ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
November 07, 2013

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

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Form 10-Q

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(Mark One)

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

For the quarterly period ended September 30, 2013

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

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ARC DOCUMENT SOLUTIONS, INC.
(Exact name of Registrant as specified in its Charter)

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| | |
|---|---|
| Delaware | 20-1700361 |
| (State or other jurisdiction of incorporation or organization) | (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)

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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 ý 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 ý 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 ý |
| 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 ý

As of October 30, 2013, there were 46,356,018 shares of the issuer's common stock outstanding.

ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
For the Quarter Ended September 30, 2013
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## FORWARD-LOOKING STATEMENTS

This Quarterly Report on 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,” “would,” “could,” and variations of such words a expressions as they relate to our management or to ARC Document Solutions, Inc. (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 Securities and Exchange Commission 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.

PART I—FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements
ARC DOCUMENT SOLUTIONS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

| (In thousands, except per share data) | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $37,054 | $28,021 |
| Accounts receivable, net of allowances for accounts receivable of $2,672 and $2,634 | 58,643 | 51,855 |
| Inventories, net | 13,750 | 14,251 |
| Deferred income taxes | 468 | — |
| Prepaid expenses | 4,711 | 3,277 |
| Other current assets | 3,418 | 6,819 |
| Total current assets | 118,044 | 104,223 |
| Property and equipment, net of accumulated depreciation of $204,231 and $197,830 | 56,367 | 56,471 |
| Goodwill | 212,608 | 212,608 |
| Other intangible assets, net | 29,436 | 34,498 |
| Deferred financing fees, net | 3,291 | 4,219 |
| Deferred income taxes | 1,269 | 1,246 |
| Other assets | 2,591 | 2,574 |
| Total assets | $423,606 | $415,839 |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Accounts payable | $21,889 | $21,215 |
| Accrued payroll and payroll-related expenses | 12,834 | 6,774 |
| Accrued expenses | 27,623 | 22,321 |
| Current portion of long-term debt and capital leases | 11,505 | 13,263 |
| Total current liabilities | 73,851 | 63,573 |
| Long-term debt and capital leases | 201,880 | 209,262 |
| Deferred income taxes | 30,938 | 28,936 |
| Other long-term liabilities | 3,122 | 3,231 |
| Total liabilities | 309,791 | 305,002 |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity: | | |
| ARC Document Solutions, Inc. 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; 46,356 and 46,274 shares issued and 46,316 and 46,262 shares outstanding | 46 | 46 |
| Additional paid-in capital | 104,572 | 102,510 |
| Retained earnings | 1,382 | 695 |
| Accumulated other comprehensive income | 736 | 689 |
| | 106,736 | 103,940 |
| Less cost of common stock in treasury, 40 and 12 shares | 134 | 44 |
| Total ARC Document Solutions, Inc. stockholders' equity | 106,602 | 103,896 |
| Noncontrolling interest | 7,213 | 6,941 |

| | | |
|---|---|---|
| Total equity | 113,815 | 110,837 |
| Total liabilities and equity | $423,606 | $415,839 |

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

ARC DOCUMENT SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share data) | 2013 | 2012 | 2013 | 2012 |
| Service sales | $88,830 | $85,836 | $268,258 | $267,291 |
| Equipment and supplies sales | 12,422 | 13,590 | 37,652 | 41,936 |
| Total net sales | 101,252 | 99,426 | 305,910 | 309,227 |
| Cost of sales | 68,372 | 70,178 | 205,040 | 214,348 |
| Gross profit | 32,880 | 29,248 | 100,870 | 94,879 |
| Selling, general and administrative expenses | 24,019 | 23,916 | 72,683 | 71,346 |
| Amortization of intangible assets | 1,610 | 1,846 | 5,056 | 9,244 |
| Goodwill impairment | — | 16,707 | — | 16,707 |
| Restructuring expense | 657 | — | 1,765 | — |
| Income (loss) from operations | 6,594 | (13,221) | 21,366 | (2,418) |
| Other income | (25) | (25) | (86) | (79) |
| Loss on extinguishment of debt | 262 | — | 262 | — |
| Interest expense, net | 5,895 | 6,982 | 18,012 | 21,675 |
| Income (loss) before income tax provision (benefit) | 462 | (20,178) | 3,178 | (24,014) |
| Income tax provision (benefit) | 790 | (84) | 1,946 | 1,845 |
| Net (loss) income | (328) | (20,094) | 1,232 | (25,859) |
| Income attributable to noncontrolling interest | (122) | (18) | (545) | (213) |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(450) | $(20,112) | $687 | $(26,072) |
| (Loss) earnings per share attributable to ARC Document Solutions, Inc. shareholders: | | | | |
| Basic | $(0.01) | $(0.44) | $0.01 | $(0.57) |
| Diluted | $(0.01) | $(0.44) | $0.01 | $(0.57) |
| Weighted average common shares outstanding: | | | | |
| Basic | 45,976 | 45,716 | 45,880 | 45,641 |
| Diluted | 45,976 | 45,716 | 45,947 | 45,641 |

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

ARC DOCUMENT SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income | $(328) | $(20,094) | $1,232 | $(25,859) |
| Other comprehensive income, net of tax | | | | |
| Foreign currency translation adjustments | 385 | 270 | 259 | 281 |
| Amortization of derivative, net of tax effect of $0 for the three and nine months ended September 30, 2013, and $289 and $1,138 for the three and nine months ended September 30, 2012, respectively | — | 486 | — | 1,908 |
| Other comprehensive income, net of tax | 385 | 756 | 259 | 2,189 |
| Comprehensive income (loss) | 57 | (19,338) | 1,491 | (23,670) |
| Comprehensive income (loss) attributable to noncontrolling interest | 182 | (9) | 757 | 205 |
| Comprehensive (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(125) | $(19,329) | $734 | $(23,875) |

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

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ARC DOCUMENT SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

| | ARC Document Solutions, Inc. Shareholders | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | | | | | | | |
| (In thousands, except per share data) | Shares | Par Value | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Common Stock in Treasury | Noncontrolling Interest | Total |
| Balance at December 31, 2011 | 46,235 | $46 | $99,728 | $32,663 | $ (1,760 ) | $— | $ 6,388 | $137,065 |
| Stock-based compensation | 29 | — | 1,457 | — | — | — | — | 1,457 |
| Issuance of common stock under Employee Stock Purchase Plan | 6 | — | 28 | — | — | — | — | 28 |
| Stock options exercised | 15 | — | 79 | — | — | — | — | 79 |
| Tax benefit from stock-based compensation, net of tax deficiency | — | — | 676 | — | — | — | — | 676 |
| Comprehensive loss: | | | | | | | | |
| Net (loss) income | — | — | — | (26,072 ) | — | — | 213 | (25,859 ) |
| Foreign currency translation adjustments | — | — | — | — | 289 | — | (8 ) | 281 |
| Amortization on derivative, net of tax effect | — | — | — | — | 1,908 | — | — | 1,908 |
| Comprehensive loss | | | | | | | | (23,670 ) |
| Balance at September 30, 2012 | 46,285 | $46 | $101,968 | $6,591 | $ 437 | $— | $ 6,593 | $115,635 |

| | ARC Document Solutions, Inc. Shareholders | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | | | | | | | |
| (In thousands, except per share data) | Shares | Par Value | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Common Stock in Treasury | Noncontrolling Interest | Total |
| Balance at December 31, 2012 | 46,274 | $46 | $102,510 | $695 | $ 689 | $(44 ) | $ 6,941 | $110,837 |
| Stock-based compensation | 50 | — | 2,049 | — | — | — | — | 2,049 |
| Issuance of common stock under Employee Stock Purchase Plan | 4 | — | 13 | — | — | — | — | 13 |
| Treasury shares | 28 | — | — | — | — | (90 ) | — | (90 ) |
| Dividends paid to noncontrolling interest | — | — | — | — | — | — | (485 ) | (485 ) |
| Comprehensive income: | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net income | — | — | — | 687 | — | — | 545 | 1,232 |
| Foreign currency translation adjustments | — | — | — | — | 47 | — | 212 | 259 |
| Comprehensive income | | | | | | | | 1,491 |
| Balance at September 30, 2013 | 46,356 | $46 | $104,572 | $1,382 | $ 736 | $(134 ) | $ 7,213 | $113,815 |

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

ARC DOCUMENT SOLUTIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Cash flows from operating activities | | | | |
| Net (loss) income | $(328) | $(20,094) | $1,232 | $(25,859) |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | | |
| Allowance for accounts receivable | 105 | 128 | 551 | 532 |
| Depreciation | 7,059 | 7,143 | 21,034 | 21,266 |
| Amortization of intangible assets | 1,610 | 1,846 | 5,056 | 9,244 |
| Amortization of deferred financing costs | 270 | 276 | 831 | 812 |
| Amortization of bond discount | 168 | 156 | 500 | 453 |
| Goodwill impairment | — | 16,707 | — | 16,707 |
| Stock-based compensation | 728 | 554 | 2,049 | 1,457 |
| Deferred income taxes | 182 | (3,797) | 918 | (4,301) |
| Deferred tax valuation allowance | 386 | 3,854 | 560 | 6,766 |
| Restructuring expense, non-cash portion | 70 | — | 363 | — |
| Amortization of derivative, net of tax effect | — | 486 | — | 1,908 |
| Other non-cash items, net | 194 | (123) | (101) | (216) |
| Changes in operating assets and liabilities, net of effect of business acquisitions: | | | | |
| Accounts receivable | 4,491 | 2,796 | (7,358) | (3,331) |
| Inventory | 441 | (1,081) | 721 | (2,666) |
| Prepaid expenses and other assets | (1,102) | (795) | 1,988 | (1,201) |
| Accounts payable and accrued expenses | 5,745 | 5,973 | 11,666 | 9,308 |
| Net cash provided by operating activities | 20,019 | 14,029 | 40,010 | 30,879 |
| Cash flows from investing activities | | | | |
| Capital expenditures | (4,814) | (4,932) | (14,856) | (14,194) |
| Other | 83 | 317 | 622 | 133 |
| Net cash used in investing activities | (4,731) | (4,615) | (14,234) | (14,061) |
| Cash flows from financing activities | | | | |
| Proceeds from stock option exercises | — | — | — | 79 |
| Proceeds from issuance of common stock under Employee Stock Purchase Plan | 4 | — | 13 | 28 |
| Share repurchases, including shares surrendered for tax withholding | — | — | (90) | — |
| Proceeds from borrowings on long-term debt agreements | — | — | 402 | — |
| Payments of debt extinguishment costs | (66) | — | (66) | — |
| Early extinguishment of long-term debt | (7,000) | — | (7,000) | — |
| Payments on long-term debt agreements and capital leases | (2,988) | (3,575) | (9,395) | (12,041) |
| Net (repayments) borrowings under revolving credit facilities | (228) | 1,424 | (438) | 1,041 |
| Payment of deferred financing costs | — | — | — | (839) |
| Dividends paid to noncontrolling interest | (485) | — | (485) | — |
| Net cash used in financing activities | (10,763) | (2,151) | (17,059) | (11,732) |
| Effect of foreign currency translation on cash balances | 152 | (47) | 316 | 11 |

