ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
November 03, 2017

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

Form 10-Q

(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, 2017
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

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

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)

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

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

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

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

As of October 27, 2017, there were 46,457,281 shares of the issuer’s common stock outstanding.

ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
For the Quarter Ended September 30, 2017
Table of Contents

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, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 26,363	$ 25,239
Accounts receivable, net of allowances for accounts receivable of $2,495 and $2,060	59,006	59,735
Inventories, net	19,095	18,184
Prepaid expenses	5,008	3,861
Other current assets	5,034	4,785
Total current assets	114,506	111,804
Property and equipment, net of accumulated depreciation of $205,435 and $201,192	65,645	60,735
Goodwill	121,051	138,688
Other intangible assets, net	10,087	13,202
Deferred income taxes	41,364	42,667
Other assets	2,590	2,185
Total assets	$ 355,243	$ 369,281
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 25,027	$ 24,782
Accrued payroll and payroll-related expenses	10,908	12,219
Accrued expenses	15,041	16,138
Current portion of long-term debt and capital leases	20,268	13,773
Total current liabilities	71,244	66,912
Long-term debt and capital leases	128,917	143,400
Other long-term liabilities	3,329	2,148
Total liabilities	203,490	212,460
Commitments and contingencies (Note 6)		
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; 47,891 and 47,428 shares issued and 46,451 and 45,988 shares outstanding	48	47
Additional paid-in capital	120,204	117,749
Retained earnings	32,681	41,822
Accumulated other comprehensive loss	(2,545)	(3,793)
	150,388	155,825
Less cost of common stock in treasury, 1,440 shares	5,909	5,909
Total ARC Document Solutions, Inc. stockholders’ equity	144,479	149,916
Noncontrolling interest	7,274	6,905
Total equity	151,753	156,821
Total liabilities and equity	$ 355,243	$ 369,281

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)	2017	2016	2017	2016
Service sales	$85,625	$89,178	$262,459	$272,394
Equipment and supplies sales	10,833	11,265	35,010	35,369
Total net sales	96,458	100,443	297,469	307,763
Cost of sales	67,231	67,713	202,918	204,904
Gross profit	29,227	32,730	94,551	102,859
Selling, general and administrative expenses	25,843	24,893	76,540	76,752
Amortization of intangible assets	1,053	1,160	3,250	3,705
Goodwill impairment	17,637	—	17,637	73,920
Restructuring expense	—	—	—	7
(Loss) income from operations	(15,306)	6,677	(2,876)	(51,525)
Other income, net	(19)	(16)	(60)	(54)
Loss on extinguishment and modification of debt	124	66	230	156
Interest expense, net	1,530	1,563	4,679	4,535
(Loss) income before income tax (benefit) provision	(16,941)	5,064	(7,725)	(56,162)
Income tax (benefit) provision	(2,174)	2,162	1,574	(5,884)
Net (loss) income	(14,767)	2,902	(9,299)	(50,278)
Income attributable to the noncontrolling interest	(7)	(61)	(55)	(211)
Net (loss) income attributable to ARC Document Solutions, Inc. shareholders	$(14,774)	$2,841	$(9,354)	$(50,489)
(Loss) earnings per share attributable to ARC Document Solutions, Inc. shareholders:				
Basic	$(0.32)	$0.06	$(0.20)	$(1.10)
Diluted	$(0.32)	$0.06	$(0.20)	$(1.10)
Weighted average common shares outstanding:				
Basic	45,834	45,599	45,756	46,055
Diluted	45,834	46,189	45,756	46,055

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)	2017	2016	2017	2016
Net (loss) income	$(14,767)	$2,902	$(9,299)	$(50,278)
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments, net of tax	681	(250)	1,421	(873)
Fair value adjustment of derivatives, net of tax	55	47	141	(50)
Other comprehensive income (loss), net of tax	736	(203)	1,562	(923)
Comprehensive (loss) income	(14,031)	2,699	(7,737)	(51,201)
Comprehensive income attributable to noncontrolling interest	149	36	369	22
Comprehensive (loss) income attributable to ARC Document Solutions, Inc. shareholders	$(14,180)	$2,663	$(8,106)	$(51,223)

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

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

	ARC Document Solutions, Inc. Shareholders							
	Common Stock				Accumulated			
(In thousands, except per share data)	Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Loss	Common Stock in Treasury	Noncontrolling Interest	Total
Balance at December 31, 2015	47,130	$ 47	$ 115,089	$ 89,687	$ (2,097)	$ (612)	$ 7,020	$ 209,134
Stock-based compensation	229	—	2,073	—	—	—	—	2,073
Issuance of common stock under Employee Stock Purchase Plan	28	—	96	—	—	—	—	96
Stock options exercised	28	—	76	—	—	—	—	76
Tax deficiency from stock-based compensation			(70)					(70)
Treasury shares	—	—	—	—	—	(5,297)	—	(5,297)
Comprehensive loss:								
Net (loss) income	—	—	—	(50,489)	—	—	211	(50,278)
Foreign currency translation adjustments, net of tax	—	—	—	—	(684)	—	(189)	(873)
Fair value adjustment of derivatives, net of tax	—	—	—	—	(50)	—	—	(50)
Comprehensive loss								(51,201)
Balance at September 30, 2016	47,415	$ 47	$ 117,264	$ 39,198	$ (2,831)	$ (5,909)	$ 7,042	$ 154,811

