should be adequate to cover the next twelve months of working capital needs, debt service requirements consisting of scheduled principal and interest payments, and planned capital expenditures, to the extent such items are known or are reasonably determinable based on current business and market conditions. In addition, we may elect to finance certain of our capital expenditure requirements through borrowings under our senior secured revolving credit facility, which had no debt outstanding as of September 30, 2012. See **Debt Obligations** section for further information related to our current credit facility.

We generate the majority of our revenue from sales of products and services provided to the AEC industry. As a result, our operating results and financial condition can be significantly affected by economic factors and business practices that influence the AEC industry, such as non-residential construction spending and the adoption of technology to manage construction documents. The effects of the current economic downturn in the United States have resulted in a downturn in construction spending in the AEC industry, which have affected our operating results. During the recent past we have also seen customers increasingly adopt technology to manage construction documents and print fewer documents as a result. The current diminished liquidity and credit availability in financial markets and the general economic downturn may adversely affect the ability of our customers and suppliers to obtain financing for significant operations and purchases, and to perform their obligations under their agreements with us. We believe the credit constraints in the financial markets are resulting in a decrease in, or cancellation of, existing business, could limit new business, and could negatively impact our ability to collect our accounts receivable on a timely basis. We are unable to predict the duration and severity of the current economic downturn or its effects on our business and results of operations, but the consequences may be materially adverse and more severe than other recent economic slowdowns.

We may buy our own bonds or equity securities from time to time in the open market or in private transactions. While we have not been actively seeking growth through acquisition during the current economic and industry downturn, the executive team continues to selectively evaluate potential acquisitions.

*Debt Obligations***10.5% Senior Notes due 2016**

## Edgar Filing: American Reprographics CO - Form 10-Q

On December 1, 2010, we completed a private placement of 10.5% senior unsecured notes due 2016 (the Notes ).

The Notes have an aggregate principal amount of \$200 million, and are general unsecured senior obligations and are subordinate to all of our existing and future senior secured debt to the extent of the assets securing such debt. We received gross proceeds of \$195.6 million from the Notes offering. Our obligations under the Notes are jointly and severally guaranteed by all of our domestic subsidiaries. The issue price was 97.824% with a yield to maturity of 11.0%. Interest on the Notes accrues at a rate of 10.5% per annum and is payable semiannually in arrears on June 15 and December 15 of each year, commencing on June 15, 2011. We will make each interest payment to the holders of record of the Notes on the immediately preceding June 1 and December 1.

*Repurchase upon Change of Control.* In connection with the issuance of the Notes, we entered into an indenture (the Indenture ). Upon the occurrence of a change in control (as defined in the Indenture), each holder of the Notes may require us to repurchase all of the then-outstanding Notes in cash at a price equal to 101% of the aggregate principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, to the date of repurchase.

## **Table of Contents**

*Other Covenants.* The Indenture contains covenants that limit, among other things, our company's and certain of our subsidiaries' ability to (1) incur certain additional debt and issue preferred stock, (2) make certain restricted payments, (3) consummate specified asset sales, (4) enter into certain transactions with affiliates, (5) create liens, (6) declare or pay any dividend or make any other distributions, (7) make certain investments, and (8) merge or consolidate with another person.

*Events of Default.* The Indenture provides for customary events of default (subject in certain cases to customary grace and cure periods), which include non-payment, breach of covenants in the Indenture, cross default and acceleration of other indebtedness, a failure to pay certain judgments and certain events of bankruptcy and insolvency. Generally, if an event of default occurs, the Trustee or holders of at least 25% in principal amount of the then outstanding Notes may declare the principal of and accrued but unpaid interest on all of the then-outstanding Notes to be due and payable.

*Exchange Offer.* Pursuant to a registered exchange offer in May 2011, we offered to exchange up to \$200.0 million aggregate principal amount of the Notes, for new notes that were registered under the Securities Act. The terms of the registered notes are the same as the terms of the Notes, except that they are registered under the Securities Act and the transfer restrictions, registration rights and additional interest provisions are not applicable. We accepted the exchange of \$200.0 million aggregate principal amounts of the Notes that were properly tendered in the exchange offer.