| | | | | |
|---|---|---|---|---|
| Net change in cash and cash equivalents | 4,677 | 7,216 | 9,033 | 5,097 |
| Cash and cash equivalents at beginning of period | 32,377 | 23,318 | 28,021 | 25,437 |
| Cash and cash equivalents at end of period | $37,054 | $30,534 | $37,054 | $30,534 |
| Supplemental disclosure of cash flow information | | | | |
| Noncash financing activities | | | | |
| Capital lease obligations incurred | $2,491 | $1,781 | $6,737 | $8,511 |

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

ARC DOCUMENT SOLUTIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data or where otherwise noted)
(Unaudited)

1. Description of Business and Basis of Presentation

ARC Document Solutions, Inc. (“ARC Document Solutions,” “ARC” or the “Company”) provides specialized document management services to businesses of all types, with an emphasis on the non-residential segment of the architectural, engineering and construction (“AEC”) industry. ARC offers a variety of services including: Onsite Services, Digital Services, Color Services, and Traditional Reprographics Services. In addition, ARC also sells Equipment and Supplies. 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, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

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 2012 Form 10-K.

Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2013-05. The new guidance covers the accounting for a cumulative translation adjustment on the parent entity upon de-recognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The adoption of ASU 2013-05 will be effective beginning January 1, 2014. The Company does not anticipate the adoption to materially impact the Company’s Condensed Consolidated Financial Statements.

In February 2013, the FASB issued ASU 2013-02. This new guidance requires entities to present (either on the face of the income statement or in the notes) the effects on the line items of the income statement for amounts reclassified out of accumulated other comprehensive income. The adoption of ASU 2013-02 had no impact to the Company’s 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 Company's Chief Executive Officer and Chief Operating Officer, who, acting jointly, are deemed to be the chief operating decision makers. Because its operating segments have similar products and services, classes of customers, production processes and economic characteristics, the Company is deemed to operate as a single reportable segment.

Net sales of the Company's principal services and products were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Service Sales | | | | |
| Traditional reprographics | $28,907 | $30,820 | $88,981 | $98,427 |
| Color | 20,638 | 19,335 | 63,389 | 59,839 |
| Digital | 8,295 | 8,565 | 25,346 | 27,763 |
| Subtotal(1) | 57,840 | 58,720 | 177,716 | 186,029 |
| Onsite services(2) | 30,990 | 27,116 | 90,542 | 81,262 |
| Total services sales | 88,830 | 85,836 | 268,258 | 267,291 |
| Equipment and supplies sales | 12,422 | 13,590 | 37,652 | 41,936 |
| Total net sales | $101,252 | $99,426 | $305,910 | $309,227 |

(1) For comparison purposes this subtotal agrees with Reprographics Services historically reported prior to the 2012 Annual Report on Form 10-K.

(2) Represents work done at the Company's customer sites which includes Facilities Management ("FM") and Managed Print Services ("MPS").

Risk and Uncertainties

The Company generates the majority of its revenue from sales of services and products 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. Reduced activity (relative to historic levels) in the AEC industry would diminish demand for some of ARC's services and products, and would therefore negatively affect revenues and have a material adverse effect on its business, operating results and financial condition.

As part of the Company's growth strategy, ARC intends to continue to offer and grow a variety of service offerings that are relatively new to the Company. The success of the Company's efforts will be affected by its ability to acquire new customers for the Company's new service offerings as well as sell the new service offerings to existing customers. The Company's inability to successfully market and execute these relatively new service offerings 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 ended September 30, 2013, stock options for 2.2 million and 3.6 million common shares, respectively, 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, 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.

Basic and diluted earnings per share for the three and nine months ended September 30, 2013 and 2012 were calculated using the following common shares:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Weighted average common shares outstanding—basic | 45,976 | 45,716 | 45,880 | 45,641 |

| | | | | |
|---|---|---|---|---|
| Effect of dilutive impact on equity-based compensation awards | — | — | 67 | — |
| Weighted average common shares outstanding—diluted | 45,976 | 45,716 | 45,947 | 45,641 |

3. Restructuring Expenses

To ensure that the Company's costs and resources were in line with demand for its current portfolio of services and products, management initiated a restructuring plan in the fourth quarter of 2012. Through September 30, 2013, the restructuring plan included the closure of 48 of the Company's service centers, which represented more than 15% of its total number of service center locations. In addition, as part of the restructuring plan, the Company reduced headcount and middle management associated with its service center locations, streamlined the senior operational management team, and allocated more resources into growing sales categories such as managed print services. The reduction in headcount totaled approximately 300 full-time employees, which represented approximately 10% of the Company's total workforce.

Restructuring expenses include employee termination costs, estimated lease termination and obligation costs, and other restructuring expenses. The Company's restructuring efforts included service center closures in both 2012 and 2013. For the three and nine months ended September 30, 2013, the Company closed seven and fifteen service center locations, respectively, in addition to 33 closures in 2012. In total, the Company estimates that 2013 closures will result in restructuring expenses of less than $2.5 million.

The following table summarizes restructuring expenses incurred in the three and nine months ended September 30, 2013.

| | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2013 |
|---|---|---|
| Employee termination costs | $1 | $12 |
| Estimated lease termination and obligation costs | 395 | 1,361 |
| Other restructuring expenses | 261 | 392 |
| Total restructuring expenses | $657 | $1,765 |

The changes in the restructuring liability from December 31, 2012 through September 30, 2013 are summarized as follows:

| | Nine Months Ended September 30, 2013 |
|---|---|
| Balance, December 31, 2012 | $2,299 |
| Restructuring expenses | 1,765 |
| Payments | (3,324) |
| Balance, September 30, 2013 | $740 |

4. 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, 2013, the Company assessed goodwill for impairment and determined that goodwill was not 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 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. 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.

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 2013 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 2014, or on an interim basis, if any such change constitutes a triggering event (as defined under ASC 350, Intangibles—Goodwill and Other ) 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, 2012 through September 30, 2013 are summarized as follows:

| | Gross Goodwill | Accumulated Impairment Loss | Net Carrying Amount |
|---|---|---|---|
| January 1, 2012 | $405,558 | $176,243 | $229,315 |
| Additions | — | — | — |
| Goodwill impairment | — | 16,707 | (16,707 ) |
| December 31, 2012 | 405,558 | 192,950 | 212,608 |
| Additions | — | — | — |
| Goodwill impairment | — | — | — |
| September 30, 2013 | $405,558 | $192,950 | $212,608 |

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.

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 North American 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 was accounted for on a prospective basis, resulting in increased amortization expense over the revised useful life of each trade name. There was no related impact for the three and nine months ended September 30, 2013 or for the three months ended September 30, 2012. The impact of this change for the nine months ended September 30, 2012 was an increase in amortization expense of approximately $3.2 million. Trade names were amortized using the straight-line method. The Company retired the original North American trade names in April 2012.

The following table sets forth the Company's other intangible assets resulting from business acquisitions as of September 30, 2013 and December 31, 2012 which continue to be amortized:

| | September 30, 2013 | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Amortizable other intangible assets | | | | | | |
| Customer relationships | $97,861 | $69,005 | $28,856 | $97,926 | $64,024 | $33,902 |
| Trade names and trademarks | 20,370 | 19,790 | 580 | 20,350 | 19,754 | 596 |
| | $118,231 | $88,795 | $29,436 | $118,276 | $83,778 | $34,498 |

Based on current information, estimated future amortization expense of amortizable intangible assets for the remainder of the 2013 fiscal year, each of the subsequent four fiscal years and thereafter are as follows:

| | |
|---|---|
| 2013 (excluding the nine months ended September 30, 2013) | $1,548 |
| 2014 | 5,761 |
| 2015 | 5,218 |
| 2016 | 4,518 |
| 2017 | 4,002 |
| Thereafter | 8,389 |
| | $29,436 |

5. 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 provision of $0.8 million and $1.9 million in relation to pretax income of $0.5 million and $3.2 million for the three and nine months ended September 30, 2013, respectively. The income tax provision was primarily due to the impact of amortization of tax basis goodwill in a deferred tax liability position.

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, 2012 and the nine months ended September 30, 2013, 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, 2013, the Company has a $78.8 million valuation allowance against certain of its deferred tax assets.

Based on the Company's assessment, the remaining net deferred tax assets of $1.7 million as of September 30, 2013 which relate to foreign entities are considered to be more likely than not to be realized. The valuation allowance of $78.8 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 $0.2 million as of September 30, 2013 included in other current assets in its condensed consolidated balance sheet primarily related to income tax refunds for prior years.

