ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
May 04, 2016

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 March 31, 2016

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

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

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

As of April 29, 2016, there were 47,278,061 shares of the issuer's common stock outstanding.

ARC DOCUMENT SOLUTIONS, INC.
Form 10-Q
For the Quarter Ended March 31, 2016
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FORWARD-LOOKING STATEMENTS

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

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

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

(In thousands, except per share data)	March 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$16,793	$ 23,963
Accounts receivable, net of allowances for accounts receivable of $1,853 and $2,094	61,377	60,085
Inventories, net	18,529	16,972
Prepaid expenses	4,356	4,555
Other current assets	3,687	4,131
Total current assets	104,742	109,706
Property and equipment, net of accumulated depreciation of $205,486 and $202,457	56,247	57,590
Goodwill	212,608	212,608
Other intangible assets, net	16,872	17,946
Deferred income taxes	72,991	74,196
Other assets	2,501	2,492
Total assets	$465,961	$ 474,538
Liabilities and Equity		
Current liabilities:		
Accounts payable	$21,385	$ 23,989
Accrued payroll and payroll-related expenses	8,507	12,118
Accrued expenses	19,707	19,194
Current portion of long-term debt and capital leases	14,651	14,374
Total current liabilities	64,250	69,675
Long-term debt and capital leases	152,353	157,018
Deferred income taxes	36,490	35,933
Other long-term liabilities	2,869	2,778
Total liabilities	255,962	265,404
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; 47,275 and 47,130 shares issued and 46,474 and 47,029 shares outstanding	47	47
Additional paid-in capital	115,842	115,089
Retained earnings	92,261	89,687
Accumulated other comprehensive loss	(1,928)	(2,097)
	206,222	202,726
Less cost of common stock in treasury, 801 and 101 shares	3,345	612
Total ARC Document Solutions, Inc. stockholders' equity	202,877	202,114
Noncontrolling interest	7,122	7,020
Total equity	209,999	209,134
Total liabilities and equity	$465,961	$ 474,538

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

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

	Three Months Ended March 31,					
(In thousands, except per share data)	2016			2015		
Service sales	$	90,635		$	93,325	
Equipment and supplies sales	12,915			10,994		
Total net sales	103,550			104,319		
Cost of sales	69,813			68,298		
Gross profit	33,737			36,021		
Selling, general and administrative expenses	26,356			27,455		
Amortization of intangible assets	1,313			1,489		
Restructuring expense	2			74		
Income from operations	6,066			7,003		
Other income, net	(23		)	(26		)
Loss on extinguishment of debt	46			—		
Interest expense, net	1,446			1,857		
Income before income tax provision	4,597			5,172		
Income tax provision	1,969			761		
Net income	2,628			4,411		
(Income) loss attributable to the noncontrolling interest	(54		)	25		
Net income attributable to ARC Document Solutions, Inc. shareholders	$	2,574		$	4,436	
Earnings per share attributable to ARC Document Solutions, Inc. shareholders:						
Basic	$	0.06		$	0.10	
Diluted	$	0.05		$	0.09	
Weighted average common shares outstanding:						
Basic	46,608			46,443		
Diluted	47,203			47,654		

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

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

	Three Months Ended March 31,	
(In thousands)	2016	2015
Net income	$2,628	$4,411
Other comprehensive income (loss), net of tax		
Foreign currency translation adjustments, net of tax	312	(405)
Fair value adjustment of derivatives, net of tax	(95)	(111)
Other comprehensive income (loss), net of tax	217	(516)
Comprehensive income	2,845	3,895
Comprehensive income (loss) attributable to noncontrolling interest	102	(24)
Comprehensive income attributable to ARC Document Solutions, Inc. shareholders	$2,743	$3,919

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 Deficit	Other Comprehensive Loss	Common Stock in Treasury	Noncontrolling Interest	Total
Balance at December 31, 2014	46,800	$ 47	$110,650	$(7,353)	$ (161)	$(408)	$ 7,063	$109,838
Stock-based compensation	115	—	1,351	—	—	—	—	1,351
Issuance of common stock under Employee Stock Purchase Plan	3	—	27	—	—	—	—	27
Stock options exercised	121	—	545	—	—	—	—	545
Comprehensive income:								
Net income (loss)	—	—	—	4,436	—	—	(25)	4,411
Foreign currency translation adjustments, net of tax	—	—	—	—	(406)	—	1	(405)
Fair value adjustment of derivatives, net of tax	—	—	—	—	(111)	—	—	(111)
Comprehensive income								3,895
Balance at March 31, 2015	47,039	$ 47	$112,573	$(2,917)	$ (678)	$(408)	$ 7,039	$115,656

	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	130	—	772	—	—	—	—	772
Issuance of common stock under Employee Stock Purchase Plan	10	—	39	—	—	—	—	39
Stock options exercised	5	—	11	—	—	—	—	11
Tax deficiency from stock-based compensation	—	—	(69)	—	—	—	—	(69)
Treasury shares	—	—	—	—	—	(2,733)	—	(2,733)
Comprehensive income:								
Net income	—	—	—	2,574	—	—	54	2,628
Foreign currency translation adjustments, net of tax	—	—	—	—	264	—	48	312
Fair value adjustment of derivatives, net of tax	—	—	—	—	(95)	—	—	(95)
Comprehensive income								2,845
Balance at March 31, 2016	47,275	$ 47	$115,842	$92,261	$ (1,928)	$(3,345)	$ 7,122	$209,999