	ARC Document Solutions, Inc. Shareholders							
	Common Stock				Accumulated			
(In thousands, except per share data)	Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Loss	Common Stock in Treasury	Noncontrolling Interest	Total
Balance at December 31, 2016	47,428	$ 47	$ 117,749	$ 41,822	$ (3,793)	$ (5,909)	$ 6,905	$ 156,821
Stock-based compensation	403	1	2,250	—	—	—	—	2,251
ASU 2016-09 adoption adjustment	—	—	29	213	—	—	—	242
Issuance of common stock under Employee Stock Purchase Plan	33	—	103	—	—	—	—	103
Stock options exercised	27	—	73	—	—	—	—	73
Comprehensive loss:								
Net (loss) income	—	—	—	(9,354)	—	—	55	(9,299)
Foreign currency translation adjustments, net of tax	—	—	—	—	1,107	—	314	1,421
Fair value adjustment of derivatives, net of tax	—	—	—	—	141	—	—	141
Comprehensive loss								(7,737)
Balance at September 30, 2017	47,891	$ 48	$ 120,204	$ 32,681	$ (2,545)	$ (5,909)	$ 7,274	$ 151,753

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)	2017	2016	2017	2016
Cash flows from operating activities				
Net (loss) income	$(14,767)	$2,902	$(9,299)	$(50,278)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:				
Allowance for accounts receivable	306	324	867	644
Depreciation	7,377	6,697	21,787	20,032
Amortization of intangible assets	1,053	1,160	3,250	3,705
Amortization of deferred financing costs	69	111	246	344
Goodwill impairment	17,637	—	17,637	73,920
Stock-based compensation	699	650	2,251	2,073
Deferred income taxes	(2,380)	2,299	1,045	(6,018)
Deferred tax valuation allowance	454	(1)	488	(16)
Loss on extinguishment and modification of debt	124	66	230	156
Other non-cash items, net	(205)	(87)	(340)	(540)
Changes in operating assets and liabilities:				
Accounts receivable	554	(897)	406	(2,285)
Inventory	(142)	(429)	(650)	(3,196)
Prepaid expenses and other assets	1,029	1,179	(1,129)	513
Accounts payable and accrued expenses	(482)	(1,811)	(33)	(5,008)
Net cash provided by operating activities	11,326	12,163	36,756	34,046
Cash flows from investing activities				
Capital expenditures	(2,335)	(2,430)	(7,246)	(7,580)
Other	72	135	466	842
Net cash used in investing activities	(2,263)	(2,295)	(6,780)	(6,738)
Cash flows from financing activities				
Proceeds from stock option exercises	2	46	73	76
Proceeds from issuance of common stock under Employee Stock Purchase Plan	37	26	103	96
Share repurchases	—	(200)	—	(5,297)
Contingent consideration on prior acquisitions	(63)	(86)	(214)	(453)
Early extinguishment of long-term debt	—	(7,000)	(14,150)	(16,000)
Payments on long-term debt agreements and capital leases	(52,146)	(3,310)	(60,060)	(9,651)
Borrowings under revolving credit facilities	52,350	—	54,850	—
Payments under revolving credit facilities	(9,375)	—	(9,675)	—
Payment of deferred financing costs	(270)	(76)	(270)	(106)
Net cash used in financing activities	(9,465)	(10,600)	(29,343)	(31,335)
Effect of foreign currency translation on cash balances	161	(80)	491	(296)
Net change in cash and cash equivalents	(241)	(812)	1,124	(4,323)
Cash and cash equivalents at beginning of period	26,604	20,452	25,239	23,963
Cash and cash equivalents at end of period	$26,363	$19,640	$26,363	$19,640
Supplemental disclosure of cash flow information				

Noncash investing and financing activities				
Capital lease obligations incurred	$6,404	$3,738	$20,714	$12,345
Contingent liabilities in connection with acquisition of businesses	$—	$—	$27	$85

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”) is a leading document solutions provider to architectural, engineering, construction, and facilities management professionals, while also providing document solutions to businesses of all types. ARC offers a variety of services including: Construction Document Information Management ("CDIM"), Managed Print Services ("MPS"), and Archive and Information Management ("AIM"). In addition, ARC also sells Equipment and Supplies. The Company conducts its operations through its wholly-owned operating subsidiary, ARC Document Solutions, LLC, a Texas limited liability company, and its affiliates.

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 Securities and Exchange Commission (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, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

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 2016 Form 10-K.

Correction to 2016 Financial Statements

Subsequent to the issuance of the Company's 2016 Consolidated Financial Statements, management identified an immaterial error in the balance sheet presentation of the Company's deferred tax assets and liabilities as of December 31, 2016. In its 2016 Consolidated Financial Statements, the Company presented its deferred taxes on a gross basis; however, such deferred taxes should have been presented on a net basis by taxing jurisdiction in accordance with Accounting Standards Codification (ASC) 740, Income Taxes. As a result of the error, the Company has corrected the deferred tax assets and deferred tax liabilities balances as of December 31, 2016 in the accompanying Condensed Consolidated Balance Sheets. The correction resulted in a decrease to the Company's deferred tax liabilities balance of $30.3 million with a corresponding decrease of the same amount to the Company's deferred tax assets balance as of December 31, 2016. This correction had no impact to the Company's previously reported Consolidated Statements of Operations, Consolidated Statements of Comprehensive Income (Loss), Consolidated Statements of Equity, Consolidated Statements of Cash Flows, or Notes to the Consolidated Financial Statements. The Company has concluded that the error correction was not material to the Consolidated Financial Statements.

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-04, Intangibles-Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment. The new guidance simplifies subsequent goodwill measurement by eliminating step two from the goodwill impairment test. Accordingly, the Company is required to perform its annual, or interim, goodwill impairment tests by comparing the fair value of a reporting unit with its respective carrying value, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The Company elected to early-adopt ASU 2017-04 for its annual goodwill impairment test as of September 30, 2017. See Note 3, “Goodwill and Other Intangibles” for further information regarding the process of assessing goodwill impairment and the results of the Company's 2017 annual goodwill impairment test.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments. The new guidance addresses diversity in practice for classification of certain transactions in the statement of cash flows including, but not limited to: debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, and distributions received from equity method investees. ASU 2016-15 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2016-15 on its Condensed Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. The new guidance requires excess tax benefits and tax deficiencies to be recorded in the statement of operations when share-based awards vest or are settled. In addition, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows. The standard also allows the Company to repurchase more of an employee’s shares for tax withholding purposes without triggering liability accounting, clarifies that all cash payments made on an employee’s behalf for withheld shares should be presented as a financing activity on the Company's statement of cash flows, and provides an accounting policy election to account for forfeitures as they occur. The Company adopted ASU 2016-09 on January 1, 2017, which resulted in a cumulative adjustment to equity of $0.2 million. In conjunction with the adoption of ASU 2016-09, the Company elected to account for forfeitures of share-based awards when they occur.