6. Long-Term Debt

Long-term debt consists of the following:

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| 10.5% senior notes due 2016, net of bond discount of $2,549 and $3,148 | $190,451 | $196,852 |
| Various capital leases; weighted average interest rate of 7.5% at September 30, 2013 and December 31, 2012; principal and interest payable monthly through September 2018 | 20,841 | 23,445 |
| Borrowings from foreign revolving credit facilities; 0.6% interest rate at September 30, 2013 and December 31, 2012 | 1,596 | 1,985 |
| Various other notes payable with a weighted average interest rate of 6.4% and 6.0% at September 30, 2013 and December 31, 2012, respectively; principal and interest payable monthly through June 2016 | 497 | 243 |
| | 213,385 | 222,525 |
| Less current portion | (11,505) | (13,263) |
| | $201,880 | $209,262 |

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 (i) on December 15, 2013 or during the 12 month period thereafter, at a redemption price equal to 105.25% of the principal amount thereof and (ii) on or after December 15, 2014, at the redemption price set forth in the Indenture, in each case, 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.
Note Repurchase. In July 2013, the Company repurchased $7.0 million in aggregate principal amount of its 10.5% senior unsecured notes due December 15, 2016 in the open market using available cash.

In October and November of 2013, the Company repurchased an additional $5.3 million in aggregate principal amount of its
10.5% senior unsecured notes due December 15, 2016 in the open market using available cash.
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 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.
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 three and nine months ended September 30, 2013, the Company did not have any outstanding debt under the 2012 Credit Agreement.

As of September 30, 2013, 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 $48.8 million. Standby letters of credit totaling $2.5 million reduced the Company's borrowing availability under the 2012 Credit Agreement to $46.3 million as of September 30, 2013.

Foreign Credit Agreement

In the third quarter of 2013, 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 with a term of 18 months . The facility provide for a maximum credit amount of 10.0 million Chinese Yuan Renminbi, which translates to U.S. $1.6 million as of September 30, 2013. 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.

Other Notes Payable

Includes notes payable collateralized by equipment previously purchased and subordinated seller notes payable related to prior acquisitions.

7. 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, 2013, the Company has potential future earnout obligations for acquisitions consummated before the adoption of ASC 805, Business Combinations, of approximately $1.8 million through 2014 if predetermined financial targets are met or exceeded. 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 the present, 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. On March 15, 2013, the Company participated in a private mediation session with claimants’ counsel which did not result in resolution of the claim. A subsequent court status conference was held on July 8, 2013 with no resolution reached. Although the Company believes that it has meritorious defenses to the claim, the Company also believes that a loss is probable and recorded a liability of $0.9 million as of September 30, 2013. The case remains unresolved as of September 30, 2013. As such, the ultimate resolution of the claim could result in a loss different than the estimated loss recorded.

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 effect on its consolidated financial position, results of operations or cash flows.

8. 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, 2013, 0.7 million shares remain available for issuance under the Stock Plan.

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.
During the nine months ended September 30, 2013, the Company granted options to acquire a total of 1.5 million shares, of the Company’s common stock to certain key employees with an exercise price equal to the fair market value of the Company’s

common stock on the date of grant. The stock options granted to those key employees vest annually over three to four years and expire 10 years after the date of grant.
The impact of stock-based compensation before income taxes on the interim Condensed Consolidated Statements of Operations was $0.7 million and $0.6 million for the three months ended September 30, 2013 and 2012, respectively. The impact of stock-based compensation before income taxes on the interim Condensed Consolidated Statements of Operations was $2.0 million and $1.5 million for the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, total unrecognized compensation cost related to unvested stock-based payments totaled $4.9 million and is expected to be recognized over a weighted-average period of 1.9 years.

9. Derivatives and Hedging Transactions

As of September 30, 2013 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, 2013, there is no amount deferred in accumulated other comprehensive income related to any swap transactions.
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, 2013 and 2012:

| | Amount of Gain or (Loss) Reclassified from Accumulated Comprehensive Income (Loss) into Income | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | (effective portion) | | | | (ineffective portion) | | | |
| | Three Months Ended September 30, | | Nine Months Ended September 30, | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Location of Loss Reclassified from AOCL into Income | | | | | | | | |
| Interest expense | $— | $(776) | $— | $(3,047) | $— | $— | $— | $— |

10. 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:
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.

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, 2013 and 2012:

| | Significant Other Unobservable Inputs September 30, 2013 | | September 30, 2012 | |
|---|---|---|---|---|
| | Level 3 | Total Losses | Level 3 | Total Losses |
| Nonrecurring Fair Value Measure | | | | |
| Goodwill | $212,608 | $— | $212,608 | $16,707 |

In accordance with ASC 350, goodwill was written down to its implied fair value of $212.6 million as of September 30, 2012, resulting in an impairment charge of $16.7 million during the nine months ended September 30, 2012. See Note 4, “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 $12.5 million and $13.7 million as of September 30, 2013 and December 31, 2012, 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, 2013 for its Notes and other notes payable is $193.0 million and $0.5 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 other notes payable is $201.2 million and $0.5 million, respectively, as of September 30, 2013.

11. 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.

Condensed Consolidating Balance Sheet
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $— | $21,115 | $ 15,939 | $— | $37,054 |
| Accounts receivable, net | — | 49,186 | 9,457 | — | 58,643 |
| Intercompany operations | 128,672 | 5,109 | — | (133,781 ) | — |
| Inventories, net | — | 10,469 | 3,281 | — | 13,750 |
| Deferred income taxes | — | 3 | 465 | — | 468 |
| Prepaid expenses | 1 | 3,702 | 1,008 | — | 4,711 |
| Other current assets | — | 1,834 | 1,584 | — | 3,418 |
| Total current assets | 128,673 | 91,418 | 31,734 | (133,781 ) | 118,044 |
| Property and equipment, net | — | 48,471 | 7,896 | — | 56,367 |
| Goodwill | — | 212,608 | — | — | 212,608 |
| Investment in subsidiaries | 171,077 | 18,089 | — | (189,166 ) | — |
| Other intangible assets, net | — | 27,508 | 1,928 | — | 29,436 |
| Deferred financing costs, net | 3,291 | — | — | — | 3,291 |
| Deferred income taxes | — | 69 | 1,200 | — | 1,269 |
| Other assets | — | 2,095 | 496 | — | 2,591 |
| Total assets | $303,041 | $400,258 | $ 43,254 | $(322,947 ) | $423,606 |
| Liabilities and Equity | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | $— | $19,491 | $ 2,398 | $— | $21,889 |
| Accrued payroll and payroll-related expenses | — | 12,089 | 745 | — | 12,834 |
| Accrued expenses | 5,984 | 18,451 | 3,188 | — | 27,623 |
| Intercompany loans | — | 128,377 | 5,404 | (133,781 ) | — |
| Current portion of long-term debt and capital leases | — | 8,581 | 2,924 | — | 11,505 |
| Total current liabilities | 5,984 | 186,989 | 14,659 | (133,781 ) | 73,851 |
| Long-term debt and capital leases | 190,455 | 9,974 | 1,451 | — | 201,880 |
| Deferred income taxes | — | 30,910 | 28 | — | 30,938 |
| Other long-term liabilities | — | 1,308 | 1,814 | — | 3,122 |
| Total liabilities | 196,439 | 229,181 | 17,952 | (133,781 ) | 309,791 |
| Commitments and contingencies | | | | | |
| Total equity | 106,602 | 171,077 | 25,302 | (189,166 ) | 113,815 |
| Total liabilities and equity | $303,041 | $400,258 | $ 43,254 | $(322,947 ) | $423,606 |

Condensed Consolidating Balance Sheet
December 31, 2012
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $— | $10,965 | $ 17,056 | $— | $28,021 |
| Accounts receivable, net | — | 45,289 | 6,566 | — | 51,855 |
| Intercompany operations | 146,475 | 4,869 | — | (151,344 ) | — |
| Inventories, net | — | 9,426 | 4,825 | — | 14,251 |
| Prepaid expenses | — | 2,732 | 545 | — | 3,277 |
| Other current assets | — | 5,854 | 965 | — | 6,819 |
| Total current assets | 146,475 | 79,135 | 29,957 | (151,344 ) | 104,223 |
| Property and equipment, net | — | 48,484 | 7,987 | — | 56,471 |
| Goodwill | — | 212,608 | — | — | 212,608 |
| Investment in subsidiaries | 151,015 | 14,233 | — | (165,248 ) | — |
| Other intangible assets, net | — | 32,327 | 2,171 | — | 34,498 |
| Deferred financing costs, net | 4,219 | — | — | — | 4,219 |
| Deferred income taxes | — | — | 1,246 | — | 1,246 |
| Other assets | — | 1,788 | 786 | — | 2,574 |
| Total assets | $301,709 | $388,575 | $ 42,147 | $(316,592 ) | $415,839 |
| Liabilities and Equity | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | $1 | $19,395 | $ 1,819 | $— | $21,215 |
| Accrued payroll and payroll-related expenses | — | 6,460 | 314 | — | 6,774 |
| Accrued expenses | 951 | 17,230 | 4,140 | — | 22,321 |
| Intercompany loans | — | 143,450 | 7,894 | (151,344 ) | — |
| Current portion of long-term debt and capital leases | — | 9,909 | 3,354 | — | 13,263 |
| Total current liabilities | 952 | 196,444 | 17,521 | (151,344 ) | 63,573 |
| Long-term debt and capital leases | 196,861 | 10,945 | 1,456 | — | 209,262 |
| Deferred income taxes | — | 28,900 | 36 | — | 28,936 |
| Other long-term liabilities | — | 1,271 | 1,960 | — | 3,231 |
| Total liabilities | 197,813 | 237,560 | 20,973 | (151,344 ) | 305,002 |
| Commitments and contingencies | | | | | |
| Total equity | 103,896 | 151,015 | 21,174 | (165,248 ) | 110,837 |
| Total liabilities and equity | $301,709 | $388,575 | $ 42,147 | $(316,592 ) | $415,839 |