### ***2010 Credit Agreement***

In connection with the issuance of the Notes, our company and certain of our subsidiaries also entered into the 2010 Credit Agreement that provided for a \$50.0 million senior secured revolving line of credit.

### ***2012 Credit Agreement***

On January 27, 2012, we entered into a new Credit Agreement (the "2012 Credit Agreement") and terminated the 2010 Credit Agreement. The 2012 Credit Agreement provides revolving loans in an aggregate principal amount not to exceed \$50.0 million, with a Canadian sublimit of \$5.0 million, based on inventory, accounts receivable and unencumbered equipment of our subsidiaries organized in the US and Canada ("Domestic Subsidiaries") that meet certain eligibility criteria. The 2012 Credit Agreement has a maturity date of June 15, 2016.

Amounts borrowed in US dollars under the 2012 Credit Agreement bear interest, in the case of LIBOR loans, at a per annum rate equal to the LIBOR plus the LIBOR Margin, which may range from 1.75% to 2.25%, based on Average Daily Net Availability (as defined in the 2012 Credit Agreement). All other amounts borrowed in US dollars that are not LIBOR loans bear interest at a per annum rate equal to (i) the greatest of (A) the Federal Funds rate plus 0.5%, (B) the LIBOR (calculated based upon an interest period of three months and determined on a daily basis), plus 1.0% per annum, and (C) the rate of interest announced, from time to time, within Wells Fargo Bank, National Association at its principal office in San Francisco as its prime rate, plus (ii) the Base Rate Margin (as defined in the 2012 Credit Agreement), which may range from 0.75% to 1.25% percent, based on Average Daily Net Availability (as defined in the 2012 Credit Agreement). Amounts borrowed in Canadian dollars bear interest at a per annum rate equal to the Canadian Base Rate (as defined in the 2012 Credit Agreement) plus the LIBOR Margin, which may range from 1.75% to 2.25%, based on Average Daily Net Availability.

The 2012 Credit Agreement contains various loan covenants that restrict our ability to take certain actions, including restrictions on incurrence of indebtedness, creation of liens, mergers or consolidations, dispositions of assets, repurchase or redemption of capital stock, making certain investments, entering into certain transactions with affiliates or changing the nature of our business. In addition, at any time when Excess Availability (as defined in the 2012 Credit Agreement) is less than \$10.0 million we are required to maintain a Fixed Charge Coverage Ratio (as defined in the 2012 Credit Agreement) of at least 1.0. Our obligations under the 2012 Credit Agreement are secured by substantially all of our assets pursuant to a Guaranty and Security Agreement.

As of and during the nine months ended September 30, 2012, we did not have any outstanding debt under the 2012 Credit Agreement.

As of September 30, 2012, based on inventory, accounts receivable and unencumbered equipment of our subsidiaries organized in the US and Canada, our borrowing availability under the 2012 Credit Agreement was \$47.5 million. Standby letters of credit aggregating \$2.9 million reduced our borrowing availability under the 2012 Credit Agreement to \$44.6 million as of September 30, 2012.

### ***Foreign Credit Facility***

In the third quarter of 2012, UDS, ARC's Chinese operations, entered into a one-year revolving credit facility. The facility provides for a maximum credit amount of 11.1 million Chinese Yuan Renminbi, which translates to U.S. \$1.8 million as of September 30, 2012. Draws on the

Edgar Filing: American Reprographics CO - Form 10-Q

facility are limited to 30 day periods and incur a fee of 0.05% of the amount drawn and no additional interest is charged.

---

## **Table of Contents**

### ***Capital Leases***

As of September 30, 2012, we had \$25.4 million of capital lease obligations outstanding, with a weighted average interest rate of 8.5% and maturities between 2012 and 2017.

### ***Seller Notes***

As of September 30, 2012, we had \$0.4 million of seller notes outstanding, with a weighted average interest rate of 6.0% and maturities between 2013 and 2014. These notes were issued in connection with prior acquisitions.

### ***Off-Balance Sheet Arrangements***

As of September 30, 2012, we did not have any off-balance-sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

### ***Contractual Obligations and Other Commitments***

***Operating Leases.*** We have entered into various non-cancelable operating leases primarily related to facilities, equipment and vehicles used in the ordinary course of business.