In February 2016, the FASB issued Accounting Standards Codification (“ASC”) 842 (“ASC 842”), Leases. ASC 842 requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use (ROU) asset and a corresponding lease liability. For finance leases the lessee would recognize interest expense and amortization of the ROU asset and for operating leases the lessee would recognize a straight-line total lease expense. ASC 842 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. While the Company is continuing to assess the potential impacts that ASC 842 will have on its condensed consolidated financial statements, the Company believes that the most significant impact relates to its accounting for facility leases related to its service centers and office space, which are currently classified as operating leases. The resulting impact of the adoption of ASC 842 will be an increase to assets and a corresponding increase to liabilities for the same amount on the Company's consolidated balance sheet. The Company expects the accounting for capital leases related to its machinery and equipment will remain substantially unchanged under the new standard.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory. The new guidance requires that inventory be measured at the lower of cost or net realizable value and amends existing guidance which requires inventory be measured at the lower of cost or market. Replacing the concept of market with the single measurement of net realizable value is intended to create efficiencies for financial statement preparers. ASU 2015-11 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company adopted ASU 2015-11 on January 1, 2017. The adoption of ASU 2015-11 did not have a material impact on its Condensed Consolidated Financial Statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new guidance requires entities to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received in exchange for those goods or services. In addition, ASU 2014-09 provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. The new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period.

The Company will adopt the new standard on January 1, 2018 under the modified retrospective method and expects the cumulative effect adjustment in retained earnings as of adoption date to be minimal. While the Company is

continuing to finalize its ASU 2014-09 assessment and the resulting impact the adoption will have on its consolidated financial statements, the Company does not expect the adoption will have a material impact to its consolidated financial statements.
The Company has performed an analysis of each of its service revenue categories (CDIM, MPS and AIM) to identify any differences in the recognition, measurement, or presentation of revenue recognition and related costs. In addition, the Company is analyzing its product revenue category (equipment and supplies sales). Based on its preliminary analyses, the Company expects the pattern of revenue recognition and the costs to acquire customer contracts to remain consistent with the Company's current revenue recognition policy. The Company is also analyzing detailed disclosure requirements as well as any changes to the Company’s systems and internal controls to support adoption of the new standard.
Segment Reporting
The provisions of ASC 280, Segment Reporting, 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 and whose operating results are reviewed by the Company's Chief Executive Officer, who is the Company's chief operating decision maker. Because its operating segments have similar products and services, classes of customers, production processes, distribution methods and economic characteristics, the Company operates 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,	
	2017	2016	2017	2016
Service Sales				
CDIM	$50,089	$53,228	$155,031	$161,753
MPS	32,153	32,796	97,697	100,082
AIM	3,383	3,154	9,731	10,559
Total service sales	85,625	89,178	262,459	272,394
Equipment and supplies sales	10,833	11,265	35,010	35,369
Total net sales	$96,458	$100,443	$297,469	$307,763

Risk and Uncertainties

The Company generates the majority of its revenue from sales of services and products to customers in the architectural, engineering, construction and building owner/operator (AEC/O) industry. As a result, the Company’s operating results and financial condition can be significantly affected by economic factors that influence the AEC/O 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/O 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, some of which 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 to 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 common share is computed similarly 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 share equivalents are excluded from the computation if their effect is anti-dilutive. For the three and nine months ended September 30, 2017, 5.3 million common shares were excluded from the calculation of diluted net income attributable to ARC per common share, because they were anti-dilutive. For the three and nine months ended September 30, 2016, 3.0 million and 4.4 million common shares were excluded from the calculation of diluted net loss attributable to ARC per common share, respectively, because they were anti-dilutive. The Company's common share equivalents consist of stock options issued under the Company's stock plan.

Basic and diluted weighted average common shares outstanding were calculated as follows for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,	Nine Months Ended September 30,

	2017	2016	2017	2016
Weighted average common shares outstanding during the period—basic	45,834	45,599	45,756	46,055
Effect of dilutive stock options	—	590	—	—
Weighted average common shares outstanding during the period—diluted	45,834	46,189	45,756	46,055

Stock Repurchase Program

On February 8, 2016, the Company announced that the Company's Board of Directors had approved a stock repurchase program that authorizes the Company to purchase up to $15.0 million of the Company's outstanding common stock through December 31, 2017. Under the repurchase program, purchases of shares of common stock may be made from time to time in the open market, or in privately negotiated transactions, in compliance with applicable state and federal securities laws. The stock repurchase program does not obligate the company to acquire any specific number of shares in any period, and may be expanded, extended, modified or discontinued at any time without prior notice. See Part II, Item 2., “Unregistered Sales of Equity Securities and Use of Proceeds” of this report for additional information on the stock repurchase program.

3. Goodwill and Other Intangibles

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 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.

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.

Traditionally, 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 an implied fair value of goodwill.

For its annual goodwill impairment test as of September 30, 2017, the Company elected to early-adopt ASU 2017-04 which simplifies subsequent goodwill measurement by eliminating step two from the goodwill impairment test. As a result, the Company compared the fair value of a reporting unit with its respective carrying value, and recognized an impairment charge for the amount by which the carrying amount exceeded the reporting unit’s fair value.

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. 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.

