UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter Ended June 30, 2006

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 0-27460

PERFORMANCE TECHNOLOGIES, INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	16-1158413
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
205 Indigo Creek Drive, Rochester, New York	14626
(Address of principal executive offices)	(Zip Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

The number of shares outstanding of the registrant's common stock was 13,251,378 as of August 1, 2006.

PERFORMANCE TECHNOLOGIES, INCORPORATED AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

ASSETS

	June 30, 2006	December 31, 2005
Current assets:		
Cash and cash equivalents	$11,435,000	$11,803,000
Investments	21,075,000	21,150,000
Accounts receivable, net	11,180,000	9,523,000
Inventories	6,451,000	7,148,000
Prepaid expenses and other assets	413,000	470,000
Deferred taxes	3,506,000	3,272,000
Total current assets	54,060,000	53,366,000
Property, equipment and improvements, net	2,190,000	2,004,000
Software development costs, net	3,351,000	3,182,000
Investment in unconsolidated company	248,000	248,000
Goodwill	4,143,000	4,143,000
Total assets	$63,992,000	$62,943,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 1,201,000	$ 1,836,000
Income taxes payable	322,000	244,000
Accrued expenses	4,204,000	4,438,000
Total current liabilities	5,727,000	6,518,000
Deferred taxes	1,221,000	1,138,000
Total liabilities	6,948,000	7,656,000
Stockholders' equity:		
Preferred stock - $.01 par value; 1,000,000 shares authorized; none issued		
Common stock - $.01 par value; 50,000,000 shares authorized; 13,260,038 shares issued	133,000	133,000
Additional paid-in capital	14,448,000	13,903,000
Retained earnings	42,605,000	42,601,000
Treasury stock - at cost; 8,660 and 171,757 shares held at June 30, 2006 and December 31, 2005, respectively	(142,000)	(1,350,000)
Total stockholders' equity	57,044,000	55,287,000
Total liabilities and stockholders' equity	$63,992,000	$62,943,000

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Sales	$13,052,000	$10,802,000	$25,220,000	$23,959,000
Cost of goods sold	6,143,000	5,916,000	12,100,000	12,378,000
Non RoHS inventory charge (Note C)	801,000		801,000	
Gross profit	6,108,000	4,886,000	12,319,000	11,581,000
Operating expenses:				
Selling and marketing	1,453,000	1,369,000	2,823,000	2,846,000
Research and development	2,981,000	2,327,000	5,781,000	4,872,000
General and administrative	1,462,000	1,094,000	2,746,000	2,527,000
Restructuring charges (Note H)	559,000	139,000	994,000	196,000

Total operating expenses	6,455,000	4,929,000	12,344,000	10,441,000
(Loss) income from operations	(347,000)	(43,000)	(25,000)	1,140,000
Other income, net	371,000	330,000	705,000	625,000
Income before income taxes	24,000	287,000	680,000	1,765,000
Income tax (benefit) provision	(48,000)	83,000	62,000	512,000
Net income	$ 72,000	$ 204,000	$ 618,000	$ 1,253,000
Basic earnings per share	$ .01	$ .02	$ .05	$ .10
Diluted earnings per share	$ .01	$ .02	$ .05	$ .10
Weighted average number of common shares used in basic earnings per share	13,181,034	12,863,345	13,141,358	12,836,333
Potential common shares	175,385	180,747	203,107	293,643
Weighted average number of common shares used in diluted earnings per share	13,356,419	13,044,092	13,344,465	13,129,976

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

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

	Six Months Ended June 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 618,000	$ 1,253,000
Non-cash adjustments:		
Depreciation and amortization	1,156,000	1,325,000
Tax benefit from stock option exercises	233,000	143,000
Stock-based compensation expense	289,000	12,000
Deferred income taxes	(151,000)	210,000
Other	15,000	29,000
Changes in operating assets and liabilities:		
Accounts receivable	(1,649,000)	1,653,000
Inventories	697,000	237,000
Prepaid expenses and other assets	57,000	385,000
Accounts payable and accrued expenses	(869,000)	(427,000)
Income taxes payable	78,000	131,000
Net cash provided by operating activities	474,000	4,951,000
Cash flows from investing activities:		
Purchases of property, equipment and improvements	(588,000)	(198,000)
Capitalized software development costs	(948,000)	(1,308,000)

Purchases of investments	(41,425,000)	(32,900,000)
Proceeds from sales of investments	41,500,000	29,550,000
Net cash used by investing activities	(1,461,000)	(4,856,000)
Cash flows from financing activities:		
Tax windfall benefit from stock option exercises	24,000	
Exercise of stock options	595,000	373,000
Net cash provided by financing activities	619,000	373,000
Net (decrease) increase in cash and cash equivalents	(368,000)	468,000
Cash and cash equivalents at beginning of period	11,803,000	10,361,000
Cash and cash equivalents at end of period	$ 11,435,000	$ 10,829,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Non-cash financing activity:		
Exercise of stock options using 57,484 shares of common stock	$ 426,000	$

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

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

Note A - Basis of Presentation

The unaudited Consolidated Financial Statements of Performance Technologies, Incorporated and Subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the Consolidated Financial Statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair statement have been included. The results for the interim periods are not necessarily indicative of the results to be expected for the year. The accompanying Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of the Company as of December 31, 2005, as reported in its Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Note B - Stock-Based Compensation and Earnings Per Share

The Company has stock options outstanding from three stock-based employee compensation plans, the Amended and Restated 1986 Incentive Stock Option Plan, the 2001 Incentive Stock Option Plan, and the 2003 Omnibus Incentive Plan.

Effective January 1, 2006, the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment", and related interpretations, were adopted to account for stock-based compensation using the modified prospective transition method and therefore, prior period results were not restated. SFAS No. 123(R) supersedes Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees", and revises guidance of SFAS No. 123, "Accounting for Stock-Based Compensation". Among other things, SFAS No. 123(R) requires that compensation expense be recognized in the financial statements for share-based awards based on the grant-date fair value of those awards. The modified prospective transition method applies to (a) stock options granted prior to December 31, 2005 which had unrecognized compensation expense at January 1, 2006, calculated under SFAS No. 123, and (b) any new share-based awards granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Additionally, stock-based compensation expense includes an estimate for pre-vesting forfeitures and is recognized over the requisite service periods of the awards on a straight-line or graded vesting basis, which is generally commensurate with the vesting term. Stock-based compensation expense associated with stock option grants of $168,000 and $289,000 was recorded during the second quarter and the first six months of 2006, respectively, as a result of the adoption of SFAS No. 123(R). Of these amounts, for the second quarter and the first six months of 2006, $72,000 and $177,000, respectively, were related to stock options that were granted prior to December 31, 2005.