Condensed Consolidating Statement of Operations
Three Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net sales | $— | $88,766 | $12,486 | $— | $101,252 |
| Cost of sales | — | 58,727 | 9,645 | — | 68,372 |
| Gross profit | — | 30,039 | 2,841 | — | 32,880 |
| Selling, general and administrative expenses | 2 | 21,672 | 2,345 | — | 24,019 |
| Amortization of intangible assets | — | 1,534 | 76 | — | 1,610 |
| Restructuring expense | — | 657 | — | — | 657 |
| (Loss) income from operations | (2) | 6,176 | 420 | — | 6,594 |
| Other income, net | — | (25) | — | — | (25) |
| Loss on extinguishment of debt | 262 | — | — | — | 262 |
| Interest expense, net | 5,584 | 357 | (46) | — | 5,895 |
| (Loss) income before equity earnings of subsidiaries and income tax provision | (5,848) | 5,844 | 466 | — | 462 |
| Equity in earnings of subsidiaries | (5,398) | (253) | — | 5,651 | — |
| Income tax provision | — | 699 | 91 | — | 790 |
| Net (loss) income | (450) | 5,398 | 375 | (5,651) | (328) |
| Income attributable to noncontrolling interest | — | — | (122) | — | (122) |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(450) | $5,398 | $253 | $(5,651) | $(450) |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| 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, net | — | (25) | — | — | (25) |
| Interest expense, net | 5,752 | 1,238 | (8) | — | 6,982 |
| | (5,754) | (14,725) | 301 | — | (20,178) |

| | | | | | |
|---|---|---|---|---|---|
| (Loss) income before equity earnings of subsidiaries and income tax (benefit) provision | | | | | |
| 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) |
| Income attributable to noncontrolling interest | — | — | (18) | — | (18) |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(20,112) | $(14,358) | $ 200 | $14,158 | $(20,112) |

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Condensed Consolidating Statement of Operations
Nine Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net sales | $— | $268,530 | $37,380 | $— | $305,910 |
| Cost of sales | — | 176,300 | 28,740 | — | 205,040 |
| Gross profit | — | 92,230 | 8,640 | — | 100,870 |
| Selling, general and administrative expenses | 5 | 65,950 | 6,728 | — | 72,683 |
| Amortization of intangible assets | — | 4,821 | 235 | — | 5,056 |
| Restructuring expense | — | 1,758 | 7 | — | 1,765 |
| (Loss) income from operations | (5) | 19,701 | 1,670 | — | 21,366 |
| Other income, net | — | (86) | — | — | (86) |
| Loss on extinguishment of debt | 262 | — | — | — | 262 |
| Interest expense, net | 17,101 | 1,056 | (145) | — | 18,012 |
| (Loss) income before equity earnings of subsidiaries and income tax provision (benefit) | (17,368) | 18,731 | 1,815 | — | 3,178 |
| Equity in earnings of subsidiaries | (18,055) | (1,550) | — | 19,605 | — |
| Income tax provision (benefit) | — | 2,226 | (280) | — | 1,946 |
| Net income (loss) | 687 | 18,055 | 2,095 | (19,605) | 1,232 |
| Income attributable to noncontrolling interest | — | — | (545) | — | (545) |
| Net income (loss) attributable to ARC Document Solutions, Inc. shareholders | $687 | $18,055 | $1,550 | $(19,605) | $687 |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| 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 |
| Goodwill impairment | — | 15,204 | 1,503 | — | 16,707 |
| (Loss) income from operations | (5) | (4,425) | 2,012 | — | (2,418) |
| Other income, net | — | (79) | — | — | (79) |
| Interest expense, net | 17,219 | 4,514 | (58) | — | 21,675 |
| | (17,224) | (8,860) | 2,070 | — | (24,014) |

| | | | | | |
|---|---|---|---|---|---|
| (Loss) income before equity earnings of subsidiaries and income tax provision | | | | | |
| 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) |
| Income attributable to noncontrolling interest | — | — | (213) | — | (213) |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(26,072) | $(8,848) | $ 1,527 | $7,321 | $(26,072) |

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Condensed Consolidating Statement of Comprehensive Income (Loss)
Three Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net (loss) income | $(450) | $5,398 | $375 | $(5,651) | $(328) |
| Other comprehensive income, net of tax | | | | | |
| Foreign currency translation adjustments, net of tax | — | — | 385 | — | 385 |
| Other comprehensive income, net of tax | — | — | 385 | — | 385 |
| Comprehensive (loss) income | (450) | 5,398 | 760 | (5,651) | 57 |
| Comprehensive income attributable to noncontrolling interest | — | — | 182 | — | 182 |
| Comprehensive (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(450) | $5,398 | $578 | $(5,651) | $(125) |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| 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 loss attributable to noncontrolling interest | — | — | (9) | — | (9) |
| Comprehensive (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(20,112) | $(13,872) | $497 | $14,158 | $(19,329) |

Condensed Consolidating Statement of Comprehensive Income (Loss)
Nine Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net income (loss) | $687 | $18,055 | $ 2,095 | $(19,605) | $1,232 |
| Other comprehensive income, net of tax | | | | | |
| Foreign currency translation adjustments, net of tax | — | — | 259 | — | 259 |
| Other comprehensive income, net of tax | — | — | 259 | — | 259 |
| Comprehensive income (loss) | 687 | 18,055 | 2,354 | (19,605) | 1,491 |
| Comprehensive income attributable to noncontrolling interest | — | — | 757 | — | 757 |
| Comprehensive income (loss) attributable to ARC Document Solutions, Inc. shareholders | $687 | $18,055 | $ 1,597 | $(19,605) | $734 |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| 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 ARC Document Solutions, Inc. shareholders | $(26,072) | $(6,940) | $ 1,816 | $7,321 | $(23,875) |

Condensed Consolidating Statement of Cash Flows
Three Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Cash flows from operating activities | | | | | |
| Net cash (used in) provided by operating activities | $(110) | $17,199 | $2,930 | $— | $20,019 |
| Cash flows from investing activities | | | | | |
| Capital expenditures | — | (4,478) | (336) | — | (4,814) |
| Other | — | 93 | (10) | — | 83 |
| Net cash used in investing activities | — | (4,385) | (346) | — | (4,731) |
| Cash flows from financing activities | | | | | |
| Proceeds from issuance of common stock under Employee Stock Purchase Plan | — | 4 | — | — | 4 |
| Payments of debt extinguishment costs | (66) | — | — | — | (66) |
| Early extinguishment of long-term debt | (7,000) | — | — | — | (7,000) |
| Payments on long-term debt agreements and capital leases | — | (2,555) | (433) | — | (2,988) |
| Net repayments under revolving credit facilities | — | — | (228) | — | (228) |
| Payment of deferred financing fees | — | — | (485) | — | (485) |
| Advances to/from subsidiaries | 7,176 | (4,228) | (2,948) | — | — |
| Net cash provided by (used in) financing activities | 110 | (6,779) | (4,094) | — | (10,763) |
| Effect of foreign currency translation on cash balances | — | — | 152 | — | 152 |
| Net change in cash and cash equivalents | — | 6,035 | (1,358) | — | 4,677 |
| Cash and cash equivalents at beginning of period | — | 15,080 | 17,297 | — | 32,377 |
| Cash and cash equivalents at end of period | $— | $21,115 | $15,939 | $— | $37,054 |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Cash flows from operating activities | | | | | |
| Net cash (used in) provided by operating activities | $(54) | $13,893 | $190 | $— | $14,029 |
| Cash flows from investing activities | | | | | |
| Capital expenditures | — | (4,588) | (344) | — | (4,932) |
| Other | — | 350 | (33) | — | 317 |
| Net cash used in investing activities | — | (4,238) | (377) | — | (4,615) |
| Cash flows from financing activities | | | | | |
| Payments on long-term debt agreements and capital leases | — | (3,125) | (450) | — | (3,575) |
| Net borrowings under revolving credit facilities | — | — | 1,424 | — | 1,424 |
| 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 |

Condensed Consolidating Statement of Cash Flows
Nine Months Ended
September 30, 2013
(Unaudited)

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Cash flows from operating activities | | | | | |
| Net cash (used in) provided by operating activities | $(10,737) | $46,353 | $4,394 | $— | $40,010 |
| Cash flows from investing activities | | | | | |
| Capital expenditures | — | (13,285) | (1,571) | — | (14,856) |
| Other | — | 280 | 342 | — | 622 |
| Net cash used in investing activities | — | (13,005) | (1,229) | — | (14,234) |
| Cash flows from financing activities | | | | | |
| Proceeds from issuance of common stock under Employee Stock Purchase Plan | — | 13 | — | — | 13 |
| Share repurchases, including shares surrendered for tax withholding | — | (90) | — | — | (90) |
| Proceeds from borrowings on long-term debt agreements | — | 402 | — | — | 402 |
| Payments of debt extinguishment costs | (66) | — | — | — | (66) |
| Early extinguishment of long-term debt | (7,000) | — | — | — | (7,000) |
| Payments on long-term debt agreements and capital leases | — | (8,210) | (1,185) | — | (9,395) |
| Net repayments under revolving credit facilities | — | — | (438) | — | (438) |
| Dividends paid to noncontrolling interest | — | — | (485) | — | (485) |
| Advances to/from subsidiaries | 17,803 | (15,313) | (2,490) | — | — |
| Net cash provided by (used in) financing activities | 10,737 | (23,198) | (4,598) | — | (17,059) |
| Effect of foreign currency translation on cash balances | — | — | 316 | — | 316 |
| Net change in cash and cash equivalents | — | 10,150 | (1,117) | — | 9,033 |
| Cash and cash equivalents at beginning of period | — | 10,965 | 17,056 | — | 28,021 |
| Cash and cash equivalents at end of period | $— | $21,115 | $15,939 | $— | $37,054 |

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

| (In thousands) | ARC Document Solutions, Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Cash flows from operating activities | | | | | |
| Net cash (used in) provided by operating activities | $(10,636) | $40,281 | $ 1,234 | $— | $30,879 |
| Cash flows from investing activities | | | | | |
| Capital expenditures | — | (12,997) | (1,197) | — | (14,194) |
| Other | — | 233 | (100) | — | 133 |
| Net cash used in investing activities | — | (12,764) | (1,297) | — | (14,061) |
| Cash flows from financing activities | | | | | |
| 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 costs | (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 |

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 2012 Form 10-K and this Quarterly Report on Form 10-Q for the quarter ended September 30, 2013.