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 March 31,					
(In thousands)	2016			2015		
Cash flows from operating activities						
Net income	$	2,628		$	4,411	
Adjustments to reconcile net income to net cash provided by operating activities:						
Allowance for accounts receivable	71			26		
Depreciation	6,677			7,066		
Amortization of intangible assets	1,313			1,489		
Amortization of deferred financing costs	118			161		
Stock-based compensation	772			1,083		
Deferred income taxes	1,749			2,176		
Deferred tax valuation allowance	72			(1,534		)
Loss on early extinguishment of debt	46			—		
Other non-cash items, net	(334		)	(174		)
Changes in operating assets and liabilities:						
Accounts receivable	(1,264		)	(4,522		)
Inventory	(1,568		)	(1,093		)
Prepaid expenses and other assets	397			1,999		
Accounts payable and accrued expenses	(5,374		)	(5,800		)
Net cash provided by operating activities	5,303			5,288		
Cash flows from investing activities						
Capital expenditures	(2,505		)	(3,501		)
Other	226			155		
Net cash used in investing activities	(2,279		)	(3,346		)
Cash flows from financing activities						

Proceeds from stock option exercises	11			545		
Proceeds from issuance of common stock under Employee Stock Purchase Plan	39			27		
Share repurchases	(2,733		)	—		
Contingent consideration on prior acquisitions	(65		)	—		
Early extinguishment of long-term debt	(4,400		)	—		
Payments on long-term debt agreements and capital leases	(3,121		)	(6,067		)
Net repayments under revolving credit facilities	—			(984		)
Payment of deferred financing costs	(30		)	(24		)
Payment of hedge premium	—			(632		)
Net cash used in financing activities	(10,299		)	(7,135		)
Effect of foreign currency translation on cash balances	105			118		
Net change in cash and cash equivalents	(7,170		)	(5,075		)
Cash and cash equivalents at beginning of period	23,963			22,636		
Cash and cash equivalents at end of period	$	16,793		$	17,561	
Supplemental disclosure of cash flow information						
Noncash investing and financing activities						
Capital lease obligations incurred	$	2,865		$	3,500	
Liabilities in connection with the acquisition of businesses	$	104		$	—	

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 company serving businesses of all types, with an emphasis on the non-residential segment of the architecture, engineering and construction (“AEC”) industry. 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 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 months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

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 2015 Form 10-K.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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. ASU 2016-09 is effective for annual reporting periods beginning after December 15, 2016, 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 2016-09 on its condensed consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Codification (“ASC”) 842, Leases. The new guidance replaces the existing guidance in ASC 840, 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. The Company is currently in the process of evaluating the impact of the adoption of ASC 842 on its consolidated financial statements.

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. Early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2015-11 on its condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the existing revenue recognition requirements in “Revenue Recognition (Topic 605).” 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. ASU 2014-09 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 2014-09 on its condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. The new guidance amends Accounting Standards Codification ("ASC") 350-40, Intangibles - Goodwill and Other, Internal-Use Software, to provide guidance on determining whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software. ASU 2015-05 is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company adopted ASU 2015-05 on January 1, 2016. The adoption of ASU 2015-05 did not have a material impact to the Company's condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which changes the presentation of deferred financing fees in an entity's financial statements. Under the ASU, deferred financing fees are to be presented in the balance sheet as a direct deduction from the related debt liability rather than as an asset. ASU 2015-03 is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company adopted ASU 2015-03 for its quarterly report on Form 10-Q for the three months ended March 31, 2016. In conjunction with the adoption of ASU 2015-03, the Company reclassified net deferred financing fees of $1,586 at December 31, 2015 from an asset to a direct deduction from the related debt liability to conform to the current period presentation.

Segment Reporting

The provisions of ASC 280, Disclosures about Segments of an Enterprise and Related Information, require public companies to report financial and descriptive information about their reportable operating segments. The Company identifies operating segments based on the various business activities that earn revenue and incur expense 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 March 31,	
	2016	2015
Service Sales		
CDIM	$53,665	$54,643
MPS	33,231	35,877
AIM	3,739	2,805
Total service sales	90,635	93,325
Equipment and supplies sales	12,915	10,994
Total net sales	$103,550	$104,319

Risk and Uncertainties

The Company generates the majority of its revenue from sales of services and products to customers in the AEC industry. As a result, the Company’s operating results and financial condition can be significantly affected by economic factors that influence the AEC industry, such as non-residential construction spending, GDP growth, interest rates, unemployment rates, and office vacancy rates. Reduced activity (relative to historic levels) in the AEC industry would diminish demand for some of ARC’s services and products, and would therefore negatively affect

revenues and have a material adverse effect on its business, operating results and financial condition.
As part of the Company's growth strategy, ARC intends to continue to offer and grow a variety of service offerings that are relatively new to the Company. The success of the Company's efforts will be affected by its ability to acquire new customers for the Company's new service offerings, as well as 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 months ended March 31, 2016, stock options for 2.8 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 months ended March 31, 2015, stock options of 0.2 million common shares, were excluded from the calculation of diluted net income attributable to ARC per common share 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 months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
	2016	2015
Weighted average common shares outstanding during the period—basic	46,608	46,443
Effect of dilutive stock options	595	1,211
Weighted average common shares outstanding during the period—diluted	47,203	47,654

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 Resulting from Business Acquisitions

Goodwill

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

In accordance with ASC 350, Intangibles-Goodwill and Other, the Company assesses goodwill for impairment annually as of September 30, and more frequently if events and circumstances indicate that goodwill might be impaired. At September 30, 2015, the Company performed its assessment and determined that goodwill was not

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.