Prior to January 1, 2006, stock-based compensation plans were accounted for in accordance with APB No. 25 and related interpretations. Stock options may be granted to any officer or employee at not less than the fair market value at the date of grant (not less than 110% of the fair market value in the case of holders of more than 10% of the Company's common stock). Options granted under the plans generally expire between five and ten years from the date of grant and vest in periods ranging from one to six years. Prior to the adoption of SFAS No. 123(R), as required under the disclosure provisions of SFAS No. 123, as amended, pro forma net income (loss) and earnings (loss) per common share were provided for each period as if the fair value method were applied to measure stock-based compensation expense.

The table below summarizes the impact of outstanding stock options and restricted stock on the results of operations for the three and six months ended June 30, 2006 under the provisions of SFAS No. 123(R):

	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
Stock based compensation expense:		
Stock options	$ 162,000	$ 277,000
Restricted stock	6,000	12,000
Income tax benefit	(64,000)	(110,000)
Net decrease in net income	$ 104,000	$ 179,000
Decrease in earnings per share:		
Basic	$ .01	$ .01
Diluted	$ .01	$ .01

The Black-Scholes-Merton option pricing model was used to estimate the fair value of share-based awards under SFAS No. 123(R) as well as for pro forma disclosures under SFAS No. 123. The Black-Scholes-Merton option pricing model incorporates various and highly subjective assumptions, including expected term and expected volatility. For valuation purposes, stock option awards were categorized into two groups, stock option grants to employees and stock option grants to members of the Board of Directors.

The expected term of options granted prior to January 1, 2006 equaled the vesting period. The expected term of options granted in 2006 was the average of the vesting term and the contractual life. The expected volatility at the grant date is estimated using historical stock prices based upon the expected term of the options granted. The risk-free interest rate assumption is determined using the rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. Cash dividends have never been paid and are not anticipated to be paid in the foreseeable future. Therefore, the assumed expected dividend yield is zero.

SFAS No. 123(R) requires pre-vesting option forfeitures at the time of grant be estimated and periodically revised in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense is recorded only for those awards expected to vest using an estimated forfeiture rate based on historical pre-vesting forfeiture data. Previously, forfeitures were accounted for as they occurred under the pro forma disclosure provisions of SFAS No. 123 for periods prior to 2006.

The following table shows the detailed assumptions used to compute the fair value of stock options granted during the six months ended June 30, 2006:

	Six Months Ended June 30, 2006
Expected term (years)	2 to 6.5
Volatility	56% to 66%
Risk free interest rate	4.6% to 5.0%

The weighted average grant date fair value of options granted during the six months ended June 30, 2006 was $3.93 per option. Unrecognized stock-based compensation expense was approximately $1,869,000 as of June 30, 2006, relating to a total of 561,000 unvested stock options under the Company's stock options plans. This stock-based compensation expense is expected to be recognized over a weighted average period of approximately four years.

The following table summarizes stock option activity for the six months ended June 30, 2006:

	Number of Shares	Weighted Average Exercise Price	Exercise Price Range
Outstanding at December 31, 2005	2,118,164	$9.71	$3.40 - $18.13
Granted	245,000	$6.82	$6.64 - $7.50
Exercised	(220,581)	$4.63	$3.40 - $7.25
Expired	(220,232)	$13.34	$3.80 - $18.13
Outstanding at June 30, 2006	1,922,351	$9.56	$3.40 - $18.13

The following table summarizes stock option information at June 30, 2006:

	Options outstanding			Options exercisable		
Range of exercise price	Shares	Weighted average remaining life (yrs)	Weighted average exercise price	Shares	Weighted average remaining life (yrs)	Weighted average exercise price
$3.40 to $5.94	411,045	3.21	$4.57	323,811	2.21	$4.25
$5.95 to $8.60	871,727	5.30	$7.68	401,727	2.04	$8.06
$8.61 to $11.40	65,500	2.68	$10.27	65,330	2.67	$10.27
$11.41 to $14.24	287,429	.55	$13.74	283,729	.54	$13.74
$14.25 to $18.13	286,650	2.81	$18.06	286,650	2.81	$18.06

1,922,351	3.68	$9.56	1,361,247	1.96	$10.55

The total intrinsic value of all outstanding options and all exercisable options at June 30, 2006, whose exercise price was less than the Company's closing stock price at June 30, 2006, was $1,008,000 and $865,000 respectively. The total intrinsic value, determined as of the date of exercise, of options exercised in the first six months of 2006 and 2005 was $592,000 and $430,000, respectively. Cash received from option exercises for the six months ended June 30, 2006 and 2005, amounted to $595,000 and $373,000, respectively. The total fair value of options that vested during the six months ended June 30, 2006 was $220,000. In 2005 and 2006, shares of common stock were issued from treasury for stock option exercises.

The following table illustrates the effect on net income and earnings per common share for the three months and six months ended June 30, 2005, as if the provisions of SFAS No. 123 were applied using the fair value method to measure stock-based compensation:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	$ 204,000	$ 1,253,000
Add: Restricted stock compensation expense, net of tax	4,000	7,000
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(154,000)	(2,290,000)
Pro forma net income (loss)	$ 54,000	$(1,030,000)
Earnings (loss) per share:		
Basic - as reported	$ .02	$ .10
Basic - pro forma	$ .00	$ (.08)
Diluted - as reported	$ .02	$ .10
Diluted - pro forma	$ .00	$ (.08)

During the six months ended June 30, 2005, the Company granted options to purchase 204,000 shares of common stock. The assumption for vesting of the stock options granted was generally 33% per year. The following weighted-average assumptions were used for these 2005 grants: Dividend yield of 0%; expected volatility ranges of 65% to 70%, risk-free interest rate ranges of 3.3% to 3.7%, and expected life ranges of one to three years.

During the fourth quarter 2005 and the first quarter 2006, stock options to purchase 225,000 and 185,000 shares of common stock, respectively, were granted that are subject to accelerated vesting based upon the achievement of certain milestones, as defined in the option agreements.

During 2003, 17,720 shares of restricted stock were granted at prices ranging from $6.89 to $12.54. During 2003, 1,740 shares of restricted stock were forfeited, without vesting. In January 2004, 10,524 shares vested and were issued. The remaining shares vest in November 2006. The value of restricted stock is charged to compensation expense over the vesting period of the grant. Unrecognized compensation expense totaled approximately $8,000 at June 30, 2006, related to restricted stock.