Business Summary

ARC Document Solutions, Inc. ("ARC Document Solutions," "ARC," "we," "us," or "our") provides specialized document management services to businesses of all types, with an emphasis on the non-residential segment of the architecture, engineering and construction ("AEC") industry.

We help our customers reduce their costs and improve efficiency in the use of their documents, improve their access and control over documents, and offer a wide variety of ways to print, produce, distribute, collaborate on and store documents.

In an effort to increase the visibility into the nature and changing dynamics of our consolidated business, effective with our 2012 annual report on Form 10-K we have categorized our service and product offerings to better report distinct sales recognized from our Onsite Services, Color Services, Digital Services, Traditional Reprographics Services, and Equipment and Supplies Sales. Under our previous revenue reporting structure, the categories of Traditional Reprographics, Color Services, and Digital Services presented below were combined and reported as "Reprographics Services."

Onsite Services consists of placement, management, and optimization of print and imaging equipment in our customer's facilities, relieving them of the burden of owning and managing print devices and print networks, and shifting their costs to a "per-use" basis. Onsite Services sales are driven by the ongoing print needs of our customers, and are less exposed to the episodic large-format printing needs associated with construction projects. This category has been renamed from "Facilities Management," but the service offerings reported in this category remain unchanged.

Color Services consists of specialized color printing and finishing services to marketing departments, regional and national retailers, and our traditional AEC customer base. This includes services provided under our Riot Creative Imaging brand.

Digital Services consists of digital document management services of all kinds, including archive and information management ("AIM"), "digital shipping" and managed file transfer, software licensing, and technology consulting services.

Traditional Reprographics consists of the management, distribution, and print-on-demand of black and white construction drawings (frequently referred to as "blueprints") and specification books, and derives a majority of its revenue from large-format black and white printing.

Equipment and Supplies consists of reselling printing, imaging, and related equipment to customers primarily in the AEC industry. This category remains unchanged from prior filings.

Traditional Reprographics, Color Services, and Digital Services were previously disclosed as "Reprographic Services" sales. We believe the updated presentation of our sales categories reflects the drivers of our consolidated sales and will provide greater insight into the opportunities and risk diversification provided by our portfolio of service and product offerings.

We are expanding our business beyond the services we have traditionally provided to the AEC industry and are currently focused on growing managed print services, digital color imaging, and technology-based document management services, as we believe the mix of services demanded by the AEC industry continues to shift toward document management at customer locations (represented primarily by our Onsite Services), and away from its historical emphasis on printing of large-format black and white construction drawings "offsite" in our service centers (represented primarily by our Traditional Reprographics). This belief is supported by the fact that our Onsite Services in the third quarter of 2013 are 31% of our total sales as compared to 29% for Traditional Reprographics. Onsite Services is now our largest service offering and continues to grow at a rate of over 10% on a year over year basis.

We deliver our services through a nationwide network of service centers, regionally-based technical specialists, locally-based sales executives, and a national/regional sales force known as Global Solutions.

Acquisition activity during the last three years has been minimal and did not materially affect our overall business. We believe ARC Document Solutions offers a distinct portfolio of services within the AEC industry that include its legacy reprographics business as well as its newer offerings in Onsite Services, Color Services, and Digital Services. Our customer base for these services, however, is still distinctly related to the AEC industry. Based on our analysis of our operating results, we estimate that sales to the AEC industry accounted for approximately 76% of our net sales for the nine months ended September 30, 2013, with the remaining 24% consisting of sales to non-AEC industries.

Historically, our local service centers operated under their acquired brand to maintain the local brand identity. In response to changes in our markets, consisting primarily of the consolidation of our larger customers and prospects as noted above, we branded all of our operations “ARC” in 2011 to highlight the national and global scope and scale of our services. We refined our identity further at the end of 2012 by renaming our Delaware corporation “ARC Document Solutions, Inc.” Our non-AEC Color Services are 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 materials (paper, toner and other consumables), labor, and “indirect costs” which consist primarily of 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.

We maintain low levels of inventory. Historically, our capital expenditure requirements have varied due to the cost and availability of capital lease lines of credit. During 2012 and through the first three quarters of 2013, we were more frequently electing to purchase equipment for our facilities and onsite service installations rather than lease equipment due to the availability of cash to fund capital expenditures and the interest savings thereby. As we continue to foster our relationships with credit providers and obtain attractive lease rates, we may increasingly choose to lease rather than purchase equipment in the future.

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

We believe customers are increasingly (1) adopting technology and digital document management practices, and (2) changing their workflow patterns and thereby their document and printing needs. While the construction market appeared to begin a slow recovery in 2012, we believe that there was a growing body of evidence by the third quarter of 2012 that demonstrated Traditional Reprographics sales, produced at our service centers, would not likely recover at the same pace due to these factors.

To ensure that the Company’s costs and resources were in line with demand for our current portfolio of services and products, management initiated a restructuring plan in October of 2012. The restructuring plan included the closure of 33 of the Company’s service centers in 2012, which represented more than 10% of our total number of service center locations, and an additional 15 closures of service centers in 2013. In addition, as part of the restructuring plan, we reduced headcount and middle management associated with our service center locations, streamlined the senior operational management team, and allocated more resources into growing sales categories such as managed print services and digital services. The reduction in headcount totaled approximately 300 full-time employees, which represented approximately 10% of our total workforce.

In the nine months of 2013, our gross margins improved by 230 basis points compared to the same period in 2012, which we attribute primarily to our restructuring efforts initiated in October 2012, and suggests continuing year-over-year 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;
- 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.

Specifically, we have presented adjusted net income (loss) attributable to ARC and adjusted earnings (loss) per share attributable to ARC shareholders for the three and nine months ended September 30, 2013 and 2012 to reflect the exclusion of amortization impact related specifically to the change in useful lives of trade names, loss on extinguishment of debt, goodwill impairment, restructuring expense, interest rate swap related costs, and changes in the valuation allowances 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, 2013 and 2012. We believe these charges were the result of the current macroeconomic environment, our capital restructuring, or other items which are not indicative of our actual operating performance.

We presented adjusted EBITDA in three and nine months ended September 30, 2013 and 2012 to exclude stock-based compensation expense, restructuring expense, goodwill impairment and loss on extinguishment of debt. The adjustment of EBITDA for non-cash adjustments 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) income attributable to ARC Document Solutions, Inc. shareholders:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Cash flows provided by operating activities | $20,019 | $14,029 | $40,010 | $30,879 |
| Changes in operating assets and liabilities, net of effect of business acquisitions | (9,575) | (6,893) | (7,017) | (2,110) |
| Non-cash expenses, including depreciation, amortization and restructuring | (10,772) | (27,230) | (31,761) | (54,628) |
| Income tax provision (benefit) | 790 | (84) | 1,946 | 1,845 |
| Interest expense, net | 5,895 | 6,982 | 18,012 | 21,675 |
| Income attributable to the noncontrolling interest | (122) | (18) | (545) | (213) |
| EBIT | 6,235 | (13,214) | 20,645 | (2,552) |
| Depreciation and amortization | 8,669 | 8,989 | 26,090 | 30,510 |
| EBITDA | 14,904 | (4,225) | 46,735 | 27,958 |
| Interest expense, net | (5,895) | (6,982) | (18,012) | (21,675) |
| Income tax provision | (790) | 84 | (1,946) | (1,845) |
| Depreciation and amortization | (8,669) | (8,989) | (26,090) | (30,510) |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(450) | $(20,112) | $687 | $(26,072) |

The following is a reconciliation of net (loss) income attributable to ARC Document Solutions, Inc. to EBIT, EBITDA and adjusted EBITDA:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income attributable to ARC Document Solutions, Inc. shareholders | $(450) | $(20,112) | $687 | $(26,072) |
| Interest expense, net | 5,895 | 6,982 | 18,012 | 21,675 |
| Income tax provision (benefit) | 790 | (84) | 1,946 | 1,845 |
| EBIT | 6,235 | (13,214) | 20,645 | (2,552) |
| Depreciation and amortization | 8,669 | 8,989 | 26,090 | 30,510 |
| EBITDA | 14,904 | (4,225) | 46,735 | 27,958 |
| Loss on extinguishment of debt | 262 | — | 262 | — |
| Goodwill impairment | — | 16,707 | — | 16,707 |
| Restructuring expense | 657 | — | 1,765 | — |
| Stock-based compensation | 728 | 554 | 2,049 | 1,457 |
| Adjusted EBITDA | $16,551 | $13,036 | $50,811 | $46,122 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 (1) | 2012 (1) | 2013 (1) | 2012 (1) |
| Net (loss) income margin attributable to ARC | (0.4)% | (20.2)% | 0.2% | (8.4)% |
| Interest expense, net | 5.8 | 7.0 | 5.9 | 7.0 |
| Income tax provision (benefit) | 0.8 | (0.1) | 0.6 | 0.6 |
| EBIT margin | 6.2 | (13.3) | 6.7 | (0.8) |
| Depreciation and amortization | 8.6 | 9.0 | 8.5 | 9.9 |
| EBITDA margin | 14.7 | (4.2) | 15.3 | 9.0 |
| Loss on extinguishment of debt | 0.3 | — | 0.1 | — |
| Goodwill impairment | — | 16.8 | — | 5.4 |
| Restructuring expense | 0.6 | — | 0.6 | — |
| Stock-based compensation | 0.7 | 0.6 | 0.7 | 0.5 |
| Adjusted EBITDA margin | 16.3% | 13.1% | 16.6% | 14.9% |