At September 30, 2017, the Company's goodwill impairment analysis showed one reporting unit with goodwill attributed to it had a carrying amount which exceeded its fair value. The underperformance of the Company relative to its forecast in the third quarter of 2017, and more specifically, the underperformance against forecast of one of the Company's reporting units which previously had goodwill impairment in 2016 drove the decline in the fair value of the reporting unit. As a result, the Company recorded a pretax, non-cash charge for the three and nine months ended September 30, 2017 to reduce the carrying value of goodwill by $17.6 million.

At June 30, 2016, the Company determined that there were sufficient indicators to trigger an interim goodwill impairment analysis. The indicators included, among other factors: (1) the underperformance against plan of the Company's reporting units, (2) a revision of the Company's forecasted future earnings, and (3) a decline in the Company's market capitalization in 2016. The Company's interim goodwill impairment analysis as of June 30, 2016 indicated that five of its eight reporting units, four in the United States and one in Canada, failed step one of the impairment analysis. Accordingly, the Company recorded a pretax, non-cash charge for the three and six months ended June 30, 2016 to reduce the carrying value of goodwill by $73.9 million.

Given the changing document and printing needs of the Company’s customers, and the uncertainties regarding the effect on the Company’s business, there can be no assurance that the estimates and assumptions made for purposes of the Company’s goodwill impairment test in 2017 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 2018, 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, 2016 through September 30, 2017 are summarized as follows:

	Gross Goodwill	Accumulated Impairment Loss	Net Carrying Amount
January 1, 2016	$405,558	$ 192,950	$212,608
Additions	—	—	—
Goodwill impairment	—	73,920	(73,920)
December 31, 2016	405,558	266,870	138,688
Additions	—	—	—
Goodwill impairment	—	17,637	(17,637)
September 30, 2017	$405,558	$ 284,507	$121,051

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 and Other Intangible 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 regional level, which is the operating segment level.

Factors considered by the Company include, but are not limited to, significant underperformance relative to historical or projected operating results; significant changes in the manner of use of the acquired assets or the strategy for the overall business; and significant negative industry or economic trends. When the carrying value of a long-lived asset may not be recoverable based upon the existence of one or more of the above indicators of impairment, the Company estimates the future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future undiscounted cash flows and eventual disposition is less than the carrying amount of the asset, the Company recognizes an impairment loss. An impairment loss is reflected as the amount by which the carrying amount of the asset exceeds the fair value of the asset, based on the fair value if available, or discounted cash flows, if fair value is not available. The Company assessed potential impairments of its long lived assets as of September 30, 2017 and concluded that there was no impairment.

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.

The following table sets forth the Company’s other intangible assets resulting from business acquisitions as of September 30, 2017 and December 31, 2016 which continue to be amortized:

	September 30, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable other intangible assets						
Customer relationships	$99,484	$ 89,789	$9,695	$99,104	$ 86,305	$12,799
Trade names and trademarks	20,283	19,891	392	20,281	19,878	403

$119,767	$ 109,680	$10,087	$119,385	$ 106,183	$13,202

Estimated future amortization expense of other intangible assets for the remainder of the 2017 fiscal year, each of the subsequent four fiscal years and thereafter are as follows:

13

2017 (excluding the nine months ended September 30, 2017)	$1,027
2018	3,875
2019	3,151
2020	1,539
2021	178
Thereafter	317
	$10,087

4. Income Taxes

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

The Company recorded an income tax benefit of $2.2 million and an income tax provision of $1.6 million in relation to pretax losses of $16.9 million and $7.7 million for the three and nine months ended September 30, 2017, respectively, which resulted in an effective income tax rate of 12.8% and (20.4)%, for the three and nine months ended September 30, 2017, respectively. The Company recorded an income tax provision of $2.2 million in relation to pretax income of $5.1 million for the three months ended September 30, 2016, and an income tax benefit of $5.9 million in relation to pretax losses of $56.2 million for the nine months ended September 30, 2016, which resulted in an effective income tax rate of 15.2% and 13.1%, for the three and nine months ended September 30, 2016, respectively. The Company's low effective income tax rate was primarily due to the portion of its goodwill impairments related to historical stock acquisitions which cannot be deducted for income tax purposes until the related stock is disposed of ($10.0 million and $41.4 million recognized in 2017 and 2016, respectively).

In accordance with ASC 740-10, Income Taxes, the Company evaluates the need for deferred tax asset valuation allowances based on a more likely than not standard. The ability to realize deferred tax assets depends on the ability to generate sufficient taxable income within the carryback or carryforward periods provided for in the tax law for each applicable tax jurisdiction. The Company considers the following possible sources of taxable income when assessing the realization of deferred tax assets:

- Future reversals of existing taxable temporary differences;
- Future taxable income exclusive of reversing temporary differences and carryforwards;
- Taxable income in prior carryback years; and
- Tax-planning strategies.

The assessment regarding whether a valuation allowance is required or should be adjusted also considers all available positive and negative evidence factors, including but not limited to:

- Nature, frequency, and severity of recent losses;
- Duration of statutory carryforward periods;
- Historical experience with tax attributes expiring unused; and
- Near- and medium-term financial outlook.

The Company utilizes a rolling three years of actual and current year anticipated results as the primary measure of cumulative income/losses in recent years, as adjusted for permanent differences. The evaluation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in the Company's financial statements or tax returns and future profitability. The Company's accounting for deferred tax consequences represents its best estimate of those future events. Changes in the Company's current estimates, due to unanticipated events or otherwise, could have a material effect on its financial condition and results of operations. The Company has a $1.8 million valuation allowance against certain deferred tax assets as of September 30, 2017.

Based on the Company’s current assessment, the remaining net deferred tax assets as of September 30, 2017 are considered more likely than not to be realized. The valuation allowance of $1.8 million may be increased or reduced 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, 2017 included in prepaid expenses in its Condensed Consolidated Balance Sheet primarily related to income tax refunds for prior years.