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share calculations reflect the assumed exercise and conversion of dilutive stock options and unvested restricted stock, applying the treasury stock method. Diluted earnings per share calculations exclude the effect of approximately 1,208,000 and 1,330,000 options for the three months ended June 30, 2006 and 2005, respectively, and 1,236,000 and 1,144,000 options for the six months ended June 30, 2006 and 2005 since such options have an exercise price in excess of the average market price of the Company's common stock.

Note C - Inventories

Inventories consisted of the following:

	June 30, 2006	December 31, 2005
Purchased parts and components	$ 2,434,000	$ 2,884,000
Work in process	2,667,000	3,378,000
Finished goods	1,350,000	886,000
Net	$ 6,451,000	$ 7,148,000

The Restriction of Certain Hazardous Substances ("RoHS") Directive issued by the European Union (EU) became effective on July 1, 2006. This directive restricts the distribution of products within the EU that exceed very low maximum concentration values of certain substances, including lead. In the second quarter 2006, the Company recorded a charge to cost of goods sold for excess non-compliant "RoHS" inventory, which is not expected to be sold, in the amount of $801,000.

Note D - Investments

At June 30, 2006 and December 31, 2005, investments consisted of high grade, auction rate municipal securities which were classified as available-for-sale. The contractual maturities of the available-for-sale securities at June 30, 2006 all exceeded five years.

These investments are recorded at cost, which approximates fair market value due to their variable interest rates. These investments typically reset on approximately a monthly basis, and, despite the long-term nature of their stated contractual maturities, these securities historically had the ability to be quickly liquidated. All income generated from these investments was recorded as interest income.

Note E - Warranty Obligations

Warranty obligations are incurred in connection with the sale of certain products. The warranty period is generally one year. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. Future warranty costs are estimated based on product-based historical performance rates and related costs to repair. Changes in accrued warranty obligations for the six months ended June 30, 2006 and 2005 were as follows:

	2006	2005
Accrued warranty obligations, January 1,	$310,000	$288,000
Actual warranty experience	(30,000)	(57,000)
Warranty provisions	(4,000)	69,000

Accrued warranty obligations, June 30,	$276,000	$300,000

Note F - Stock Repurchase Program

On July 11, 2005, a plan to repurchase shares of common stock for an aggregate amount not to exceed $10,000,000 was authorized by the Board of Directors. This program was extended by the Board of Directors in July 2006. Under this program, shares of common stock may be repurchased through open market or private transactions, including block purchases, through July 13, 2007. Repurchased shares can be used for stock option plans, potential acquisition initiatives and general corporate purposes. To date, there have been no repurchases of shares under the original or the extended program.

Note G - Income Taxes

The Company's effective income tax rate is a combination of federal, state and foreign tax rates and is generally lower than statutory rates because it includes benefits derived from international operations, research activities, tax exempt interest and foreign sales. For the second quarter 2006, the effective tax rate was a benefit of 200%. The tax rate in the second quarter 2006 was the result of a combination of an adjustment to the annual expected effective tax rate to 18% and a discrete tax benefit recorded in the first quarter 2006 of $.1 million which related to a previously unused tax credit. The effective rate for the six month period ended June 30, 2006 was 9%. The effective tax rate was 29% for the second quarter and for the first six months of 2005.

Note H - Restructuring Costs

Restructuring charges amounted to $559,000 and $139,000 in the second quarter 2006 and 2005, respectively, and $994,000 and $196,000 for the six months ended June 30, 2006 and 2005, respectively. Restructuring charges in 2006 are primarily related to severance and facility expenses incurred for the closing of the Company's Norwood, Massachusetts engineering center. During the second quarter 2006, the Company accrued $122,000 of lease termination costs related to the closing of this facility. Restructuring charges in 2005 relate primarily to severance payments associated with the Company's efforts to centralize operations.

Total cash paid related to restructuring efforts in the second quarter 2006 included $548,000 related to employee severance costs (14 employees) and $73,000 in lease and facility related closing costs. Total cash paid related to restructuring efforts in the six months ended June 30, 2006, included $805,000 of employee severance costs (22 employees) and $84,000 of lease and facility related closing costs. The accrued lease termination costs totaled $103,000 at June 30, 2006.

During the third quarter 2006, the Company is planning to relocate its San Luis Obispo operation to a new facility in the same city. In connection with that relocation, the Company expects restructuring costs in the third quarter to be in the range of $500,000 to $750,000.

Note I - Lease Commitments

During the second quarter 2006, the Company entered into a lease for a facility in the Ottawa, Canada area. The lease term extends from August 1, 2006 to October 31, 2011. The Company's Ottawa operation is expected to relocate to this facility during the third quarter 2006.

In July 2006, the Company entered into a two-year lease for a facility in the San Luis Obispo area which commences on September 1, 2006. During the third quarter 2006, the Company's San Luis Obispo operation is expected to relocate to this facility.

For both lease agreements, the Company is required to pay the pro rata share of the real property taxes and assessments, expenses and other charges associated with these facilities.

Future minimum payments under these two new leases are as follows:

	Amount
2006	$ 75,000
2007	244,000
2008	224,000
2009	169,000
2010	181,000
Thereafter	151,000
Total	$1,044,000

Note J - Recent Accounting Pronouncements

On January 1, 2006, the Company adopted SFAS No. 151, "Inventory Costs - An Amendment of ARB No. 43, Chapter 4". SFAS No. 151 states that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. This adoption did not have a material impact on the Company's consolidated results of operations and financial condition.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company is currently evaluating the impact of FIN 48. The Company will adopt this Interpretation in the first quarter of 2007.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Matters discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those discussed in the forward-looking statements.

Critical Accounting Estimates and Assumptions

In preparing the financial statements in accordance with GAAP, estimates and assumptions are required to be made that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information disclosures, including information about contingencies, risk and financial condition. Estimates are generally not made until preliminary results for a financial quarter are known and analyzed. It is believed that given the current facts and circumstances, these estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. The critical accounting policies, judgments and estimates that we believe have the most significant effect on our financial statements are set forth below:

- Revenue Recognition
- Software Development Costs
- Valuation of Inventories
- Income Taxes
- Product Warranty
- Carrying Value of Goodwill
- Stock-Based Compensation
- Restructuring Costs

Revenue Recognition: Revenue is recognized from product sales in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Product sales represent the majority of our revenue and include hardware products and hardware products with embedded software. Revenue is recognized from these product sales when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured. Additionally, products are sold on terms which transfer title and risk of loss at a specified location, typically the shipping point. Accordingly, revenue recognition from product sales occurs when all factors are met, including transfer of title and risk of loss, which typically occurs upon shipment. If these conditions are not met, revenue recognition is deferred until such time that these conditions have been satisfied.