(1) Column does not foot due to rounding

The following is a reconciliation of net (loss) income attributable to ARC Document Solutions, Inc. to unaudited adjusted net income (loss) attributable to ARC Document Solutions, Inc.:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share amounts) | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income attributable to ARC Document Solutions, Inc. | $(450) | $(20,112) | $687 | $(26,072) |
| Loss on extinguishment of debt | 262 | — | 262 | — |
| Goodwill impairment | — | 16,707 | — | 16,707 |
| Restructuring expense | 657 | — | 1,765 | — |
| Change in trade name impact to amortization | — | — | — | 3,158 |
| Interest rate swap related costs | — | 776 | — | 3,047 |
| Income tax benefit related to above items | (359) | (4,230) | (790) | (6,279) |
| Deferred tax valuation allowance and other discrete tax items | 685 | 5,142 | 1,073 | 8,575 |
| Unaudited adjusted net income (loss) attributable to ARC Document Solutions, Inc. | $795 | $(1,717) | $2,997 | $(864) |
| Actual: | | | | |
| (Loss) earnings per share attributable to ARC Document Solutions, Inc. shareholders: | | | | |
| Basic | $(0.01) | $(0.44) | $0.01 | $(0.57) |
| Diluted | $(0.01) | $(0.44) | $0.01 | $(0.57) |
| Weighted average common shares outstanding: | | | | |
| Basic | 45,976 | 45,716 | 45,880 | 45,641 |
| Diluted | 45,976 | 45,716 | 45,947 | 45,641 |
| Adjusted: | | | | |
| Earnings (loss) per share attributable to ARC Document Solutions, Inc. shareholders: | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | $0.02 | $(0.04) | $0.07 | $(0.02) |
| Diluted | $0.02 | $(0.04) | $0.07 | $(0.02) |
| Weighted average common shares outstanding: | | | | |
| Basic | 45,976 | 45,716 | 45,880 | 45,641 |
| Diluted | 46,487 | 45,716 | 45,947 | 45,641 |

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:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Cash flows provided by operating activities [1] | $20,019 | $14,029 | $40,010 | $30,879 |
| Capital expenditures | (4,814) | (4,932) | (14,856) | (14,194) |
| Free Cash Flows | $15,205 | $9,097 | $25,154 | $16,685 |

(1) Cash flows provided by operating activities includes a $10.5 million semi-annual interest payment on the Company’s 10.5% senior notes for the nine months ended September 30, 2013 and 2012; and $0.7 million and $3.3 million, in cash payments related to restructuring for the three and nine months ended September 30, 2013, respectively.

Results of Operations

| | Three Months Ended September 30, | | Increase (decrease) | | Nine Months Ended September 30, | | Increase (decrease) | |
|---|---|---|---|---|---|---|---|---|
| (In millions, except percentages) | 2013 (1) | 2012 | $(1) | % | 2013 (1) | 2012(1) | $(1) | % |
| Traditional reprographics | $28.9 | $30.8 | $(1.9) | (6.2)% | $89.0 | $98.4 | $(9.4) | (9.6)% |
| Color | 20.6 | 19.3 | 1.3 | 6.7% | 63.4 | 59.8 | 3.6 | 5.9% |
| Digital | 8.3 | 8.6 | (0.3) | (3.2)% | 25.3 | 27.8 | (2.4) | (8.7)% |
| Subtotal (2) | $57.8 | $58.7 | $(0.9) | (1.5)% | $177.7 | $186.0 | $(8.3) | (4.5)% |
| Onsite services (3) | 31.0 | 27.1 | 3.9 | 14.3% | 90.5 | 81.3 | 9.3 | 11.4% |
| Equipment and supplies sales | 12.4 | 13.6 | (1.2) | (8.6)% | 37.7 | 41.9 | (4.3) | (10.2)% |
| Total net sales | $101.3 | $99.4 | $1.8 | 1.8% | $305.9 | $309.2 | $(3.3) | (1.1)% |
| Gross profit | $32.9 | $29.2 | $3.6 | 12.4% | $100.9 | $94.9 | $6.0 | 6.3% |
| Selling, general and administrative expenses | $24.0 | $23.9 | $0.1 | 0.4% | $72.7 | $71.3 | $1.3 | 1.9% |
| Amortization of intangibles | $1.6 | $1.8 | $(0.2) | (12.8)% | $5.1 | $9.2 | $(4.2) | (45.3)% |
| Goodwill impairment | $— | $16.7 | $(16.7) | (100.0)% | $— | $16.7 | $(16.7) | (100.0)% |
| Restructuring expense | $0.7 | $— | $0.7 | 100.0% | $1.8 | $— | $1.8 | 100.0% |
| Loss on extinguishment of debt | $0.3 | $— | $0.3 | 100.0% | $0.3 | $— | $0.3 | 100.0% |
| Interest expense, net | $5.9 | $7.0 | $(1.1) | (15.6)% | $18.0 | $21.7 | $(3.7) | (16.9)% |
| Income tax provision | $0.8 | $(0.1) | $0.9 | (1,040.5)% | $1.9 | $1.8 | $0.1 | 5.5% |
| Net (loss) income attributable to ARC | $(0.5) | $(20.1) | $19.7 | (97.8)% | $0.7 | $(26.1) | $26.8 | (102.6)% |
| Adjusted net income attributable to ARC | $0.8 | $(1.7) | $2.5 | (146.3)% | $3.0 | $(0.9) | $3.9 | (446.9)% |
| EBITDA | $14.9 | $(4.2) | $19.1 | (452.8)% | $46.7 | $28.0 | $18.8 | 67.2% |
| Adjusted EBITDA | $16.6 | $13.0 | $3.5 | 27.0% | $50.8 | $46.1 | $4.7 | 10.2% |

(1) Column does not foot due to rounding

(2) For comparison purposes to public reporting prior to December 2012, this subtotal agrees with the “Reprographics Services” revenue line historically reported.

(3) Represents services provided at our customers’ sites, which includes both Managed Print Services (MPS) and Facilities Management (FM).

The following table provides information on the percentages of certain items of selected financial data as a percentage of 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, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 (1) | 2012 (1) |
| Net Sales | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of sales | 67.5 | 70.6 | 67.0 | 69.3 |
| Gross profit | 32.5 | 29.4 | 33.0 | 30.7 |
| Selling, general and administrative expenses | 23.7 | 24.1 | 23.8 | 23.1 |
| Amortization of intangibles | 1.6 | 1.9 | 1.7 | 3.0 |
| Goodwill impairment | — | 16.8 | — | 5.4 |
| Restructuring expense | 0.6 | — | 0.6 | — |
| Income (loss) from operations | 6.5 | (13.3 ) | 7.0 | (0.8 ) |
| Loss on extinguishment of debt | 0.3 | — | 0.1 | — |
| Interest expense, net | 5.8 | 7.0 | 5.9 | 7.0 |
| Income (loss) before income tax provision (benefit) | 0.5 | (20.3 ) | 1.0 | (7.8 ) |
| Income tax provision (benefit) | 0.8 | (0.1 ) | 0.6 | 0.6 |
| Net (loss) income | (0.3 ) | (20.2 ) | 0.4 | (8.4 ) |
| Income attributable to the noncontrolling interest | (0.1 ) | — | (0.2 ) | (0.1 ) |
| Net (loss) income attributable to ARC | (0.4 )% | (20.2 )% | 0.2 % | (8.4 )% |
| EBITDA | 14.7 % | (4.2 )% | 15.3 % | 9.0 % |
| Adjusted EBITDA | 16.3 % | 13.1 % | 16.6 % | 14.9 % |

(1) Column does not foot due to rounding

Three and Nine Months Ended September 30, 2013 Compared to Three and Nine Months Ended September 30, 2012

Net Sales

Net sales for the three and nine months ended September 30, 2013 increased by 1.8% and decreased by 1.1%%, respectively, compared to the same period in 2012. The increase for the three months ended September 30, 2013 was primarily due to the higher sales activity for Onsite and Color Services, which were partially offset by lower sales activity in our Traditional Reprographics Services offering and Equipment and Supplies Sales. In the third quarter of 2013, Onsite Services sales was our largest product or service offering as a percentage of total net sales, and had the highest percentage change from the prior year (14.3% growth). For the nine months ended September 30, 2013 the decrease in net sales was primarily due to lower sales activity in our Traditional Reprographics Services offering and Equipment and Supplies Sales, which were partially offset by higher sales activity in our Onsite and Color Services. Declines in Traditional Reprographics sales remain influenced by the continuing trend of a greater use of digital processes for document workflow and less reliance on print.

Traditional Reprographics. Year-over-year sales of Traditional Reprographics Services decreased $1.9 million or 6.2%, and $9.4 million or 9.6%, during the three and nine months ended September 30, 2013, respectively. Revenues from Traditional Reprographics represented approximately 29% of total net sales for the three and nine months ended September 30, 2013, as compared to approximately 31% and 32% during to the same periods in 2012, respectively. Overall Traditional Reprographics Services sales nationwide were negatively affected by the lower volume of construction drawings produced through large-format black and white printing driven by the effect of technology adoption referenced above, as well as increased production of documents on customer sites as opposed to documents being produced at our service centers.

Color Services. Year-over-year sales of Color Services increased $1.3 million or 6.7%, and $3.6 million or 5.9%, for the three and nine months ended September 30, 2013, respectively. Revenues from Color Services comprised approximately 20% and 21% of our total net sales for the three and nine months ended September 30, 2013, respectively, as compared to approximately 19% during the same periods in 2012. We attribute this increase to our continued focus on the expansion and enhancement of our Color Services offerings through our Riot Creative Imaging brand and to our AEC industry customer base.

Digital. Year-over-year sales of Digital Services decreased by $0.3 million or 3.2%, and $2.4 million or 8.7%, for the three and nine months ended September 30, 2013, respectively. Revenues from Digital Services sales decreased slightly to approximately 8% of total net sales for the three and nine months ended September 30, 2013, as compared to approximately 9% for the same periods in 2012. We attribute this decrease in Digital Services to a decline in those services related to project-based work performed at our service centers, offset in part by sales of our AIM services which were introduced into the market in 2013. Currently, the revenue generating activities included in Digital Services consist of both construction project and non-construction project related services. New digital service offerings such as AIM have grown in 2013, but not at a rate sufficient to offset the decline in digital service sales related to construction project work.