5. Long-Term Debt
Long-term debt consists of the following:

	September 30, 2017	December 31, 2016
Term A loan facility maturing 2022 net of deferred financing fees of $811 and $1,039; 3.07% and 2.86% interest rate at September 30, 2017 and December 31, 2016	$58,064	$119,961
Borrowings from revolving loan facility under the Term A Credit Agreement; 3.23% and 2.64% interest rate at September 30, 2017 and December 31, 2016	46,125	950
Various capital leases; weighted average interest rate of 4.6% and 5.6% at September 30, 2017 and December 31, 2016; principal and interest payable monthly through September 2022	44,975	36,231
Various other notes payable with a weighted average interest rate of 10.8% and 10.7% at September 30, 2017 and December 31, 2016; principal and interest payable monthly through November 2019	21	31
	149,185	157,173
Less current portion	(20,268)	(13,773)
	$128,917	$143,400

Amended Term A Loan Facility
On July 14, 2017, the Company amended its Credit Agreement (the “Term A Credit Agreement”) which was originally entered into on November 20, 2014 with Wells Fargo Bank, National Association, as administrative agent and the lenders party thereto.
The original Term A Credit Agreement provided for the extension of term loans (“Term Loans”) in an aggregate principal amount of $175.0 million, the entirety of which was disbursed on the Closing Date in order to pay outstanding obligations under the Company’s then effective Term Loan Credit Agreement. The original Credit Agreement also provided for the extension of revolving loans (“Revolving Loans”) in an aggregate principal amount not to exceed $30.0 million. The amendment increases the maximum aggregate principal amount of Revolving Loans under the agreement from $30 million to $80 million and resizes the outstanding principal amount of the Term Loan under the agreement at $60 million. Upon the execution of the amendment to the Term A Credit Agreement, the total principal amount outstanding under the agreement remained unchanged at $110.0 million. As amended, the principal of the resized Term Loan balance will amortize at an annual rate of 7.5% during the first and second years following the date of the amendment and at an annual rate of 10% during the third, fourth and fifth years following the date of the amendment, with any remaining balance payable upon the maturity date. The amendment also extended the maturity date for both the Revolving Loans and the Term Loans until July 14, 2022.
As of September 30, 2017, the Company's borrowing availability under the amended Term A Credit Agreement was $32.1 million, which was the maximum borrowing limit of $80.0 million reduced by outstanding letters of credit of $1.8 million and revolver credit facility balance of $46.1 million.

Loans borrowed under the amended Term A Credit Agreement bear interest, in the case of LIBOR rate loans, at a per annum rate equal to the applicable LIBOR rate, plus a margin ranging from 1.25% to 2.25%, based on the Company’s Total Leverage Ratio (as defined in the amended Term A Credit Agreement). Loans borrowed under the amended Term A Credit Agreement that are not LIBOR rate loans bear interest at a per annum rate equal to (i) the greatest of (A) the Federal Funds Rate plus 0.50%, (B) the one month LIBOR rate plus 1.00%, per annum, and (C) the rate of interest announced, from time to time, by Wells Fargo Bank, National Association as its “prime rate,” plus (ii) a margin ranging from 0.25% to 1.25%, based on the Company’s Total Leverage Ratio. The amendment reduced the rate of interest payable on the loans borrowed under the amended Term A Credit Agreement by 0.25%.

The Company pays certain recurring fees with respect to the credit facility, including administration fees to the administrative agent.

Subject to certain exceptions, including in certain circumstances, reinvestment rights, the loans extended under the amended Term A Credit Agreement are subject to customary mandatory prepayment provisions with respect to: the net proceeds from certain asset sales; the net proceeds from certain issuances or incurrences of debt (other than debt permitted to be incurred under the terms of the amended Term A Credit Agreement); the net proceeds from certain issuances of equity securities; and net proceeds of certain insurance recoveries and condemnation events of the Company.

The amended Term A Credit Agreement contains customary representations and warranties, subject to limitations and exceptions, and customary covenants restricting the ability (subject to various exceptions) of the Company and its subsidiaries to: incur additional indebtedness (including guarantee obligations); incur liens; sell certain property or assets; engage in mergers or other fundamental changes; consummate acquisitions; make investments; pay dividends, other distributions or repurchase equity interest of the Company or its subsidiaries; change the nature of their business; prepay or amend certain indebtedness; engage in certain transactions with affiliates; amend their organizational documents; or enter into certain restrictive agreements. In addition, the amended Term A Credit Agreement contains financial covenants which requires the Company to maintain (i) at all times, a Total Leverage Ratio in an amount not to exceed 3.25 to 1.00; and (ii) a Fixed Charge Coverage Ratio (as defined in the amended Term A Credit Agreement), as of the last day of each fiscal quarter, an amount not less than 1.15 to 1.00.

The amended Term A Credit Agreement contains customary events of default, including with respect to: nonpayment of principal, interest, fees or other amounts; failure to perform or observe covenants; material inaccuracy of a representation or warranty when made; cross-default to other material indebtedness; bankruptcy, insolvency and dissolution events; inability to pay debts; monetary judgment defaults; actual or asserted invalidity or impairment of any definitive loan documentation, repudiation of guaranties or subordination terms; certain ERISA related events; or a change of control.

The obligations of the Company’s subsidiary that is the borrower under the amended Term A Credit Agreement are guaranteed by the Company and each other United States domestic subsidiary of the Company. The amended Term A Credit Agreement and any interest rate protection and other hedging arrangements provided by any lender party to the Credit Facility or any affiliate of such a lender are secured on a first priority basis by a perfected security interest in substantially all of the borrower’s, the Company’s and each guarantor’s assets (subject to certain exceptions).
Prior to entering into the amended Term A Credit Agreement, the Company had paid $68.2 million in aggregate principal on its original $175.0 million Term Loan Credit Agreement. Principal payments on the Term Loan Credit Agreement of $14.2 million in 2017 resulted in a loss on extinguishment and modification of debt of $0.1 million and $0.2 million for the three and nine months ended September 30, 2017.

6. Commitments and Contingencies
Operating Leases. The Company leases machinery, equipment, and office and operational facilities under non-cancelable operating lease agreements used in the ordinary course of business.