Revenue earned from arrangements for software is accounted for under the provisions of Statement of Position 97-2, "Software Revenue Recognition" and EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." Revenue from software requiring significant production, modification, or customization is recognized using the percentage of completion method of accounting. Any anticipated losses on contracts are charged to operations as soon as such losses are determined. If all conditions of revenue recognition are not met, revenue recognition is deferred and revenue will be recognized when all obligations under the arrangement are fulfilled. Revenue from software maintenance contracts is recognized ratably over the contractual period.

Revenue from consulting and other services is recognized at the time the services are rendered. Certain products are sold through distributors who are granted limited rights of return. Potential returns are accounted for at the time of sale.

The accounting estimate related to revenue recognition is considered a "critical accounting estimate" because terms of sale can vary, and judgment is exercised in determining whether to defer revenue recognition. Such judgments may materially affect net sales for any period. Judgment is exercised within the parameters of GAAP in determining when contractual obligations are met, title and risk of loss are transferred, sales price is fixed or determinable and collectability is reasonably assured.

Software Development Costs: All software development costs incurred in establishing the technological feasibility of computer software products to be sold are research and development costs. Software development costs incurred subsequent to the establishment of technological feasibility of a computer software product to be sold and prior to general release of that product are capitalized. Amounts capitalized are amortized commencing after general release of that product over the estimated remaining economic life of that product, generally three years, or using the ratio of current revenues to current and anticipated revenues from such product, whichever provides greater amortization. If the technological feasibility for a particular project is judged not to have been met or recoverability of amounts capitalized is in doubt, project costs are expensed as research and development or charged to cost of goods sold, as applicable. The accounting estimate related to software development costs is considered a "critical accounting estimate" because judgment is exercised in determining whether project costs are expensed as research and development or capitalized as an asset. Such judgments may materially affect expense amounts for any period. Judgment is exercised within the parameters of GAAP in determining when technological feasibility has been met and recoverability of software development costs is reasonably assured.

Valuation of Inventories: Inventories are stated at the lower of cost or market, using the first-in, first-out method. Inventory includes purchased parts and components, work in process and finished goods. Provisions for excess, obsolete or slow moving inventory are recorded after periodic evaluation of historical sales, current economic trends, forecasted sales, estimated product lifecycles and estimated inventory levels. Purchasing practices, electronic component obsolescence, accuracy of sales and production forecasts, introduction of new products, product lifecycles, product support and foreign regulations governing hazardous materials are the factors that contribute to inventory valuation risks. Exposure to inventory valuation risks is managed by maintaining safety stocks, minimum purchase lots, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing certain inventory minimization strategies such as vendor-managed inventories. The accounting estimate related to valuation of inventories is considered a "critical accounting estimate" because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors ranging from purchasing, to sales, to production, to after-sale support. If actual demand, market conditions or product lifecycles are adversely different from those estimated, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs and a decrease to gross margins.

Income Taxes: Income taxes are accounted for using the asset and liability approach which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of the temporary differences between the carrying amounts and the tax basis of such assets and liabilities. A valuation allowance is recorded to reduce deferred tax assets to the amount that is more likely than not to be realized. The accounting estimate related to income taxes is considered a "critical accounting estimate" because judgment is exercised in estimating future taxable income, including prudent and feasible tax planning strategies, and in assessing the need for any valuation allowance. If it should be determined that all or part of a net deferred tax asset is not able to be realized in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. Likewise, in the event that it should be determined that all or part of a deferred tax asset in the future is in excess of the net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Product Warranty: Warranty obligations are incurred in connection with the sale of certain products. The warranty period for these products is generally one year. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. Future warranty costs are estimated based on historical performance rates and related costs to repair given products. The accounting estimate related to product warranty is considered a "critical accounting estimate" because judgment is exercised in determining future estimated warranty costs. Should actual performance rates or repair costs differ from estimates, revisions to the estimated warranty liability would be required.

Carrying Value of Goodwill: Tests for impairments of goodwill are conducted annually, at year end, or more frequently if circumstances indicate that the asset might be impaired. The accounting estimate related to impairment of goodwill is considered a "critical accounting estimate" because these impairment tests include estimates of future cash flows that are dependent upon subjective assumptions regarding future operating results including growth rates, discount rates, capital requirements and other factors that impact the estimated fair value. An impairment loss is recognized to the extent that the goodwill's carrying amount exceeds its fair value.

Stock-Based Compensation: Stock options are granted to purchase our common stock. Under the provisions of SFAS No. 123(R), stock compensation expense is recorded based upon the fair value of the stock option at the date of grant. The accounting estimate related to stock-based compensation is considered a "critical accounting estimate" because estimates are made in calculating compensation expense including: expected option lives, forfeiture rates and expected volatility. Expected option lives are estimated using vesting terms and contractual lives. Expected forfeiture rates and volatility are calculated using historical information. Actual option lives and forfeiture rates may be different from estimates and may result in potential future adjustments which would impact the amount of stock-based compensation expense recorded in a particular period.

Restructuring Costs: Restructuring costs consist of employee-related severance costs, lease termination costs and other facility related closing expenses. Employee-related severance benefits are estimated and recorded pro-rata over the period of each planned restructuring activity. The accounting estimate related to restructuring costs is considered a "critical accounting estimate" because estimates are made in calculating the amount of employee-related severance benefits that will ultimately be paid in future periods. Actual amounts paid for employee-related severance benefits can vary from these estimates depending upon the number of employees actually receiving severance payments.

Overview

The following contains forward-looking statements within the meaning of the Securities Act of 1933 and Securities Exchange Act of 1934 and these forward-looking statements are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

The Company is a leading developer of communications platforms and systems for the communications market. We target three vertical markets: telecommunications, defense and homeland security, and commercial. Of the three vertical markets served, telecommunications is the largest and represents approximately 80% of our business. An approximate breakdown of the telecommunications applications that utilize our products is as follows: Voice-over-IP (VoIP) represents 40%, wireless infrastructure represents 40%, and the remaining 20% is spread across IP multimedia systems and other applications.

Our products are marketed through a direct worldwide sales force under a variety of brand names including IPnexus(TM), SEGway(TM), NexusWare(TM) and Advanced Managed Platforms(TM). These products are based on open standards and are sold as fully integrated, purpose built, application ready platforms, or as individual blade components for the embedded communications marketplace. When sold as platforms, known as our Advanced Managed Platform products, our customers can quickly move to the enhanced value steps of their products while realizing distinct cost advantages, increased overall system reliability and performance, and improved time-to-market. Since its introduction in 2003, our Advanced Managed Platform product line has realized more than 33 new design wins. If successfully implemented by our customers, each is expected to generate greater than $.5 million of annualized revenue when reaching production volumes. In addition, we have realized more than 35 new design wins for blade solutions in this same time period. Design wins are subject to risks and uncertainties, and therefore not all design wins are expected to result in production orders.