Goodwill impairment testing is a two-step process. Step one involves comparing the fair value of the reporting units to its carrying amount. If the carrying amount of a reporting unit is greater than zero and its fair value is greater than its carrying amount, there is no impairment. If the reporting unit's carrying amount is greater than the fair value, the second step must be completed to measure the amount of impairment, if any. Step two involves calculating the implied fair value of goodwill by deducting the fair

value of all tangible and intangible assets, excluding goodwill, of the reporting unit from the fair value of the reporting unit as determined in step one. The implied fair value of goodwill determined in this step is compared to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference.

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

Given the current economic environment, the changing document and printing needs of the Company’s customers, and the uncertainties regarding the related impact on the Company’s business, there can be no assurance that the estimates and assumptions made for purposes of the Company’s goodwill impairment testing in 2015 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 2016, 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.

There was no change to the carrying amount of goodwill from January 1, 2015 through March 31, 2016.

Long-lived Assets

The Company periodically assesses potential impairments of its long-lived assets in accordance with the provisions of ASC 360, Accounting for the Impairment or Disposal of Long-lived Assets . An impairment review is performed whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The Company groups its assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of the other assets and liabilities. The Company has determined that the lowest level for which identifiable cash flows are available is the 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 had no long-lived asset impairments in the first three months of 2016 or for the year ended December 31, 2015.

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 March 31, 2016 and December 31, 2015 which continue to be amortized:

	March 31, 2016			December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount

Amortizable other intangible assets						
Customer relationships	$99,387	$ 82,978	$16,409	$99,050	$ 81,572	$17,478
Trade names and trademarks	20,336	19,873	463	20,329	19,861	468
	$119,723	$ 102,851	$16,872	$119,379	$ 101,433	$17,946

Based on current information, estimated future amortization expense of amortizable intangible assets for the remainder of the 2016 fiscal year, each of the subsequent four fiscal years and thereafter are as follows:

2016 (excluding the three months ended March 31, 2016)	$3,539
2017	4,286
2018	3,871
2019	3,147
2020	1,536
Thereafter	493
	$16,872

4. Income Taxes

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

The Company recorded an income tax provision of $2.0 million in relation to pretax income of $4.6 million for the three months ended March 31, 2016, which resulted in an effective income tax rate of 42.8%. The Company recorded an income tax provision of $0.8 million in relation to pretax income of $5.2 million for the three months ended March 31, 2015 which resulted in an effective income tax rate of 14.7%, and was impacted by the amortization of tax goodwill in a deferred tax liability position given the Company had a valuation allowance against certain of its deferred tax assets.

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.

It is difficult to conclude a valuation allowance is not required when there is significant objective and verifiable negative evidence, such as cumulative losses in recent years. The Company utilizes a rolling three years of actual and current year anticipated results as the primary measure of cumulative losses in recent years. 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. At September 30, 2015 as a result of sustained profitability in the U.S. evidenced by three years of earnings and forecasted continuing profitability, the Company determined it was more likely than not that future earnings will be sufficient to realize certain of its deferred tax assets in the U.S. Accordingly the Company reversed most of its U.S. valuation allowance, resulting in non-cash income tax benefit of $80.7 million for the year ended December 31, 2015.

The Company continues to carry a $1.4 million valuation allowance against certain deferred tax assets as of March 31, 2016.

Based on the Company’s assessment, the remaining net deferred tax assets as of March 31, 2016 are considered more likely than not to be realized. The valuation allowance of $1.4 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 $19 thousand as of March 31, 2016 included in other current assets 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:

	March 31, 2016	December 31, 2015
Term A loan facility maturing 2019 net of deferred financing fees of $1,453 and $1,586; 2.62% and 2.50% interest rate at March 31, 2016 and December 31, 2015	$137,147	$141,414
Various capital leases; weighted average interest rate of 5.7% and 5.8% at March 31, 2016 and December 31, 2015; principal and interest payable monthly through February 2021	29,786	29,866
Various other notes payable with a weighted average interest rate of 9.3% and 8.5% at March 31, 2016 and December 31, 2015; principal and interest payable monthly through November 2019	71	112
	167,004	171,392
Less current portion	(14,651)	(14,374)
	$152,353	$157,018

Term A Loan Facility

On November 20, 2014 the Company entered into a Credit Agreement (the “Term A Credit Agreement”) with Wells Fargo Bank, National Association, as administrative agent and the lenders party thereto.

The Term A Credit Agreement provides 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 Term Loan Credit Agreement dated as of December 20, 2013. The Term A Credit Agreement also provides for the extension of revolving loans (“Revolving Loans”) in an aggregate principal amount not to exceed $30.0 million. The Revolving Loan facility under the Term A Credit Agreement replaces the Company’s Credit Agreement dated as of January 27, 2012. The Company may request incremental commitments to the aggregate principal amount of Term Loans and Revolving Loans available under the Term A Credit Agreement by an amount not to exceed $75.0 million in the aggregate. Unless an incremental commitment to increase the Term Loan or provide a new term loan matures at a later date, the obligations under the Term A Credit Agreement mature on November 20, 2019. As of March 31, 2016, the Company's borrowing availability under the Term A Credit Agreement was $28.1 million, which was the maximum borrowing limit of $30.0 million reduced by outstanding letters of credit of $1.9 million.