Legal Proceedings. We are involved in various 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.
7. Stock-Based Compensation
At the Company's annual meeting of stockholders held on May 1, 2014, the Company's stockholders approved the Company's 2014 Stock Plan (the “2014 Stock Plan”) as adopted by the Company's board of directors. The 2014 Stock Plan replaces the American Reprographics Company 2005 Stock Plan (the "2005 Plan"). The 2014 Stock Plan provides for the grant of incentive and non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units, stock bonuses and other forms of awards granted or denominated in the Company's common stock or units of the Company's common stock, as well as cash bonus awards to employees, directors and consultants of the Company. The 2014 Stock Plan authorizes the Company to issue up to 3.5 million shares of common stock. As of September 30, 2017, 0.7 million shares remain available for issuance under the Stock Plan.
Stock options granted under the 2014 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 three to four 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% 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, 2017, the Company granted options to acquire a total of 0.5 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. During the nine months ended September 30, 2017, the Company granted 0.4 million shares of restricted stock to certain key employees at a price per share equal to the closing price of the Company's common stock on the date the restricted stock was granted. The granted stock options and restricted stock vest annually over a period of three to four years from the grant date.

Stock-based compensation was $0.7 million for the three months ended September 30, 2017 and 2016. Stock-based compensation was $2.3 million and $2.1 million for the nine months ended September 30, 2017 and 2016, respectively.

As of September 30, 2017, total unrecognized compensation cost related to unvested stock-based payments totaled $3.7 million and is expected to be recognized over a weighted-average period of approximately 1.9 years.

8. Derivatives and Hedging Transactions

The Company uses derivative financial instruments to hedge its exposure to interest rate volatility related to its Term A Loan Facility. The Company does not use derivative financial instruments for speculative or trading purposes. Such derivatives are designated as cash flow hedges and accounted for under ASC 815, Derivatives and Hedging. Derivative instruments are recorded at fair value as either assets or liabilities in the interim condensed consolidated balance sheets. Changes in fair value of cash flow hedges that are designated as effective hedging instruments are deferred in equity as a component of accumulated other comprehensive loss ("AOCL"). Any ineffectiveness in such cash flow hedges is immediately recognized in earnings. Changes in the fair value of hedges that are not designated as effective hedging instruments are immediately recognized in earnings. Cash flows from the Company’s derivative instruments are classified in the condensed consolidated statements of cash flows in the same category as the items being hedged.

In January 2015, the Company entered into three one-year interest rate cap contracts to hedge against its exposure to interest rate volatility: (1) $80.0 million notional interest rate cap effective in 2015, (2) $65.0 million notional forward interest rate cap effective in 2016, and (3) $50.0 million notional forward interest rate cap effective in 2017. Over the next twelve months, the Company expects to reclassify $0.1 million from AOCL to interest expense.

The following table summarizes the fair value and classification on the Condensed Consolidated Balance Sheets of the Company's derivatives as of September 30, 2017 and December 31, 2016:

	Balance Sheet Classification	Fair Value September 30, 2017	Fair Value December 31, 2016
Derivative designated as hedging instrument under ASC 815			
Interest rate cap contracts - current portion	Other current assets	$ 10	$ 39
Interest rate cap contracts - long-term portion	Other assets	—	—
Total derivatives designated as hedging instruments		$ 10	$ 39

The following table summarizes the income (loss) recognized in AOCL of derivatives, designated and qualifying as cash flow hedges for the three and nine months ended September 30, 2017 and 2016:

	Amount of Income (Loss) Recognized in AOCL on Derivatives	
	Three Months Ended September 30,	Nine Months Ended September 30,

	2017	2016	2017	2016
Derivative in ASC 815 Cash Flow Hedging Relationship				
Interest rate cap contracts, net of tax	$55	$47	$141	$(50)

The following table summarizes the effect of the interest rate cap on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016:

17

	Amount of Loss Reclassified from AOCL into Income							
	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Location of Loss Reclassified from AOCL into Income	Effective Portion	Ineffective Portion	Effective Portion	Ineffective Portion	Effective Portion	Ineffective Portion	Effective Portion	Ineffective Portion
Interest expense	$103	$ —	$68	$ —	$261	$ —	$132	$ —

9. Fair Value Measurements

In accordance with ASC 820, Fair Value Measurement, 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 as of and for the nine months ended September 30, 2017 and 2016:

	Significant Other Unobservable Inputs			
	September 30, 2017		September 30, 2016	
	Level 3	Total Losses	Level 3	Total Losses
Nonrecurring Fair Value Measure				
Goodwill	$121,051	$17,637	$138,688	$73,920

In accordance with ASC 350, goodwill was written down to its implied fair value of $121.1 million as of September 30, 2017 and $138.7 million as of June 30, 2016, resulting in impairment charges of $17.6 million during the three and nine months ended September 30, 2017 and $73.9 million during the nine months ended September 30, 2016 . See Note 3, “Goodwill and Other Intangibles” for further information regarding the process of determining the implied fair value of goodwill and change in goodwill.

The following table summarizes the bases used to measure certain assets and liabilities at fair value on a recurring basis as of and for the nine months ended September 30, 2017 and as of and for the year ended December 31 2016:

	Significant Other Unobservable Inputs					
	September 30, 2017			December 31, 2016		
	Level 2	Level 3	Total Losses	Level 2	Level 3	Total Losses
Recurring Fair Value Measure						
Interest rate cap contracts	$10	$—	$ —	$39	$—	$ —

Contingent purchase price consideration for acquired businesses	$—	$258	$—	$—	$402	$—

The Company determines the fair value of its interest rate cap contracts based on observable interest rate yield curves and represent the expected discounted cash flows underlying the financial instruments.