***Contingent Transaction Consideration.*** We have entered into earnout obligations in connection with prior acquisitions. If the acquired businesses generate sales and/or operating profits in excess of predetermined targets, we are obligated to make additional cash payments in accordance with the terms of such earnout obligations. As of September 30, 2012, we have potential future earnout obligations for acquisitions consummated before the adoption of ASC 805, *Business Combinations*, of approximately \$1.5 million through 2014 if predetermined financial targets are met or exceeded, and earnout obligations of \$0.3 million through 2014 consummated subsequent to the adoption of ASC 805. Earnout payments prior to the adoption of ASC 805 are recorded as additional purchase price (as goodwill) when the contingent payments are earned and become payable.

***Legal Proceedings.*** On October 21, 2010, a former employee, individually and on behalf of a purported class consisting of all non-exempt employees who work or worked for American Reprographics Company, LLC and American Reprographics Company in the State of California at any time from October 21, 2006 through October 21, 2010, filed an action against us in the Superior Court of California for the County of Orange. The complaint alleges, among other things, that we violated the California Labor Code by failing to (i) provide meal and rest periods, or compensation in lieu thereof, (ii) timely pay wages due at termination, and (iii) that those practices also violate the California Business and Professions Code. The relief sought includes damages, restitution, penalties, interest, costs, and attorneys' fees and such other relief as the court deems proper. We have not accrued for any liability in our Consolidated Financial Statements in connection with this matter. We cannot reasonably estimate the amount or range of possible loss, if any, at this time.

In addition to the matter described above, we are involved in various additional legal proceedings and other legal matters from time to time in the normal course of business. We do not believe that the outcome of any of these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

### ***Critical Accounting Policies***

Our management prepares financial statements in conformity with GAAP. When we prepare these financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to accounts receivable, inventories, deferred tax assets, goodwill and intangible assets and long-lived assets. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

### ***Goodwill Impairment***

In connection with acquisitions, we apply the provisions of ASC 805, *Business Combinations*, using the acquisition method of accounting. The excess purchase price over the fair value of net tangible assets and identifiable intangible assets acquired is recorded as goodwill.

## Edgar Filing: American Reprographics CO - Form 10-Q

In accordance with ASC 350, *Intangibles - Goodwill and Other*, we assess goodwill for impairment annually as of September 30, and more frequently if events and circumstances indicate that goodwill might be impaired.

At September 30, 2012, absent the fact that we assess goodwill for impairment annually as of September 30, we determined that there were sufficient indicators to trigger a goodwill impairment analysis. The indicators included, among other factors: (1) our underperformance relative to our plan in the third quarter of 2012 (2) the performance against plan of reporting units which previously had goodwill impairment (3) the economic environment, and (4) the continued decrease in large and small format printing at our service centers, which our management believes is partly due to customers' increasing adoption of technology. Our analysis indicated that seven of our 27 reporting units, six in the United States and one in Canada, had a goodwill impairment as of September 30, 2012. Accordingly, we recorded a pretax, non-cash charge for the three months ended September 30, 2012 to reduce the carrying value of goodwill by \$16.7 million.

**Table of Contents**

At September 30, 2011, our annual goodwill impairment analysis indicated that nine of our 37 reporting units, eight in the United States and one in Canada, had a goodwill impairment as of September 30, 2011. Accordingly, we recorded a pretax, non-cash charge for the three months ended September 30, 2011 to reduce the carrying value of goodwill by \$42.1 million. Given the increased uncertainty in the timing of the recovery of the construction industry, and the increased uncertainty in the economy as a whole, as well as the significant decline in the price of our Notes (resulting in a higher yield) and a decline of our stock price during the third quarter of 2011, we concluded that it was appropriate to increase the estimated weighted average cost of capital (WACC) of our reporting units as of September 30, 2011. The increase in our WACC was the main driver in the decrease in the estimated fair value of reporting units during the third quarter of 2011, which in turn resulted in the goodwill impairment.