Loans borrowed under the 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 1.50% to 2.50%, based on the Company’s Total Leverage Ratio (as defined in the Term A Credit Agreement). Loans borrowed under the 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%, 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 0.50% to 1.50%, based on the Company’s Total Leverage Ratio.

The Company will pay 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 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 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 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 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 through the Company's fiscal quarter ending September 30, 2016, and thereafter,

in an amount not to exceed 3.00 to 1.00; and (ii) a Fixed Charge Coverage Ratio (as defined in the Term A Credit Agreement), as of the last day of each fiscal quarter, in an amount not less than 1.25 to 1.00. On February 5, 2016, the Term A Credit Agreement was amended to exclude up to $15.0 million of stock repurchases from the calculation of the Company's Fixed Charge Coverage Ratio, provided that those stock repurchases are consummated in accordance with the other terms and conditions of the agreement.

The 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 Term A Credit Agreement are guaranteed by the Company and each other United States domestic subsidiary of the Company. The 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).
As of March 31, 2016, the Company has paid $36.4 million in aggregate principal on its $175.0 million Term Loan Credit Agreement, which was $14.5 million above the required payments from inception to date, of which $4.4 million was paid in the first quarter of 2016. The $4.4 million early pay down of the term loan resulted in a loss on extinguishment of debt of $46 thousand for the three months ended March 31, 2016.
Other Notes Payable
Includes notes payable collateralized by equipment previously purchased.
6. Commitments and Contingencies
Operating Leases. The Company has entered into various non-cancelable operating leases primarily related to facilities, equipment and vehicles used in the ordinary course of business.

Legal Proceedings. On October 21, 2010, a former employee, individually and on behalf of a purported class consisting of all non-exempt employees who work or worked for American Reprographics Company, L.L.C. and American Reprographics Company in the State of California at any time from October 21, 2006 through the present, filed an action against the Company in the Superior Court of California for the County of Orange. The complaint alleges, among other things, that the Company violated the California Labor Code by failing to (i) provide meal and rest periods, or compensation in lieu thereof, (ii) timely pay wages due at termination, and (iii) that those practices also violate the California Business and Professions Code. The relief sought includes damages, restitution, penalties, interest, costs, and attorneys’ fees and such other relief as the court deems proper. On March 15, 2013, the Company participated in a private mediation session with claimants’ counsel which did not result in resolution of the claim. Subsequent to the mediation session, the mediator issued a proposal that was accepted by both parties. A final approval order was issued by the court on March 15, 2016 and the effective date of settlement will be May 19, 2016.

The Company has a liability of $1.0 million as of March 31, 2016 related to the claim, which represents management's best estimate based on information available. As such, the ultimate resolution of the claim could result in a loss different than the estimated loss recorded.

In addition to the matters described above, the Company is involved in various additional legal proceedings and other legal matters from time to time in the normal course of business. The Company does not believe that the outcome of any of these matters will have a material effect on its consolidated financial position, results of operations or cash flows.
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 March 31, 2016, 1.6 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 three months ended March 31, 2016, the Company granted options to acquire a total of 520 thousand 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 three months ended March 31, 2016, the Company granted 130 thousand 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 three years from the grant date.

The impact of stock-based compensation before income taxes on the interim Condensed Consolidated Statements of Operations was $0.8 million and $1.1 million for the three months ended March 31, 2016 and 2015, respectively.

As of March 31, 2016, total unrecognized compensation cost related to unvested stock-based payments totaled $4.5 million and is expected to be recognized over a weighted-average period of 2.0 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 $0.3 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 March 31, 2016 and December 31, 2015:

	Balance Sheet Classification	Fair Value	
		March 31, 2016	December 31, 2015
Derivative designated as hedging instrument under ASC 815			
Interest rate cap contracts - current portion	Other current assets	$13	$ 48
Interest rate cap contracts - long-term portion	Other assets	48	191
Total derivatives designated as hedging instruments		$61	$ 239

The following table summarizes the loss recognized in AOCL of derivatives, designated and qualifying as cash flow hedges for the three months ended March 31, 2016 and 2015:

	Amount of Loss Recognized in AOCL on Derivative Three Months Ended March 31,	
	2016	2015
Derivative in ASC 815 Cash Flow Hedging Relationship		
Interest rate cap contracts	$(95)	$(111)

The following table summarizes the effect of the interest rate cap on the Condensed Consolidated Statements of Income for the three months ended March 31, 2016 and 2015:

	Amount of Gain or (Loss) Reclassified from AOCL into Income			
	Three Months Ended March 31, 2016		Three Months Ended March 31, 2015	
	Effective Portion	Ineffective Portion	Effective Portion	Ineffective Portion
Location of Loss Reclassified from AOCL into Income				
Interest expense	$21	$ —	$ 1	$ —

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 recurring basis in the condensed consolidated financial statements as of and for the three months ended March 31, 2016 and as of and for the year ended December 31 2015:

	Significant Other Unobservable Inputs					
	March 31, 2016			December 31, 2015		
	Level 2	Level 3	Total Losses	Level 2	Level 3	Total Losses
Recurring Fair Value Measure						
Interest rate cap contracts	$61	$—	$ —	$239	$—	$ —

Contingent purchase price consideration for acquired businesses	$—	$868	$—	$—	$1,059	$—

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 March 31, 2016, 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 months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
	2016	2015
Beginning balance	$1,059	$1,768
Additions related to acquisitions	104	—
Payments	(65)	(26)
Adjustments included in earnings	(222)	—
Foreign currency translation adjustments	(8)	(163)
Ending balance	$868	$1,579

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

Cash equivalents: Cash equivalents are time deposits with maturity of three months or less when purchased, which are highly liquid and readily convertible to cash. Cash equivalents reported in the Company’s Condensed Consolidated Balance Sheets were $6.8 million and $6.3 million as of March 31, 2016 and December 31, 2015, 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 March 31, 2016 for borrowings under its Term Loan Credit Agreement is $138.6 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 $138.6 million as of March 31, 2016.

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 2015 Form 10-K and this Quarterly Report on Form 10-Q for the quarter ended March 31, 2016.
Business Summary
ARC Document Solutions, Inc. (“ARC Document Solutions,” “ARC,” “we,” “us,” or “our”) is the nation's leading document solutions provider for the architectural, engineering and construction (“AEC”) industry 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 produce, 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 and professional services to manage and distribute documents and information primarily related to construction projects. CDIM sales include software such as SKYSITE®, our cloud-based project communication application, as well as the provision of 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 construction plan printing have been in steady decline since the last recession as technology supplants the use of traditional “blueprints,” but sales from color printing have been increasing as demand for marketing, merchandising, and other promotional purposes has grown.

Software is a smaller part of overall CDIM sales, but continues to grow with the adoption of technology. The sale of services address 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 growth is 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 PlanWell® Archive 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 in the AEC industry.

We have expanded our business beyond the services we traditionally provided to the AEC industry in the past and are currently focused on growing MPS, AIM and CDIM, as we believe the mix of services demanded by the AEC industry continues to shift toward document management at customer locations and in the cloud (represented primarily by our MPS and AIM revenues), and away from its historical emphasis on large-format construction drawings produced “offsite” in our service centers (represented

primarily by our revenues from large-format black and white printing services). Based on growth percentage AIM is our fastest-growing service offering and has grown 33% in the first three months of 2016 as compared to the same period in 2015.

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 industry, though non-AEC clients continue to show significant interest in many of our offerings. Based on our analysis of our operating results, we estimate that sales to the AEC industry accounted for approximately 78% of our net sales for the three months ended March 31, 2016, with the remaining 22% consisting of sales to non-AEC industries.

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 have 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

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

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

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

We use EBIT and EBITDA to measure and compare the performance of our operating segments. Our operating segments’ financial performance includes all of the operating activities except debt and taxation which are managed at the corporate level for U.S. operating segments. As a result, we believe EBIT is the best measure of operating segment profitability and the most useful metric by which to measure and compare the performance of our operating segments.

We use EBITDA to measure performance for determining consolidated-level compensation. In addition, we use EBIT and EBITDA to evaluate potential acquisitions and potential capital expenditures.

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

- They do not reflect our cash expenditures, or future requirements for capital expenditures and contractual commitments;
- They do not reflect changes in, or cash requirements for, our working capital needs;
- They do not reflect the significant interest expense, or the cash requirements necessary, to service interest or principal payments on our debt;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements; and
- Other companies, including companies in our industry, may calculate these measures differently than we do, limiting their usefulness as comparative measures.

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

Our presentation of adjusted net income, adjusted EBITDA, and adjusted cash flows from operations 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 months ended March 31, 2016 and 2015 to reflect the exclusion of loss on extinguishment of debt, restructuring expense, trade secret litigation costs, and changes in the valuation allowances related to certain deferred tax assets and other discrete tax items. We have presented adjusted cash flows from operating activities for the three months ended March 31, 2016 and 2015 to reflect the exclusion of cash payments related to trade secret litigation costs and cash payments related to restructuring expenses. This presentation facilitates a meaningful comparison of our operating results for the three months ended March 31, 2016 and 2015. We believe these charges were the result of the then current macroeconomic environment, our capital restructuring, or other items which are not indicative of our actual operating performance.

We have presented adjusted EBITDA in the three months ended March 31, 2016 and 2015 to exclude loss on extinguishment of debt, trade secret litigation costs, 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 EBIT, EBITDA, and net income attributable to ARC Document Solutions, Inc. shareholders:

	Three Months Ended March 31,	
(In thousands)	2016	2015
Cash flows provided by operating activities	$5,303	$5,288
Changes in operating assets and liabilities, net of effect of business acquisitions	7,809	9,416
Non-cash expenses, including depreciation, amortization and restructuring	(10,484)	(10,293)
Income tax provision	1,969	761
Interest expense, net	1,446	1,857
(Income) loss attributable to the noncontrolling interest	(54)	25
EBIT	5,989	7,054
Depreciation and amortization	7,990	8,555
EBITDA	13,979	15,609
Interest expense, net	(1,446)	(1,857)
Income tax provision	(1,969)	(761)
Depreciation and amortization	(7,990)	(8,555)
Net income attributable to ARC Document Solutions, Inc. shareholders	$2,574	$4,436