The Company recognizes liabilities for future earnout obligations on business acquisitions, or contingent purchase price consideration for acquired businesses, at their fair value based on discounted projected payments on such obligations. The inputs to the valuation, which are level 3 inputs within the fair value hierarchy, are projected sales to be provided by the acquired businesses based on historical sales trends for which earnout amounts are contractually based. Based on the Company's assessment as of September 30, 2017, the estimated contractually required earnout amounts would be achieved.

The following table presents the change in the Level 3 contingent purchase price consideration liability for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Beginning balance	$318	$604	$402	$1,059
Additions related to acquisitions	—	—	34	104
Payments	(70)	(86)	(221)	(453)
Adjustments included in earnings	3	15	26	(180)
Foreign currency translation adjustments	7	8	17	11
Ending balance	$258	$541	$258	$541

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 Sheet were $6.4 million and $3.9 million as of September 30, 2017 and December 31, 2016, 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, 2017 for borrowings under its Term Loan Credit Agreement is $105.0 million, excluding unamortized deferred financing fees. The Company has determined, utilizing observable market quotes, that the fair value of borrowings under its Term Loan Credit Agreement is $105.0 million as of September 30, 2017.

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 2016 Form 10-K and this Quarterly Report on Form 10-Q for the quarter ended September 30, 2017.
Business Summary
ARC Document Solutions, Inc. (“ARC Document Solutions,” “ARC,” “we,” “us,” or “our”) is a leading document solutions provider to design, engineering, construction, and facilities management professionals, while also providing document solutions to businesses of all types.
Our customers need us to manage the scale, complexity and workflow of their documents. We help them reduce their costs and increase their efficiency by improving their access and control over documents, and we offer a wide variety of ways to access, distribute, collaborate on, and store documents.
Each of our service offerings is enabled through a suite of supporting proprietary technology and a wide variety of value-added services. We have categorized our service and product offerings to report distinct sales recognized from:

Construction Document and Information Management (CDIM), which consists of software services and professional services to manage and distribute documents and information primarily related to construction projects. CDIM sales include software services such as SKYSITE®, our cloud-based project communication application, as well as providing document and information management services that are often technology-enabled. The bulk of our current revenue from CDIM comes from large-format and small-format printing services we provide in both black and white and in color. Sales from traditional printing have been in steady decline since the last recession due in large measure to the adoption of technology, but we believe there is market share still to be captured.
Software services are a smaller part of overall CDIM sales which we anticipate to continue to grow with the adoption of technology. The sale of services addresses a variety of customer needs including the provision of project communication tools, project information management, building information modeling, digital document distribution services, printing services, and others.
Managed Print Services (MPS), consists of placement, management, and optimization of print and imaging equipment in our customers' offices, job sites, and other facilities. MPS relieves our customers of the burden of owning and managing print devices and print networks, and shifts their costs to a “per-use” basis. MPS is supported by our proprietary technology, Abacus™, which allows our customers to capture, control, manage, print, and account for their documents. MPS Services revenue is derived from two sources: 1) an engagement with the customer to place primarily large-format equipment, that we own or lease, at a construction site or in our customers’ offices, and 2) an arrangement by which our customers outsource their printing function to us, including all office printing, copying, and reprographics printing. In both cases this is recurring, contracted revenue with most contracts ranging from 3 to 5 years and we are paid a single cost per unit of material used, often referred to as a “click charge.” MPS sales are driven by the ongoing print needs of our customers at their facilities.
Archiving and Information Management (AIM), combines software and professional services to facilitate the capture, management, access and retrieval of documents and information that have been produced in the past. AIM includes our SKYSITE software to organize, search and retrieve documents, as well as the provision of services that include the capture and conversion of hardcopy and electronic documents, and their cloud-based storage and maintenance. AIM sales are driven by the need to leverage past intellectual property for present or future use, facilitate cost savings and efficiency improvements over current hardcopy and digital storage methods, as well as comply with regulatory and records retention requirements.
Equipment and Supplies, which consists of reselling printing, imaging, and related equipment to customers primarily to architectural, engineering and construction firms.
We focus on growing MPS, AIM and CDIM, as we believe the mix of services demanded by the architectural, engineering, construction, and building owner/operator (AEC/O) industry continues to shift toward document management at customer locations and in the cloud, and away from its historical emphasis on large-format construction drawings produced “offsite” in our service centers.

We deliver our services via the cloud, 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 we offer a distinct portfolio of services within the AEC/O industry, though clients outside of our core market continue to show significant interest in our offerings. Based on our analysis of our operating results, we estimate that sales to the AEC/O industry accounted for approximately 78% of our net sales for the nine months ended September 30, 2017, with the remaining 22% consisting of sales to businesses outside of construction.
We identify operating segments based on the various business activities that earn revenue and incur expense. Our operating results are reviewed by the Company's Chief Executive Officer, who is our Company's chief operating decision maker. Since our operating segments have similar products and services, classes of customers, production processes, distribution methods and economic characteristics, we have 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 equipment expenses related to our MPS contracts and our service center facilities. 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. Our relationships with credit providers has provided attractive lease rates over the past two years, and as a result, we chose to lease rather than purchase equipment in a significant portion of our engagements.
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.

Non-GAAP Financial Measures

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.
EBITDA represents net income before interest, taxes, depreciation and amortization. EBITDA margin is a non-GAAP measure calculated by dividing EBITDA by net sales.
We have presented 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 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. We use EBITDA to compare the performance of our operating segments and to measure performance for determining consolidated-level compensation. In addition, we use EBITDA to evaluate potential acquisitions and potential capital expenditures.
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;

21

- 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, 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 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 attributable to ARC and adjusted earnings per share attributable to ARC shareholders for the three and nine months ended September 30, 2017 and 2016 to reflect the exclusion of loss on extinguishment and modification of debt, goodwill impairment, restructuring expense, 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, 2017 and 2016. We believe these charges were the result of our capital restructuring, or other items which are not indicative of our actual operating performance.