Onsite Services. Year-over-year sales of Onsite Services increased by $3.9 million or 14.3%, and $9.3 million or 11.4%, for the three and nine months ended September 30, 2013, respectively. Revenues from Onsite Services sales represented approximately 31% and 30% of total net sales for the three and nine months ended September 30, 2013, compared to approximately 27% and 26% for the same periods in 2012. Onsite Services revenue is derived from two sources: 1) an engagement with the customer to place primarily large-format equipment that we own or lease in our customers' offices, typically referred to as a facilities management engagement or "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 accounts has grown to approximately 7,500 as of September 30, 2013, an increase of approximately 800 locations compared to September 30, 2012, due primarily to growth in new MPS placements. We believe Onsite Services 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. We intend to continue the expansion of our Onsite Service offering through our regional sales force and through Global Services, our national accounts group. As our Onsite Services, and more specifically MPS services, become a larger percentage of our sales, our overall sales will be less exposed to the seasonality associated with construction projects. MPS services are driven by non-construction project related work such as office printing and copying.

Equipment and Supplies Sales. Year-over-year sales of Equipment and Supplies decreased by $1.2 million or 8.6%, and $4.3 million or 10.2%, for the three and nine months ended September 30, 2013, respectively. We experienced declines in both our operations in the United States and in China. Revenues from Equipment and Supplies Sales represented approximately 12% of total net sales for the three and nine months ended September 30, 2013, compared to approximately 14% for the same periods in 2012. The decrease in Equipment and Supplies Sales in the United States was driven primarily by the lack of vendor promotions in 2013 that had been offered to our customers in 2012, as well as a large non-recurring equipment order in 2012. The decrease in Equipment and Supplies sales from UNIS Document Solutions Co. Ltd ("UDS"), our Chinese business venture, was due to several large non-recurring equipment orders in 2012. To date, the Chinese market has shown a preference for owning print and imaging related equipment as opposed to using equipment through an onsite services arrangement. Chinese operations had sales of equipment and supplies of $4.6 million and $13.9 million for the three and nine months ended September 30, 2013, as compared to $5.3 million and $16.2 million for the three and nine months ended September 30, 2012.

Gross Profit

During the three months ended September 30, 2013, gross profit and gross margin increased to $32.9 million, and 32.5%, compared to $29.2 million, and 29.4%, during the same period in 2012, on a sales increase of $1.8 million. During the nine months ended September 30, 2013, gross profit and gross margin increased to $100.9 million, and 33.0%, compared to $94.9 million, and 30.7%, during the same period in 2012, on a sales decline of $3.3 million.

We were able to achieve expansion of our gross margins of 310 and 230 basis points for the three and nine months ended September 30, 2013, respectively, due primarily to a combination of: (1) the closure or merging of underperforming service centers, (2) the reduction in labor costs resulting from our restructuring plan initiated in the fourth quarter of 2012, and (3) ongoing margin expansion initiatives in 2013. Overall, direct labor as a percentage of sales decreased 130 and 140 basis points for the three and nine months ended September 30, 2013, respectively, compared to the same time periods in 2012. Overhead costs for the three and nine months ended 2013 decreased 70 and 30 basis points, respectively, compared to the same time periods in 2012, due to savings from facilities closures and related cost reductions in response to the declining sales in our service centers. We believe the savings from the restructuring plan are sustainable, and we believe the effect of these measures should result in continued margin expansion.

A shift in our business mix also contributed to the year-over-year increase in gross margins for the three and nine months ended September 30, 2013. Due to a decline in lower-margin equipment and supplies sales and 2013 margin expansion initiatives, material costs as a percentage of consolidated sales for the three and nine months ended September 30, 2013 were 110 and 60 basis points lower, respectively, as compared to the same periods in 2012.

Selling, General and Administrative Expenses

The increase of $0.1 million and $1.3 million in selling, marketing, general and administrative expenses, during the three and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, were primarily due to an increase in sales and marketing expenses. The increase in sales and marketing expenses for the three and nine months ended September 30, 2013 was partially offset by cost reduction programs in general and administrative expenses initiated in 2012.

General and administrative expenses for the three and nine months ended September 30, 2013 decreased $0.5 million or 3.7% and $1.3 million or 2.9%, respectively, compared to the same period in 2012. These decreases were (1) driven primarily by decreases in headcount related to our restructuring plan initiated in the fourth quarter of 2012 and (2) partially offset by an increase in accrued incentive bonuses due to an improvement in the Company’s financial performance in 2013.

Year-over-year sales and marketing expenses increased $0.6 million and $2.6 million for the three and nine months ended September 30, 2013, driven primarily by the hiring of new sales and sales administrative personnel and the training and travel of new and existing sales personnel to implement specific sales initiatives, such as Riot Creative Imaging, and our MPS offering.

Amortization of Intangibles

Amortization of intangibles of $1.6 million and $5.1 million for the three and nine months ended September 30, 2013, respectively, decreased by $0.2 million or 12.8%, and $4.2 million or 45.3%, respectively, compared to same periods in 2012, primarily due to phasing out the use of local trade names in April 2012 and the complete amortization of customer lists related to historical acquisitions.

During the fourth quarter of 2010, the Company decided to phase out the use of local trade names 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 use of the original brand names remain in circulation to ensure business recognition and the retention of existing customers. Once the “legacy” trade names were fully transitioned to the ARC name and removed from the marketplace, they quickly lost their value. 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, 2013, we assessed goodwill for impairment and determined that goodwill was not impaired.

At September 30, 2012, our annual goodwill impairment analysis indicated that seven of our 27 reporting units, six in the United States and one in Canada, had goodwill impairments 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.

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

Restructuring expense

Restructuring expenses for the three and nine months ended September 30, 2013 totaled $0.7 million and $1.8 million, respectively, primarily consisted of estimated lease termination and obligation costs.

For further information, please see Note 3 “Restructuring Expenses” to our Condensed Consolidated Financial Statements.

Loss on extinguishment of debt

In July 2013, we repurchased $7.0 million in aggregate principal amount of our 10.5% senior unsecured notes due December 15, 2016 in the open market using available cash for a weighted average purchase price of slightly below 101% of par. The transaction resulted in a loss on extinguishment of debt of $0.3 million. For additional information regarding the impact of the note repurchase to interest expense, please see "Interest Expense, Net" discussion below.

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Interest Expense, Net

Net interest expense was $5.9 million and $18.0 million during the three and nine months ended September 30, 2013, respectively, compared to $7.0 million and $21.7 million, in the same periods in 2012. The decrease was driven by a reduction in interest expense reclassified from accumulated other comprehensive income into earnings as a result of the previously terminated interest rate swap agreement on December 1, 2010. The amortization period for the interest rate swap expense ended in December of 2012, therefore had no impact in 2013 compared to a $0.8 million and $3.0 million interest expense in the three and nine months ended September 30, 2012, respectively. Also contributing to the decrease in interest expense for the three months ended September 30, 2013 compared to the same period in 2012 was the repurchase of $7.0 million in aggregate principal amount of our outstanding 10.5% senior notes. The interest savings related to the repurchase was approximately $0.2 million for the third quarter of 2013, and the annual interest savings will be $0.7 million.

Income Taxes

We recorded an income tax provision of $0.8 million and $1.9 million in relation to pretax income of $0.5 million and $3.2 million for the three and nine months ended September 30, 2013, respectively, and an income tax benefit of $0.1 million and income tax provision $1.8 million in relation to pretax loss of $20.2 million and $24.0 million for the three and nine months ended September 30, 2012.

For the three and nine months ended September 30, 2013, our income tax provision was primarily due to the impact of amortization of tax basis goodwill in a deferred tax liability position.

Noncontrolling Interest

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

Net (Loss) Income Attributable to ARC

Net loss attributable to ARC was $0.5 million and net income attributable to ARC was $0.7 million during the three and nine months ended September 30, 2013, respectively, as compared to net loss attributable to ARC of $20.1 million and $26.1 million, respectively, in the same periods in 2012. The increase in net income attributable to ARC in 2013 versus prior year periods is primarily due to the goodwill impairment charge in 2012, as well as an increase in gross margins and a reduction in amortization expense in 2013. This increase was partially offset by the increase in selling, general and administrative expenses and restructuring expenses in 2013, as noted above.

EBITDA

EBITDA margin increased to 14.7% and 15.3% during the three and nine months ended September 30, 2013, respectively, as compared to (4.2)% and 9.0% during the same periods in 2012. Excluding the effect of stock-based compensation, restructuring expense, goodwill impairment charge in 2012 and loss on extinguishment of debt, adjusted EBITDA margin increased to 16.3% and 16.6% during the three and nine months ended September 30, 2013, respectively, as compared to 13.1% and 14.9% during the same periods in 2012. The increases in EBITDA and adjusted EBITDA were due primarily to the increase in gross profit as a result of the restructuring plan initiated in 2012 as well as ongoing 2013 margin expansion initiatives.

Impact of Inflation

We believe 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 and lease agreements. Our recent historical uses of cash have been for ongoing operations, payment of principal and interest on outstanding debt obligations, and capital expenditures. In July 2013, we repurchased $7.0 million in aggregate principal amount of our 10.5% senior unsecured notes due December 15, 2016 in the open market using available cash. Total cash as of September 30, 2013 was $37.1 million. Of this amount, $15.9 million was held in foreign countries, with $14.2 million held in China.

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, 2013 | Three Months Ended September 30, 2012 | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 |
|---|---|---|---|---|
| Net cash provided by operating activities | $20,019 | $14,029 | $40,010 | $30,879 |
| Net cash used in investing activities | $(4,731) | $(4,615) | $(14,234) | $(14,061) |
| Net cash used in financing activities | $(10,763) | $(2,151) | $(17,059) | $(11,732) |

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, 2013 over the same period in 2012 was primarily due the increase in our net income driven by our expansion of EBITDA margins as described above, as well as an income tax refund of $3.8 million received in 2013 related to our 2009 consolidated federal income tax return, and the timing of accounts payable and accrued expenses. These increases were offset, in part, by an increase in accounts receivable and cash payments in 2013 of $3.3 million related to our restructuring plan. Days sales outstanding (“DSO”) remained at 52 days as of September 30, 2013 and 2012.