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

	Three Months Ended March 31,	
(In thousands)	2016	2015
Net income attributable to ARC Document Solutions, Inc. shareholders	$2,574	$4,436
Interest expense, net	1,446	1,857
Income tax provision	1,969	761
EBIT	5,989	7,054
Depreciation and amortization	7,990	8,555
EBITDA	13,979	15,609
Loss on extinguishment of debt	46	—
Trade secret litigation costs(1)	—	34
Restructuring expense(2)	2	74
Stock-based compensation	772	1,083
Adjusted EBITDA	$14,799	$16,800

(1) On February 1, 2013, we filed a civil complaint against a competitor and a former employee in the Superior Court of California for Orange County, which alleged, among other claims, the misappropriation of ARC trade secrets; namely, proprietary customer lists that were used to communicate with ARC customers in an attempt to unfairly acquire their business. In prior litigation with the competitor based on related facts, in 2007 the competitor entered into a settlement agreement and stipulated judgment, which included an injunction. We instituted this suit to stop the defendant from using similar unfair business practices against us in the Southern California market. The case proceeded to trial in May 2014, and a jury verdict was entered for the defendants. In the first quarter of 2015, we entered into a settlement and paid the defendant. Legal fees associated with the litigation were recorded as selling, general and administrative expense.

(2)

In October 2012, we initiated a restructuring plan which included the closure or downsizing of the Company's service center locations, as well as a reduction in headcount. Restructuring expenses in 2016 and 2015 primarily consist of revised estimated lease termination and obligation costs resulting from facilities closed in 2013.

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

(in thousands)	Three Months Ended March 31, 2016	2015
Cash flows provided by operating activities	$5,303	$5,288
Payments related to trade secret litigation costs	—	999
Payments related to restructuring expenses	2	118
Adjusted cash flows provided by operating activities	$5,305	$6,405

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

	Three Months Ended March 31, 2016 (1)	2015
Net income margin attributable to ARC	2.5 %	4.3 %
Interest expense, net	1.4	1.8
Income tax provision	1.9	0.7
EBIT margin	5.8	6.8
Depreciation and amortization	7.7	8.2
EBITDA margin	13.5	15.0
Loss on extinguishment of debt	—	—
Trade secret litigation costs	—	—
Restructuring expense	—	0.1
Stock-based compensation	0.7	1.0
Adjusted EBITDA margin	14.3%	16.1%

(1) Column does not foot due to rounding

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

	Three Months Ended March 31,	
(In thousands, except per share amounts)	2016	2015
Net income attributable to ARC Document Solutions, Inc.	$2,574	$4,436
Loss on extinguishment of debt	46	—
Restructuring expense	2	74
Trade secret litigation costs	—	34
Income tax benefit related to above items	(19)	(42)
Deferred tax valuation allowance and other discrete tax items	108	(1,256)
Unaudited adjusted net income attributable to ARC Document Solutions, Inc.	$2,711	$3,246
Actual:		
Earnings per share attributable to ARC Document Solutions, Inc. shareholders:		
Basic	$0.06	$0.10
Diluted	$0.05	$0.09
Weighted average common shares outstanding:		
Basic	46,608	46,443
Diluted	47,203	47,654
Adjusted:		
Earnings per share attributable to ARC Document Solutions, Inc. shareholders:		
Basic	$0.06	$0.07
Diluted	$0.06	$0.07
Weighted average common shares outstanding:		
Basic	46,608	46,443
Diluted	47,203	47,654

Results of Operations

(In millions, except percentages)	Three Months Ended March 31,		Increase (decrease)	
	2016 (1)	2015	$	%
CDIM	$53.7	$54.6	$(1.0)	(1.8)%
MPS	33.2	35.9	(2.6)	(7.4)%
AIM	3.7	2.8	0.9	33.3%
Total service sales	90.6	93.3	(2.7)	(2.9)%
Equipment and supplies sales	12.9	11.0	1.9	17.5%
Total net sales	$103.6	$104.3	$(0.8)	(0.7)%
Gross profit	$33.7	$36.0	$(2.3)	(6.3)%
Selling, general and administrative expenses	$26.4	$27.5	$(1.1)	(4.0)%
Amortization of intangibles	$1.3	$1.5	$(0.2)	(11.8)%
Restructuring expense	$—	$0.1	$(0.1)	(97.3)%
Loss on extinguishment of debt	$—	$—	$—	—%
Interest expense, net	$1.4	$1.9	$(0.4)	(22.1)%
Income tax provision	$2.0	$0.8	$1.2	158.7%
Net income attributable to ARC	$2.6	$4.4	$(1.9)	(42.0)%
Adjusted net income attributable to ARC	$2.7	$3.2	$(0.5)	(16.5)%
EBITDA	$14.0	$15.6	$(1.6)	(10.4)%
Adjusted EBITDA	$14.8	$16.8	$(2.0)	(11.9)%

(1) Column does not foot due to rounding

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

	As Percentage of Net Sales Three Months Ended March 31,	
	2016 (1)	2015 (1)
Net Sales	100.0 %	100.0 %
Cost of sales	67.4	65.5
Gross profit	32.6	34.5
Selling, general and administrative expenses	25.5	26.3
Amortization of intangibles	1.3	1.4
Restructuring expense	—	0.1
Income from operations	5.9	6.7
Loss on extinguishment of debt	—	—
Interest expense, net	1.4	1.8
Income before income tax provision	4.4	5.0
Income tax provision	1.9	0.7
Net income	2.5	4.2
(Income) loss attributable to the noncontrolling interest	(0.1)	—
Net income attributable to ARC	2.5 %	4.3 %
EBITDA	13.5 %	15.0 %
Adjusted EBITDA	14.3 %	16.1 %

(1) Column does not foot due to rounding

Three Months Ended March 31, 2016 Compared to Three Months Ended March 31, 2015

Net Sales

Net sales for the three months ended March 31, 2016 decreased by 0.7% compared to prior year primarily due to reduced sales in CDIM and MPS.