We have presented adjusted EBITDA for the three and nine months ended September 30, 2017 and 2016 to exclude loss on extinguishment and modification of debt, goodwill impairment, restructuring expense and stock-based compensation expense. The adjustment of EBITDA for these items 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 EBITDA:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Cash flows provided by operating activities	$11,326	$12,163	$36,756	$34,046
Changes in operating assets and liabilities, net of effect of business acquisitions	(959)	1,958	1,406	9,976
Non-cash expenses, including depreciation, amortization and goodwill impairment	(25,134)	(11,219)	(47,461)	(94,300)
Income tax (benefit) provision	(2,174)	2,162	1,574	(5,884)
Interest expense, net	1,530	1,563	4,679	4,535
Income attributable to the noncontrolling interest	(7)	(61)	(55)	(211)
Depreciation and amortization	8,430	7,857	25,037	23,737
EBITDA	$(6,988)	$14,423	$21,936	$(28,101)

22

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Net (loss) income attributable to ARC Document Solutions, Inc.	$(14,774)	$2,841	$(9,354)	$(50,489)
Interest expense, net	1,530	1,563	4,679	4,535
Income tax (benefit) provision	(2,174)	2,162	1,574	(5,884)
Depreciation and amortization	8,430	7,857	25,037	23,737
EBITDA	(6,988)	14,423	21,936	(28,101)
Loss on extinguishment and modification of debt	124	66	230	156
Goodwill impairment	17,637	—	17,637	73,920
Restructuring expense	—	—	—	7
Stock-based compensation	699	650	2,251	2,073
Adjusted EBITDA	$11,472	$15,139	$42,054	$48,055

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017 (1)	2016	2017 (1)	2016 (1)
Net (loss) income margin attributable to ARC Document Solutions, Inc.	(15.3)%	2.8 %	(3.1)%	(16.4)%
Interest expense, net	1.6	1.6	1.6	1.5
Income tax (benefit) provision	(2.3)	2.2	0.5	(1.9)
Depreciation and amortization	8.7	7.8	8.4	7.7
EBITDA margin	(7.2)	14.4	7.4	(9.1)
Loss on extinguishment and modification of debt	0.1	0.1	0.1	0.1
Goodwill impairment	18.3	—	5.9	24.0
Restructuring expense	—	—	—	—
Stock-based compensation	0.7	0.6	0.8	0.7
Adjusted EBITDA margin	11.9 %	15.1 %	14.1 %	15.6 %

(1) Column does not foot due to rounding

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2017	2016	2017	2016
Net (loss) income attributable to ARC Document Solutions, Inc.	$(14,774)	$2,841	$(9,354)	$(50,489)
Loss on extinguishment and modification of debt	124	66	230	156
Goodwill impairment	17,637	—	17,637	73,920
Restructuring expense	—	—	—	7
Income tax benefit related to above items	(3,144)	(26)	(3,186)	(13,395)
Deferred tax valuation allowance and other discrete tax items	515	138	594	341
Adjusted net income attributable to ARC Document Solutions, Inc.	$358	$3,019	$5,921	$10,540
Actual:				
(Loss) earnings per share attributable to ARC Document Solutions, Inc. shareholders:				
Basic	$(0.32)	$0.06	$(0.20)	$(1.10)
Diluted	$(0.32)	$0.06	$(0.20)	$(1.10)
Weighted average common shares outstanding:				
Basic	45,834	45,599	45,756	46,055
Diluted	45,834	46,189	45,756	46,055
Adjusted:				
Earnings per share attributable to ARC Document Solutions, Inc. shareholders:				
Basic	$0.01	$0.07	$0.13	$0.23
Diluted	$0.01	$0.07	$0.13	$0.23
Weighted average common shares outstanding:				
Basic	45,834	45,599	45,756	46,055
Diluted	46,342	46,189	46,335	46,655

Results of Operations

	Three Months Ended September 30,		Increase (decrease)		Nine Months Ended September 30,		Increase (decrease)	
(In millions, except percentages)	2017 (1)	2016 (1)	$	%	2017 (1)	2016 (1)	$	%
CDIM	$50.1	$53.2	$(3.1)	(5.9)%	$155.0	$161.8	$(6.7)	(4.2)%
MPS	32.2	32.8	(0.6)	(2.0)%	97.7	100.1	(2.4)	(2.4)%
AIM	3.4	3.2	0.2	7.3%	9.7	10.6	(0.8)	(7.8)%
Total service sales	85.6	89.2	(3.6)	(4.0)%	262.5	272.4	(9.9)	(3.6)%
Equipment and supplies sales	10.8	11.3	(0.4)	(3.8)%	35.0	35.4	(0.4)	(1.0)%
Total net sales	$96.5	$100.4	$(4.0)	(4.0)%	$297.5	$307.8	$(10.3)	(3.3)%
Gross profit	$29.2	$32.7	$(3.5)	(10.7)%	$94.6	$102.9	$(8.3)	(8.1)%
Selling, general and administrative expenses	$25.8	$24.9	$1.0	3.8%	$76.5	$76.8	$(0.2)	(0.3)%
Amortization of intangibles	$1.1	$1.2	$(0.1)	(9.2)%	$3.3	$3.7	$(0.5)	(12.3)%
Goodwill impairment	$17.6	$—	$17.6	—%	$17.6	$73.9	$(56.3)	(76.1)%
Loss on extinguishment and modification of debt	$0.1	$0.1	$0.1	87.9%	$0.2	$0.2	$0.1	47.4%
Interest expense, net	$1.5	$1.6	$—	(2.1)%	$4.7	$4.5	$0.1	3.2%
Income tax (benefit) provision	$(2.2)	$2.2	$(4.3)	(200.6)%	$1.6	$(5.9)	$7.5	(126.8)%
Net (loss) income attributable to ARC	$(14.8)	$2.8	$(17.6)	(620.0)%	$(9.4)	$(50.5)	$41.1	(81.5)%
Non-GAAP (2)								
Adjusted net income attributable to ARC (2)	$0.4							