A company-wide transformation began in early 2006 which we believe will establish the foundation upon which the Company may reach its aggressive growth goals. This transformation is moving the Company from its traditional engineering and technology focus to a stronger emphasis on sales and marketing.

Since the beginning of the year, we have made investments by hiring several new sales, marketing and sales support professionals to bolster our sales organization. These include senior sales executives for global sales, signaling sales and European sales. We have largely completed the transformation plan for the sales organization with this hiring.

We recognize the need to balance investments in sales and marketing with projected revenue growth and expense reductions in other areas of the business. We instituted a reduction-in-force during the second quarter 2006 and tempered hiring in departments other than sales.

During the first six months of the year, a number of expense reductions were initiated including the closing of the Norwood engineering facility. Restructuring costs totaled $.6 million and $1.0 million in the second quarter and for the six months ended June 30, 2006, respectively. Savings from these cost reduction actions (i.e., elimination of employee and facility expenses) are expected to be realized beginning in the third quarter 2006. In addition, our San Luis Obispo operation is expected to be relocated to a smaller more economical facility within the same city during the third quarter 2006.

The Restriction of Certain Hazardous Substances ("RoHS") Directive issued by the European Union (EU) became effective on July 1, 2006. This directive restricts the distribution of products within the EU that exceed very low maximum concentration values of certain substances, including lead. In the second quarter 2006, a charge was recorded to cost of goods sold for excess non-compliant "RoHS" inventory, which is not expected to be sold, in the amount of $.8 million. No further significant non-compliant RoHS inventory charges are expected.

The telecommunications equipment manufacturer market is dependent upon carrier spending to upgrade network infrastructure to next-generation equipment. During the second quarter 2006, expectations for telecom equipment suppliers moved sharply lower amid concerns of a slowdown in capital spending by telecom carriers and service providers. In particular, investments by U.S. wireless carriers in third generation mobile networks continued to be selective during the second quarter 2006 and impacted a number of our customers that sell solutions into this market. Despite these market conditions, sales increased 21% in the second quarter from the corresponding quarter in 2005 and 7% from the first quarter 2006.

Strategy

The Company has a history of successfully adapting its products and services to a constantly changing technology-driven marketplace. This adaptation has been demonstrated through the course of several business cycles that have occurred since the Company's founding in 1981.

Through acquisitions and internal investments since 2002, we believe the Company has moved from a position of addressing approximately 20% of the available potential market to a position of currently addressing over 60% of the available potential market.

Beginning in 2003, a new product strategy was adopted. This strategy repositioned the Company to deliver fully managed, system-level platform solutions to the embedded communications marketplace. This line of platform solutions specifically addresses equipment manufacturers' requirements for an increased level of system integration and services from suppliers, thus allowing them to focus on their value-added stages of product development, which in most cases is application software. The Company's strategy also enables its customers to replace proprietary or legacy platforms with the latest generation of platform solutions.

The Company's goal is to drive sustained and profitable revenue growth. The Company expects to achieve this objective through a combination of organic growth and acquisitions. A company-wide transformation began in early 2006 which will establish the foundation upon which the Company expects to reach its aggressive growth goals. This transformation is moving the Company from its traditional engineering and technology focus to a stronger emphasis on sales and marketing. One key element of this plan is the Everest Account Sales Program, which focuses on major international telecommunications companies, which the Company refers to as "Global Tier 1" customers, using a partner and solution selling approach. By focusing on Global Tier 1 customers, the Company believes it can replicate its sales successes with its existing largest Global Tier 1 customers and use those sales as an engine for growth.

There are identifiable risks associated with carrying out the Company's growth strategy in the current uncertain economic climate. Many of the Company's end markets are forecasted to show only modest growth in the near term. In order to realize growth in this environment, the Company will have to gain market share from competitors, many of which are larger, more established companies with greater resources than the Company's. The Company believes that its strategy to increase emphasis on sales and marketing while continuing to invest in new product development will enable the Company to compete in this economic environment.

Financial Information

Revenue:

Revenue in the second quarter 2006 amounted to $13.1 million, compared to $10.8 million in the corresponding quarter a year earlier. Revenue for the six months ended June 30, 2006 amounted to $25.2 million, compared to $24.0 million during the corresponding period in 2005.

Earnings:

Net income for the second quarter 2006 totaled $.1 million, or $.01 per diluted share, based on 13.4 million shares outstanding and included:

- o A charge for non-compliant RoHS inventory of $.8 million, or $.04 per diluted share.
- o Restructuring charges of $.6 million, or $.03 per diluted share, primarily related to the closing of our Norwood engineering center.
- o Stock compensation expense of $.2 million, or $.01 per diluted share.

The diluted per share amounts above are calculated based upon a statutory income tax rate of 38%.

Net income for the second quarter 2005 amounted to $.2 million, or $.02 per diluted share and included restructuring charges of $.1 million, or $.01 per diluted share, based on 13.0 million shares outstanding.

Net income for the six months ended June 30, 2006 amounted to $.6 million, or $.05 per diluted share, based on 13.3 million shares outstanding and included:

- o A charge for non-compliant RoHS inventory of $.8 million, or $.04 per diluted share.
- o Restructuring charges of $1.0 million, or $.05 per diluted share,

primarily related to the closing of our Norwood engineering center.

- Stock compensation expense of $.3 million, or $.01 per diluted share.

The diluted per share amounts above are calculated based upon a statutory income tax rate of 38%.

Net income for the six months ended June 30, 2005 amounted to $1.3 million, or $.10 per diluted share, including restructuring charges related to cost improvement efforts amounting to $.2 million, or $.01 per diluted share, based on 13.1 million shares outstanding.

Liquidity:

Cash, cash equivalents and investments amounted to $32.5 million and $33.0 million at June 30, 2006 and December 31, 2005, respectively. We had no long-term debt at either date.

Centralization of Functions:

In January 2006, a plan was announced to close our engineering center in Norwood, Massachusetts and transfer product development and customer support for the voice technology products to our other engineering centers. This program was completed in May 2006. Restructuring expenses in the second quarter 2006 and for the six months ended June 30, 2006 totaled $.6 million and $1.0 million, respectively, primarily related to these efforts.

During the third quarter, our operation in San Luis Obispo, California, is expected to be relocated to a new facility in San Luis Obispo and our signaling organization in Ottawa is expected to be relocated to a new facility in Kanata, Ontario, outside of Ottawa.