At June 30, 2011, we determined that there were sufficient indicators to trigger an interim goodwill impairment analysis. The indicators included, among other factors: (1) the economic environment, (2) the performance against plan of reporting units which previously had goodwill impairment, and (3) revised forecasted future earnings. The results of our analysis indicated that six of our 36 reporting units, all of which are located in the United States, had a goodwill impairment as of June 30, 2011. Accordingly, we recorded a pretax, non-cash charge for the three and six months ended June 30, 2011 to reduce the carrying value of goodwill by \$23.3 million.

Goodwill impairment testing is performed at the reporting unit level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill.

Goodwill impairment testing is a two-step process. Step one involves comparing the fair value of our reporting units to their carrying amount. If the carrying amount of a reporting unit is greater than zero and its fair value is greater than its carrying amount, there is no impairment. If the reporting unit's carrying amount is greater than the fair value, the second step must be completed to measure the amount of impairment, if any. Step two involves calculating the implied fair value of goodwill by deducting the fair value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the fair value of the reporting unit as determined in step one. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference.

We determine the fair value of our reporting units using an income approach. Under the income approach, we determined fair value based on estimated discounted future cash flows of each reporting unit. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and EBITDA margins, discount rates and future market conditions, among others. The estimated fair value of our reporting units were based upon a projected EBITDA margin, which was anticipated to have a slight increase from 2012 to 2013, followed by year over year increases of approximately 150 to 200 basis points in 2014 through 2016, with stabilization expected in 2017. These projections are driven, in part, by anticipated industry growth rates, anticipated GDP growth rates, customer composition and historical performance. These cash flows were discounted using a weighted average cost of capital ranging from 13% to 15%, depending upon the size and risk profile of the reporting unit. We considered market information in assessing the reasonableness of the fair value under the income approach described above.

The results of step one of the goodwill impairment test, as of September 30, 2012, were as follows:

(Dollars in thousands)	Number of Reporting Units	Representing Goodwill of
No goodwill balance	11	\$
Reporting units failing step one that continue to carry a goodwill balance	5	24,094
Fair value of reporting unit exceeds its carrying value by 11% - 20%	2	28,196
Fair value of reporting unit exceeds its carrying value by 20% - 40%	4	91,180
Fair value of reporting unit exceeds its carrying value by more than 40%	5	69,138
	27	\$ 212,608

Based upon a sensitivity analysis, a reduction of approximately 50 basis points of projected EBITDA in 2012 and beyond, assuming all other assumptions remain constant, no additional reporting units would proceed to step two of the analysis, although the change would result in an additional impairment charge of approximately \$2.3 million.

## Edgar Filing: American Reprographics CO - Form 10-Q

Based upon a separate sensitivity analysis, a 50 basis point increase to the weighted average cost of capital would result in no additional reporting units proceeding to step two of the analysis, although the change would result in a further impairment of approximately \$2.0 million.

Given the current economic environment and the changing document and printing needs of our customers and the uncertainties regarding the impact on our business, there can be no assurance that the estimates and assumptions made for purposes of our goodwill impairment testing in 2012 will prove to be accurate predictions of the future. If our assumptions, including forecasted EBITDA of certain reporting units, are not achieved, we may be required to record additional goodwill impairment charges in future periods, whether in connection with our next annual impairment testing in the third quarter of 2013, or on an interim basis, if any such change constitutes a triggering event (as defined under ASC 350) outside of the quarter when we regularly perform our annual goodwill impairment test. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.

---

## **Table of Contents**

### ***Income Taxes***

Deferred tax assets and liabilities reflect temporary differences between the amount of assets and liabilities for financial and tax reporting purposes. Such amounts are adjusted, as appropriate, to reflect changes in tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is recorded to reduce our deferred tax assets to the amount that is more likely than not to be realized. Changes in tax laws or accounting standards and methods may affect recorded deferred taxes in future periods.

When establishing a valuation allowance, we consider future sources of taxable income such as future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards and tax planning strategies. A tax planning strategy is an action that: is prudent and feasible; an enterprise ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused; and would result in realization of deferred tax assets. In the event we determine the deferred tax assets, more likely than not, will not be realized in the future, the valuation adjustment to the deferred tax assets will be charged to earnings in the period in which we make such a determination.