CDIM. Year-over-year sales of CDIM services decreased $1.0 million, or 1.8% for the three months ended March 31, 2016. CDIM services were negatively affected by the continued reduction in demand for printed construction drawings and related services driven by the ongoing adoption of technology replacing traditional print-based service offerings. Specifically, reduced demand for construction drawings, which makes up approximately 47% of CDIM revenue, decreased by just under 5% which was consistent with the 2015 decline. These declines were partially offset by increased sales of our color print services and certain of our newer digital document management services, such as project information management and SKYSITE®. CDIM services represented 52% of total net sales for both the three months ended March 31, 2016, and 2015.

MPS. Year-over-year sales of MPS services for the three months ended March 31, 2016 decreased by $2.6 million, or 7.4% due primarily to a national MPS account that did not renew its agreement with us following a recent merger at the end of 2015. Also contributing to the decline was the continued optimization of our customers' in-house print environment driving a slight decrease in print volumes, which was offset by new MPS placements in the first quarter of 2016. The Company's MPS offering delivers value to its customers by optimizing their print infrastructure, which in turn, will lower their print volume over time. Sales reductions associated with a decline in print volume are offset by new customer acquisitions and expansion of MPS services within existing customers. Revenues from MPS Services sales represented approximately 32% of total net sales for the three months ended March 31, 2016, compared to 34% during the same period in 2015.

The number of MPS locations has grown to approximately 9,050 as of March 31, 2016, an increase of approximately 390 locations compared to March 31, 2015, due primarily to growth in new MPS placements in which customers outsource their entire printing function to us. Although we experienced a year-over-year decline in MPS revenue, we

believe over time MPS can be a growth area for us as demonstrated by the adoption of our services by large, multi-national firms in the AEC space over the past several years. We intend to continue the expansion of our MPS offering through our regional sales force and through our national accounts group "Global Solutions". Our Global Solutions sales force has established long-term contract relationships with 23 of the largest

100 AEC firms. As MPS becomes a larger percentage of our sales, our overall sales will be less exposed to the seasonality associated with construction projects. MPS services are driven in large part by the number of customer employees at an office and largely by non-construction project related work such as office printing and copying.

AIM. Year-over-year sales of AIM Services increased by $0.9 million, or 33.3%, for the three months ended March 31, 2016. The growth in AIM was driven by new sales and the opening of dedicated AIM service centers in various U.S. locations. Achieving growth in AIM is a primary focus of our management, as we believe we have developed a valuable solution to offer our existing AEC customers and non-AEC customers who wish to leverage past intellectual property for present or future use, facilitate cost savings and efficiency improvements over current hardcopy and digital storage methods, and to comply with regulatory and records retention requirements.

Equipment and Supplies Sales. Year-over-year sales of Equipment and Supplies increased by $1.9 million, or 17.5% in the first quarter of 2016. The growth in equipment and supplies sales for the three months ended March 31, 2016 was primarily driven by a temporary increase in equipment sales in the Chinese market. Equipment and Supplies Sales represented approximately 13% of total net sales for the three months ended March 31, 2016, as compared to 11% for the three months ended March 31, 2015. Equipment and Supplies Sales derived from UNIS Document Solutions Co. Ltd ("UDS"), our Chinese business venture, were $5.8 million for the three months ended March 31, 2016, as compared to $3.9 million for the three months ended March 31, 2015. Quarterly changes in Equipment and Supplies Sales are largely driven by the timing of replacements of aging equipment fleets for customers who prefer to own their equipment. In the long term we do not anticipate growth in Equipment and Supplies Sales in the United States or China, as we are placing more focus on growth in AIM and MPS sales and converting sales contracts to MPS agreements.

Gross Profit

During the three months ended March 31, 2016, gross profit and gross margin decreased to $33.7 million, and 32.6%, compared to $36.0 million, and 34.5%, during the same period in 2015, on a sales decline of $0.8 million.

The decline in our gross margins was primarily due to the temporary shift in our business mix for the three months ended March 31, 2016, driven by the increase in lower-margin equipment and supplies sales in China as noted above. The increase in Equipment and Supplies sales contributed to a 190 basis point increase in material costs as a percentage of consolidated sales for the three months ended March 31, 2016, as compared to the same period in 2015.

Selling, General and Administrative Expenses

Selling, marketing, general and administrative expenses decreased $1.1 million for the three months ended March 31, 2016 compared to the same period in 2015.

General and administrative expenses for the three months ended March 31, 2016 decreased $0.1 million or 0.6% compared to the same period in 2015. The slight reduction in expenses was primarily due to a decline in stock-based compensation expense and travel-related expenses, which were partially offset by investments in general and administrative staff to support our new technology-enabled offerings.