Key Performance Indicators:

Our communications products, platforms and systems are incorporated into current and next-generation embedded systems infrastructure. Traditionally, "design wins" have been an important metric for us to judge our product acceptance in our marketplace. Design wins, if successfully implemented by our customers, reach production volumes at varying rates, generally beginning twelve to eighteen months after the design win occurs. A variety of risks such as schedule delays, cancellations, changes in customer markets and economic conditions can adversely affect a design win before production is reached, or during deployment.

During the second quarter 2006, we earned two design wins for our Advanced Managed Platform (with multiple products) (1) and switch products (1). During the second quarter 2005, the Company earned six design wins for its advanced managed platform solutions (with multiple products) (3), individual blade design wins for IPnexus network access (2) and for a product that combines the technologies of network access and voice processing (1). Each design win is expected to generate at least $.5 million of annualized revenue when reaching production volumes. Not all design wins are expected to result in production orders. Beginning in 2006, our sales organization is focusing on realizing larger, high revenue potential design wins with Global Tier 1 customers, and therefore we expect to report fewer design wins.

We believe that another key indicator for our business is the volume of orders received from our customers. During weak economic periods, customers' visibility deteriorates causing delays in the placement of orders. While forward-looking visibility of customer orders continues to be limited, sales to customers in the second quarter 2006 amounted to $13.1 million, compared to $10.8 million in the second quarter 2005. While sales to the Company's largest customer declined during the second quarter 2006, sales to other customers increased contributing to the overall sales increase.

More in-depth discussions of our strategy and financial performance can be found in our Annual Report on Form 10-K and other filings with the Securities and Exchange Commission.

Three and Six Months Ended June 30, 2006, compared with
the Three and Six Months Ended June 30, 2005

The following table presents the percentage of sales represented by each item in our consolidated statements of income for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	47.1	54.8	48.0	51.7
Non RoHS inventory charge	6.1		3.2	
Gross profit	46.8	45.2	48.8	48.3
Operating expenses:				
Selling and marketing	11.1	12.7	11.2	11.9
Research and development	22.8	21.5	22.9	20.3
General and administrative	11.2	10.1	10.9	10.5
Restructuring charges	4.3	1.3	3.9	0.8
Total operating expenses	49.4	45.6	48.9	43.5
(Loss) income from operations	(2.6)	(0.4)	(0.1)	4.8
Other income, net	2.8	3.1	2.8	2.6
Income before income taxes	0.2	2.7	2.7	7.4
Income tax (benefit) provision	(0.4)	0.8	0.2	2.2
Net income	0.6%	1.9%	2.5%	5.2%

Sales. Total revenue for the second quarter 2006 amounted to $13.1 million, compared to $10.8 million for the corresponding quarter in 2005. Revenue for the six months ended June 30, 2006 totaled $25.2 million, compared to $24.0 million for the comparable period in 2005.

In the second quarter 2006, one customer represented 17% of our sales and another customer represented 10% of our sales. Our four largest customers together represented 40% of sales. In the second quarter 2005, the Company had two customers that each represented greater than 10% of sales, and the four largest customers together represented 42% of sales. For the six months ended June 30, 2006, one customer represented 19% of our sales and our four largest customers together represented 40% of sales. For the six months ended June 30, 2005, there were two customers that each represented greater than 10% of revenue and our four largest customers together contributed 45% to revenue.

Sales to customers outside of the United States represented 43% and 49% of our sales during the second quarter 2006 and 2005, respectively. Sales to customers based in the United Kingdom represented 12% and 18% of revenue in the second quarter 2006 and 2005, respectively.

For the six months ended June 30, 2006 and 2005, sales to customers outside of the United States represented 44% and 40% of sales, respectively. Sales to customers based in the United Kingdom represented 11% and 12% of revenue for the six months ended June 30, 2006 and 2005, respectively.

Beginning in 2006, our products are grouped into three distinct categories in one market segment: Communications (network access, signaling and voice) products, Computing products and Switching products. Revenue from each product category is expressed as a percentage of sales for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Communications	52%	49%	50%	49%
Computing	26%	32%	23%	26%
Switching	22%	18%	27%	24%
Other		1%		1%
Total	100%	100%	100%	100%

Communications products:

Communications products are comprised of network access, SEGway signaling and Voice Technology products. Network access products provide a connection between a variety of voice, data and signaling networks and embedded systems platforms that are used to control the network and/or process information being transported over networks. This family includes a complete line of communications protocols. Many of our signaling products provide a signaling bridge between traditional telephone networks and the growing IP packet-switched network, and enable the transport of signaling messages over IP networks. Voice Technology products enable voice, data and fax processing for communications applications.

Revenue from Communications products amounted to $6.7 million and $5.3 million in the second quarter of 2006 and 2005, respectively. This increase of $1.4 million, or 26%, was the result of greater demand from a variety of our customers across this product category.

Revenue from Communications products amounted to $12.6 million and $11.7 million in the six months ended June 30, 2006 and 2005, respectively. This increase in business reflects a combination of factors including one major customer in 2005 that, due to market conditions, unexpectedly decreased product requirements after the second quarter 2005, this decrease was offset by a greater demand from a variety of customers across this product category.

Computing products:

Computing products include integrated platform solutions, a range of single board computers, a variety of embedded system chassis and associated chassis management products.

Computing products revenue amounted to $3.4 million and $3.5 million in the second quarter 2006 and 2005, respectively. While the revenue in the comparative periods was essentially consistent, there were fluctuations in sales to various customers in this category.

For the six months ended June 30, 2006 and 2005, Computing products revenue totaled $5.9 million, compared to $6.2 million, respectively. The decline in revenue of $.3 million, or 5%, was primarily attributable to fluctuations in sales to various customers in this category occurring in the first quarter 2006, compared to the first quarter 2005.

Switching products:

Our Ethernet switch components operate as the "nexus" of the IP packet switching functionality of the Advanced Managed Platforms.

Revenue from switching products amounted to $2.9 million in the second quarter 2006, compared to $1.9 million in the second quarter 2005. Approximately 70% of this increase is attributable to one customer.

Switch revenue for the six months ended June 30, 2006 totaled $6.8 million, compared to $5.8 million for the six months ended June 30, 2005. Of this increase, one customer represented approximately 40% of this increase along with growth from a variety of other customers.