Investing Activities

Net cash used in investing activities was primarily related to capital expenditures. We incurred capital expenditures totaling $14.9 million and $14.2 million for the nine months ended September 30, 2013 and 2012, respectively. The increase in capital expenditures is primarily due to growth in our onsite services, and due to the fact that we more often elected to purchase rather than lease new equipment due to the availability of cash and the interest savings thereby. As we continue to foster our relationships with credit providers and obtain attractive lease rates, we may increasingly choose to lease rather than purchase equipment in the future.

Financing Activities

Net cash of $17.1 million used in financing activities during the nine months ended September 30, 2013 primarily relates to payments on our debt agreements and capital leases. In July 2013, we repurchased $7.0 million in aggregate principal amount of our 10.5% senior unsecured notes due December 15, 2016 in the open market using available cash.

Our cash position, working capital, and debt obligations as of September 30, 2013, and December 31, 2012, are shown below and should be read in conjunction with our Condensed Consolidated Balance Sheets and notes thereto contained elsewhere in this report.

| (In thousands) | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Cash and cash equivalents | $37,054 | $28,021 |
| Working capital | $44,193 | $40,650 |
| Borrowings from senior secured credit facility and Notes (1) | $190,451 | $196,852 |
| Other debt obligations | 22,934 | 25,673 |
| Total debt obligations | $213,385 | $222,525 |

(1) Notes, net of discount of $2,549 and $3,148 at September 30, 2013 and December 31, 2012, respectively.

The increase of $3.5 million in working capital in 2013 was primarily due to an increase in cash of $9.0 million, an increase in accounts receivable of $6.8 million that was offset by an increase in accrued expenses of $5.3 million and accrued payroll and payroll-related expenses of $6.1 million. The increase in cash was primarily due to the increase in our net income driven by our expansion of EBITDA margins, as described above, as well as an income tax refund of $3.8 million received in 2013 related to our 2009 consolidated federal income tax return. These increases were partially offset by $3.3 million of cash payments in 2013 related to our restructuring plan. The increase in accounts receivable was driven by higher revenue in the third quarter of 2013 as compared to the fourth quarter of 2012. The increase in accounts payable and accrued payroll expenses was due to the timing of payments and accrued incentive bonuses in 2013. To manage our working capital, we chiefly 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 $37.1 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, 2013. See “Debt Obligations” section for further information related to our current credit facility.

We generate the majority of our revenue from sales of services and products to the AEC industry. As a result, our operating results and financial condition can be significantly affected by economic factors that influence the AEC industry, such as non-residential and residential construction spending. Additionally, a 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 that credit constraints in the financial markets could result in a decrease in, or cancellation of, existing business, could limit new business, and could negatively affect our ability to collect our accounts receivable on a timely basis.

In July 2013, we repurchased $7.0 million in aggregate principal amount of our 10.5% senior unsecured notes due December 15, 2016, in the open market. In October and November of 2013, we repurchased an additional $5.3 million in
aggregate principal amount of our 10.5% senior unsecured notes due December 15, 2016 in the open market. The repurchases were intended to reduce ARC’s long-term debt and annual interest obligations, and made no use of our $50.0 million revolving credit facility which remains undrawn. We may consider additional steps to further reduce our debt and interest obligations in the future provided conditions favor the Company.

While we have not been actively seeking growth through acquisition during the last three years, the executive team continues to selectively evaluate potential acquisitions.

Debt Obligations

10.5% Senior Notes due 2016

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.

Optional Redemption. At any time prior to December 15, 2013, we 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, we may redeem some or all of the Notes (i) on December 15, 2013 or during the 12 month period thereafter, at a redemption price equal to 105.25% of the principal amount thereof and (ii) on or after December 15, 2014, at the redemption price set forth in the Indenture, in each case, together with accrued and unpaid interest, if any, to the date of redemption. At any time prior to December 15, 2013, we 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.

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, 2013, we did not have any outstanding debt under the 2012 Credit Agreement.

As of September 30, 2013, 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 $48.8 million. Standby letters of credit totaling $2.5 million reduced our borrowing availability under the 2012 Credit Agreement to $46.3 million as of September 30, 2013.

Foreign Credit Agreement

In the third quarter of 2013, UDS, ARC's Chinese operations, entered into a revolving credit facility with a term of 18 months. The facility provides for a maximum credit amount of $10.0 million Chinese Yuan Renminbi, which translates to U.S. $1.6 million as of September 30, 2013. 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. As of September 30, 2013, there was $1.6 million in outstanding debt drawn on our foreign credit facility.

Capital Leases

As of September 30, 2013, we had $20.8 million of capital lease obligations outstanding, with a weighted average interest rate of 7.5% and maturities between 2013 and 2018.

Other Notes Payable

As of September 30, 2013, we had $0.4 million of notes payable outstanding, with an interest rate of 6.5% and maturities in 2016. These notes are collateralized by equipment previously purchased.

As of September 30, 2013, we had $0.1 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, 2013, 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, 2013, we have potential future earnout obligations for acquisitions consummated before the adoption of ASC 805, Business Combinations, of approximately $1.8 million through 2014 if predetermined financial targets are met or exceeded. 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 the present—filed an action against us 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. On March 15, 2013, we participated in a private mediation session with claimants' counsel which did not result in resolution of the claim. A subsequent court status conference was held on July 8, 2013 with no resolution reached. Although we believe that we have meritorious defenses to the claim, we also believe that a loss is probable and recorded a liability of $0.9 million as of September 30, 2013. The case remains unresolved as of September 30, 2013. As such, the ultimate resolution of the claim could result in a loss different than the estimated loss recorded.

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 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.

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, 2013, we assessed goodwill for impairment and determined that goodwill was not 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.
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.
Our projections are driven, in part, by industry data gathered from third parties, including projected growth rates of the AEC industry by segment (i.e. residential and non-residential) and anticipated GDP growth rates, as well as company-specific data such as estimated composition of our customer base (i.e. non-AEC vs. AEC, residential vs. non- residential), historical revenue trends, and EBITDA margin performance of our reporting units. Our revenue projections for each of ARC's reporting units include the estimated respective customer composition for each reporting unit, year-to-date revenue at the time of the goodwill impairment analysis, and projected growth rates for the related customer types. Although we rely on a variety of internal and external sources in projecting revenue, our relative reliance on each source or trend changes from year to year. In 2012 and into 2013, we noted a continued divergence between our historic revenue growth rates and AEC non-residential construction growth rates, as well as the "dilution" of traditional reprographics as the Company's dominant business line. Therefore, we increased our reliance upon internal sources for our short-term and long-term revenue forecasts. Once the forecasted revenue was established for each of the reporting units based on the process noted above, using the current year EBITDA margin as a base line, we forecasted future EBITDA margins. In general, our EBITDA margins are significantly affected by (1) revenue trends and (2) cost management initiatives. Revenue trends impact our EBITDA margins because a significant portion of our cost of sales are considered relatively fixed therefore an increase in forecasted revenue (particularly when combined with any cost management or productivity enhancement initiatives) would result in meaningful gross margin expansion. Similarly, a significant portion of our selling, general, and administrative expenses are considered fixed. Hence, in forecasting EBITDA margins, significant reliance was placed on the historical impact of revenue trends on EBITDA margin.
The estimated fair value of our reporting units were based upon a projected EBITDA margin, which was anticipated to increase approximately 100 basis points from 2013 to 2014, followed by year-over-year increases of approximately 100 to 200 basis points in 2015 through 2017, with stabilization expected in 2017. 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, 2013, were as follows:

| (Dollars in thousands) | Number of Reporting Units | Representing Goodwill of |
|---|---|---|
| No goodwill balance | 9 | $— |
| Reporting units failing step one that continue to carry a goodwill balance | — | — |
| Fair value of reporting unit exceeds its carrying value by 1%—20% | 2 | 14,297 |
| Fair value of reporting unit exceeds its carrying value by 20%—40% | 4 | 58,285 |
| Fair value of reporting unit exceeds its carrying value by more than 40% | 10 | 140,026 |
| | 25 | $212,608 |

Based upon a sensitivity analysis, a reduction of approximately 50 basis points of projected EBITDA in 2013 and beyond, assuming all other assumptions remain constant, one reporting unit would proceed to step two of the analysis, although the change would result in no goodwill impairment.

Based upon a separate sensitivity analysis, a 50 basis point increase to the weighted average cost of capital would result in one reporting unit proceeding to step two of the analysis, although the change would result in no goodwill impairment.

Given the current economic environment and the changing document and printing needs of our customers and the uncertainties regarding the effect on our business, there can be no assurance that the estimates and assumptions made for purposes of our goodwill impairment testing in 2013 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 2014, or on an interim basis, if any such change constitutes a triggering event (as defined under ASC 350, Intangibles – Goodwill and Other) 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.

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.

As of June 30, 2011, we determined that cumulative losses for the preceding twelve quarters constituted sufficient objective evidence (as defined by ASC 740-10, Income Taxes) that a valuation allowance was needed. As of September 30, 2013, the valuation allowance against certain deferred tax assets was $78.8 million.

In future quarters we will continue to evaluate our historical results for the preceding twelve quarters and our future projections to determine whether we will generate sufficient taxable income to utilize our deferred tax assets, and whether a partial or full valuation allowance is still 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 2012 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, 2013, we had $213.4 million of total debt, net of discount, and capital lease obligations, none of which bore interest at variable rates.

We have not, and do not plan to, enter into any derivative financial instruments for trading or speculative purposes. As of September 30, 2013, we had no significant material exposure to market risk, including foreign exchange risk and commodity risks.

## 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 Exchange Act are recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’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 Securities Exchange Act of 1934) as of September 30, 2013. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that as of September 30, 2013, our disclosure controls and procedures were effective.

### Changes in Internal Control over Financial Reporting

There were no significant changes to internal control over financial reporting during the three months ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

This information is included under the caption “Legal Proceedings” in Note 7 to our Condensed Consolidated Financial Statements in Part 1, Item 1 of this Quarterly Report on 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, 2012. 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, 2012.

Item 6. Exhibits

| Exhibit Number | Description |
|---|---|
| 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

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 7, 2013

ARC DOCUMENT SOLUTIONS, INC.

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

/s/ JOHN E.D. TOTH
John E.D. Toth
Chief Financial Officer, Secretary

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