During 2011 and the nine months of 2012, we determined that cumulative losses for the preceding twelve quarters constituted sufficient objective evidence (as defined by ASC 740-10) that a valuation allowance on certain deferred tax assets was needed. As of September 30, 2012, the valuation allowance against certain deferred tax assets was \$75.3 million.

In future quarters, we will evaluate our results to determine whether we will generate sufficient taxable income to utilize our deferred tax assets, and whether a partial or full valuation allowance will be required. Should we generate sufficient taxable income, however, we may reverse a portion or all of the then current valuation allowance.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed in subsequent years. Adjustments based on filed returns are recorded when identified.

Income taxes have not been provided on certain undistributed earnings of foreign subsidiaries because such earnings are considered to be permanently reinvested.

The amount of taxable income or loss we report to the various tax jurisdictions is subject to ongoing audits by federal, state and foreign tax authorities. Our estimate of the potential outcome of any uncertain tax issue is subject to management's assessment of relevant risks, facts, and circumstances existing at that time. We use a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. We record a liability for the difference between the benefit recognized and measured and tax position taken or expected to be taken on our tax return. To the extent that our assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. We report tax-related interest and penalties as a component of income tax expense.

For further information regarding the accounting policies that we believe to be critical accounting policies and that affect our more significant judgments and estimates used in preparing our interim Condensed Consolidated Financial Statements see our 2011 Annual Report on Form 10-K.

### ***Recent Accounting Pronouncements***

See Note 1, *Description of Business and Basis of Presentation* to our interim Condensed Consolidated Financial Statements for disclosure on recent accounting pronouncements.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

Historically, our primary exposure to market risk is interest rate risk associated with our debt instruments. We use both fixed and variable rate debt as sources of financing. Historically, we have entered into derivative instruments to manage our exposure to changes in interest rates. These instruments allow us to raise funds at floating rates and effectively swap them into fixed rates, without the exchange of the underlying principal amount.

As of September 30, 2012, we had \$224.2 million of total debt, net of discount, and capital lease obligations, none of which bore interest at variable rates.

## Edgar Filing: American Reprographics CO - Form 10-Q

We have not, and do not plan to, enter into any derivative financial instruments for trading or speculative purposes. As of September 30, 2012, we had no significant material exposure to market risk, including foreign exchange risk and commodity risks.

**Table of Contents**

**Item 4.        *Controls and Procedures***

*Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities and Exchange Act of 1934, as amended (the Exchange Act ), are 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 Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2012. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of September 30, 2012, our disclosure controls and procedures were effective.

*Changes in Internal Control over Financial Reporting*

There were no changes to our internal control over financial reporting during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1.      *Legal Proceedings***

This information is included under the caption "Legal Proceedings" in Note 6 to our Condensed Consolidated Financial Statements in Part 1, Item 1 of this Form 10-Q.

**Item 1A.     *Risk Factors***

Information concerning certain risks and uncertainties appears in Part I, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. You should carefully consider those risks and uncertainties, which could materially affect our business, financial condition and results of operations. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

**Table of Contents****Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase *
101.DEF	XBRL Taxonomy Extension Definition Linkbase *
101.LAB	XBRL Taxonomy Extension Label Linkbase *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase *

\* Filed herewith

\*\* Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Users of this data are advised pursuant to Rule 406T of Regulation S-T that the interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections. The financial information contained in the XBRL-related documents is unaudited or unreviewed.

**Table of Contents**

**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.

Date: November 8, 2012

AMERICAN REPROGRAPHICS COMPANY

/s/ KUMARAKULASINGAM SURIYAKUMAR  
Kumarakulasingam Suriyakumar  
Chairman, President and Chief Executive Officer

/s/ JOHN TOTH  
John Toth  
Chief Financial Officer, Secretary

**Table of Contents**

## EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase *
101.DEF	XBRL Taxonomy Extension Definition Linkbase *
101.LAB	XBRL Taxonomy Extension Label Linkbase *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase *

\* Filed herewith

\*\* Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Users of this data are advised pursuant to Rule 406T of Regulation S-T that the interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections. The financial information contained in the XBRL-related documents is unaudited or unreviewed.