Gross profit. Gross profit consists of sales, less cost of goods sold including material costs, manufacturing expenses, depreciation, amortization of software development costs, and expenses associated with engineering contracts and the technical support function. Gross margin was 46.8% and 45.2% of sales for the second quarter 2006 and 2005, respectively. The Restriction of Certain Hazardous Substances ("RoHS") Directive issued by the European Union (EU) became effective on July 1, 2006. This directive restricts the distribution of products within the EU that exceed very low maximum concentration values of certain substances, including lead. In the second quarter 2006, the Company recorded a charge to cost of goods sold for excess non-compliant RoHS inventory, which is not expected to be sold, in the amount of $.8 million, or 6.1% of revenue. Excluding this charge, the increase in gross margin resulted from a change in sales mix from lower margin products (e.g., Computing) to higher margin products (i.e., Switching and Communications). Gross margin for the quarter was also positively impacted by higher production volumes as well as the benefits resulting from our centralization efforts that took place in 2005. Included in cost of goods sold is the amortization of software development costs which totaled $.4 million and $.5 million in the second quarter 2006 and 2005, respectively.

Gross margin for the first six months of 2006 was 48.8% compared to 48.3% for the first six months of 2005. Gross margin in 2006 was negatively impacted by the $.8 million RoHS inventory charge described above. This charge was offset by benefits resulting from a change in sales mix (lower margin products to higher margin products), increased production levels, and expense reductions resulting from our centralization efforts that took place in 2005. Included in cost of goods sold is the amortization of software development costs which totaled $.8 million and $.9 million for the six months ended June 30, 2006 and 2005, respectively.

Total Operating Expenses. Total operating expenses in the second quarter 2006 amounted to $6.5 million, compared to $4.9 million in the same period of 2005. Total operating expenses included stock compensation expense related to the adoption of SFAS 123(R) on January 1, 2006 amounting to $.2 million in the second quarter 2006.

Total operating expenses for the six months ended June 30, 2006 totaled $12.3 million, compared to $10.4 million in the corresponding period of 2005. Total operating expenses included stock compensation expense amounting to $.3 million for the six months ended June 30, 2006.

Selling and marketing expenses were $1.5 million and $1.4 million for the second quarter 2006 and 2005, respectively, and $2.8 million in each of the first six months of 2006 and 2005. Numerous personnel changes have occurred as part of the Company's transformation plan in 2006, compared to the respective periods in 2005, but overall costs remained relatively constant for the reported periods.

Research and development expenses were $3.0 million and $2.3 million in the second quarter 2006 and 2005, respectively. We capitalize certain software development costs, which reduces the amount charged to operating expenses. Amounts capitalized were $.5 million and $.7 million during the second quarter

2006 and 2005, respectively. The increase in gross research and development expenditures for the comparable period is primarily the result of increased personnel costs and product development costs associated with new product prototype builds.

For the six months ended June 30, 2006 and 2005, research and development expenses totaled $5.8 million and $4.9 million, respectively. Amounts capitalized were $1.0 million and $1.3 million for the six month periods in 2006 and 2005, respectively. The increase in gross expenditures for the comparative six month periods is primarily the result of increased personnel costs and product development costs associated with new product prototype builds.

General and administrative expenses were $1.5 million in the second quarter 2006, compared to $1.1 million in the second quarter 2005. For the six months ended June 30, 2006 and 2005, general and administrative expenses totaled $2.7 million and $2.5 million, respectively. The increase in expenses for both comparative periods is primarily related to higher corporate governance costs and the recording of stock based compensation expense.

Restructuring charges amounted to $.6 million in the second quarter 2006, compared to $.1 million during the second quarter 2005. For the six months ended June 30, 2006, restructuring expenses totaled $1.0 million, compared to $.2 million in the comparable 2005 period. Restructuring charges in 2006 are primarily related to severance and facility expenses incurred for the closing of our Norwood, Massachusetts engineering center. Restructuring charges in 2005 relate primarily to severance expenses associated with our efforts to centralize our operations.

Other Income, net. Other income consists primarily of interest income. Our funds are primarily invested in high quality auction rate municipal securities. An increase in the funds available for investment as well as higher interest rates in 2006 resulted in an increase in interest income. Interest income in 2005 also included interest income from a note receivable from an unconsolidated company.

Income taxes. The effective income tax rate is a combination of federal, state and foreign tax rates and is generally lower than statutory rates because it includes benefits derived from our international operations, research activities, tax exempt interest and foreign sales. For the second quarter 2006, the effective tax rate was a benefit of 200%. This rate was the result of a combination of an adjustment to the annual expected effective tax rate to 18% and a discrete tax benefit of $.1 million, which was related to a previously unused tax credit. The effective rate for the six month period ended June 30, 2006 was 9%. The effective tax rate was 29% for both the second quarter and the first six months of 2005.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are cash, cash equivalents and investments, which together totaled $32.5 million at June 30, 2006. The Company had working capital of $48.3 million and $46.8 million at June 30, 2006 and December 31, 2005, respectively.

Cash provided by operating activities amounted to $.5 million for the six months ended June 30, 2006. This amount included net income of $.6 million and a depreciation and amortization charge of $1.2 million. Cash provided by operations due to changes in operating assets and liabilities included a decrease in cash associated with an increase in accounts receivable of $1.6 million and a decrease in accounts payable and accrued expenses of $.9 million. The increase in accounts receivable is related to increased sales in the final month of the second quarter 2006. The decrease in accounts payable and accrued expenses is related to the timing of payments. Cash from operating activities also increased as a result of a decrease in inventory of $.7 million.

On July 1, 2006, the RoHS Directive issued by the EU became effective. This directive restricts the distribution of products within the EU that exceed very low maximum concentration values of certain substances, including lead. During the second quarter 2006, a charge was recorded in the amount of $.8 million for non-compliant RoHS inventory not expected to be sold in the future. No further significant non-compliant RoHS inventory charges are expected.

Cash used by investing activities during the first six months of 2006 totaled $1.5 million. This utilization was primarily the result of capital asset purchases of $.6 million and the capitalization of software development costs amounting to $.9 million.

Cash provided by financing activities for the first six months of 2006 amounted to $.6 million, resulting from the exercise of stock options. On July 11, 2005, our Board of Directors authorized the Company to repurchase shares of our common stock for an aggregate amount not to exceed $10.0 million. In July 2006, this program was extended to July 13, 2007. Under this program, shares of our common stock may be repurchased through open market or private transactions, including block purchases. Repurchased shares can be used for our stock option plans, potential acquisition initiatives and general corporate purposes. To date, there have been no repurchases of shares under the original or the extended program.

Off-Balance Sheet Arrangements:

No off-balance sheet arrangements were entered into during the first six months of 2006.

Contractual Obligations:

During the second quarter 2006, a lease agreement was entered into for a new facility in the Ottawa, Canada area. The term of this lease extends from August 1, 2006 to October 31, 2011. Our Ottawa operation is expected to relocate to this facility during the third quarter 2006.

In July 2006, the Company entered into a two-year lease for a facility in the San Luis Obispo area which commences on September 1, 2006. During the third quarter 2006, our San Luis Obispo operation is expected to relocate to this facility.

For both lease agreements, the Company is required to pay the pro rata share of the real property taxes and assessments, expenses and other charges associated with these facilities.

Future minimum payments under these two new leases are as follows:

	Amount
2006	$ 75,000
2007	244,000
2008	224,000
2009	169,000
2010	181,000
Thereafter	151,000
Total	$ 1,044,000

No other significant contractual obligations were entered into during the first six months of 2006.

Current Position:

Assuming there is no significant change in our business, we believe that the Company's current cash, cash equivalents and investments, together with cash generated from operations and a line of credit available on a bank credit facility, should be sufficient to meet our anticipated cash requirements, including working capital and capital expenditure requirements, for at least the next twelve months. However, we are continuing to evaluate strategic acquisitions to further accelerate our growth and market penetration efforts. These strategic acquisition efforts could have an impact on our working capital, liquidity or capital resources and we may raise additional capital to facilitate these efforts.

RECENT ACCOUNTING PRONOUNCEMENTS

On January 1, 2006, the Company adopted SFAS No. 151, "Inventory Costs - An Amendment of ARB No. 43, Chapter 4". SFAS No. 151 states that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. This adoption did not have a material impact on the Company's consolidated results of operations and financial condition.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company is currently evaluating the impact of FIN 48. The Company will adopt this Interpretation in the first quarter of 2007.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This quarterly report on Form 10-Q contains forward-looking statements, which reflect our current views with respect to future events and financial performance, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and is subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to certain risks and uncertainties, including those identified below, which could cause actual results to differ materially from historical results or those anticipated. The words "believes," "anticipates," "plans," "may," "intend," "estimate," "will," "should," "could," "feels," "is optimistic," "expects," and other expressions which indicate future events and trends also identify forward-looking statements. However, the absence of such words does not mean that a statement is not forward-looking.

The future operating results of the Company are subject to various risks and uncertainties and could differ materially from those discussed in the forward-looking statements and may be affected by various trends and factors which are beyond our control. These risks and uncertainties include, among other factors, general business and economic conditions, rapid technological changes accompanied by frequent new product introductions, competitive pressures, dependence on key customers, the attainment of design wins and obtaining orders as a result, fluctuations in quarterly and annual results, the reliance on a limited number of third party suppliers, limitations of our manufacturing capacity and arrangements, the protection of our proprietary technology, the dependence on key personnel, changes in critical accounting estimates, potential impairments related to goodwill and investments, and foreign regulations. These statements should be read in conjunction with the audited Consolidated Financial Statements, the Notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company as of December 31, 2005, as reported in its Annual Report on Form 10-K, and other documents filed with the Securities and Exchange Commission. Additional information related to risk factors can be found in the Company's Annual Report on Form 10-K as of December 31, 2005.

Stockholders are cautioned not to place undue reliance on the forward-looking statements which speak as of the date of this quarterly report or the date of the documents incorporated by reference in this quarterly report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's assets are exposed to various market risks in the normal course of business, primarily interest rate risk and changes in the market value of our investments and we believe the exposure to such risk is minimal. Investments are made in accordance with the investment policy and primarily consist of auction rate municipal securities. The Company's assets are also subject to foreign exchange risk related to our operations in Canada. We believe that the exposure to foreign currency risk is minimal for the first half of 2006. Management does not enter into the investment of derivative financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

A. Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and its Chief Financial Officer evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of such date. During the first quarter 2006, Management concluded that the Company's disclosure controls and procedures were not effective due to a material weakness related to the Company's internal control surrounding the accounting for restructuring costs. Specifically, the control deficiency related to the accounting for certain severance benefits. To address this material weakness, the Company performed additional analysis in order to prepare the unaudited quarterly consolidated financial statements for the first quarter 2006 in accordance with generally accepted accounting principles in the United States, which resulted in an adjustment to the unaudited interim financial statements for the first quarter 2006. Accordingly, management believes that the material weakness was remediated as of May 10, 2006 and that the financial statements for the first quarter 2006 were presented fairly.

B. Changes in Internal Control Over Financial Reporting

Except as noted above, there has been no change in the Company's internal control over financial reporting that occurred during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The 2006 Annual Meeting of Stockholders was held on May 25, 2006. The Directors elected at the meeting were as follows:

	Votes Cast	
Nominees	For	Withheld
Michael P. Skarzynski	11,776,765	352,329
Robert L. Tillman	11,858,162	270,932

John M. Slusser, Bernard Kozel, Charles E. Maginness, E. Mark Rajkowski and Stuart B. Meisenzahl, continue as Directors until the next Annual Meeting, or such times as their respective terms expire.

The stockholders also voted to ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for 2006. 12,091,868 shares of common stock were voted in favor of this proposal, 30,685 shares of common stock were voted against this proposal, and 6,541 shares of common stock abstained.

ITEM 6. EXHIBITS

31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Section 1350 Certification

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.

PERFORMANCE TECHNOLOGIES, INCORPORATED

August 9, 2006 By:/s/ Michael P. Skarzynski

Michael P. Skarzynski
President and
Chief Executive Officer

August 9, 2006 By:/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer and
Senior Vice President of Finance

Exhibit 31.1

Certification of Chief Executive Officer

I, Michael P. Skarzynski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Performance Technologies, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for

establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2006

By:/s/ Michael P. Skarzynski

Michael P. Skarzynski
Chief Executive Officer

Exhibit 31.2

Certification of Chief Financial Officer

I, Dorrance W. Lamb, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Performance Technologies, Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2006

By:/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer

Exhibit 32.1

Section 1350 Certification

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ("Section 906"), Michael P. Skarzynski and Dorrance W. Lamb, the Chief Executive Officer and Chief Financial Officer, respectively, of Performance Technologies, Incorporated, certify that (i) the quarterly report on Form 10-Q for the quarter ended June 30, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Performance Technologies, Incorporated.

A signed original of this written statement required by Section 906 has been provided to Performance Technologies, Incorporated and will be retained by Performance Technologies, Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.

Date: August 9, 2006

By:/s/ Michael P. Skarzynski

Michael P. Skarzynski
President and
Chief Executive Officer

Date: August 9, 2006

By:/s/ Dorrance W. Lamb

Dorrance W. Lamb
Chief Financial Officer and
Senior Vice President of Finance