Year-over-year sales and marketing expenses decreased $1.0 million, for the three months ended March 31, 2016, compared to the same period in 2015. The decrease for the three months ended March 31, 2016 was primarily due to a reduction in sales associate compensation as a result of our sales decrease.

Amortization of Intangibles

Amortization of intangibles of $1.3 million for the three months ended March 31, 2016 had a slight decrease compared to the same period in 2015, primarily due to the completed amortization of certain customer relationships related to historical acquisitions.

Restructuring Expense

Restructuring expenses for the three months ended March 31, 2016 totaled $2 thousand, primarily consisting of revised estimated lease termination and obligation costs resulting from facilities closed in 2013.

Loss on Extinguishment of Debt

As of March 31, 2016, we have paid $36.4 million in aggregate principal of our $175.0 million Term Loan Credit Agreement, which was $14.5 million above our required principal payments since the inception of the credit agreement. $4.4 million of the pay down was made during the three months ended March 31, 2016, which resulted in a loss on the early extinguishment of debt of $46 thousand.

Interest Expense, Net

Net interest expense totaled $1.4 million for the three months ended March 31, 2016, compared to $1.9 million for the same period in 2015. The decrease was primarily as a result of the early extinguishment of our long-term debt as described above.

Income Taxes

We recorded an income tax provision of $2.0 million in relation to pretax income of $4.6 million for the three months ended March 31, 2016 which resulted in an effective income tax rate of 42.8%.

For the three months ended March 31, 2016, our effective income tax rate would have been 40.6% after excluding the impact of an additional valuation allowance and certain stock based compensation not deductible for income tax purposes. We continue to carry a $1.4 million valuation allowance against certain deferred tax assets as of March 31, 2016.

Our gross deferred tax assets remain available to us for use in future years until they fully expire. As of March 31, 2016, we had approximately $83.1 million of consolidated federal, $100.6 million of state and $1.9 million of foreign net operating loss and charitable contribution carryforwards available to offset future taxable income, respectively. The federal net operating loss carryforward began in 2011 and will begin to expire in varying amounts between 2031 and 2034. The charitable contribution carryforward began in 2009 and will begin to expire in varying amounts between 2016 and 2020. The state net operating loss carryforwards expire in varying amounts between 2016 and 2034. The foreign net operating loss carryforwards begin to expire in varying amounts beginning in 2016.

Noncontrolling Interest

Net income attributable to noncontrolling interest represents 35% of the income of UDS and its subsidiaries, which together comprise our Chinese joint-venture operations.

Net Income Attributable to ARC

Net income attributable to ARC was $2.6 million, during the three months ended March 31, 2016, as compared to $4.4 million in the same period in 2015. The decrease in net income attributable to ARC in 2016 versus the prior year period is primarily due to the decrease in sales and gross margins. This decrease was partially offset by a reduction in interest expense in 2016 and the decrease in selling, general and administrative expenses, as noted above.

EBITDA

EBITDA margin decreased to 13.5% for the three months ended March 31, 2016 from 15.0% for the same period in 2015. Excluding the effect of stock-based compensation, loss on extinguishment of debt, legal fees associated with trade secret litigation, and restructuring expense, adjusted EBITDA margin decreased to 14.3% during the three months ended March 31, 2016, as compared to 16.1% for the same period in 2015. The decrease in EBITDA margin was due to the decrease in revenue and gross margin described above.

Impact of Inflation

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

Liquidity and Capital Resources

Our principal sources of cash have been operations and borrowings under our debt and lease agreements. Our recent historical uses of cash have been for ongoing operations, payment of principal and interest on outstanding debt obligations and capital expenditures.

Total cash and cash equivalents as of March 31, 2016 was $16.8 million. Of this amount, $12.3 million was held in foreign countries, with $10.8 million held in China. Repatriation of some of our cash and cash equivalents in foreign

countries could be subject to

delay for local country approvals and could have potential adverse tax consequences. As a result of holding cash and cash equivalents outside of the U.S., our financial flexibility may be reduced.
Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our interim Condensed Consolidated Statements of Cash Flows and notes thereto included elsewhere in this report.

(In thousands)	Three Months Ended March 31, 2016	2015
Net cash provided by operating activities	$5,303	$5,288
Net cash used in investing activities	$(2,279)	$(3,346)
Net cash used in financing activities	$(10,299)	$(7,135)

Operating Activities
Cash flows from operations are primarily driven by sales and net profit generated from these sales, excluding non-cash charges.
Despite the decrease in net income, cash flows from operations during the three months ended March 31, 2016, over the same period in 2015 increased primarily due to the timing of sales and cash collections, a settlement payment of $1.0 million in March 2015 related to trade secret litigation, and a reduction in our interest expense resulting from the reduction in principal of our Term A Loan Facility. Days sales outstanding (“DSO”) decreased to 53 days as of March 31, 2016 compared to 57 as of March 31, 2015 due to the timing of collections. We continue our focus on the timely collection of our accounts receivable.
Investing Activities
Net cash used in investing activities was primarily related to capital expenditures. We incurred capital expenditures totaling $2.5 million and $3.5 million for the three months ended March 31, 2016 and 2015, respectively. The change in capital expenditures is driven by the timing of new MPS placements, and whether such equipment is leased or purchased with available cash. As we continue to foster our relationships with credit providers and obtain attractive lease rates, we may increasingly choose to lease rather than purchase equipment in the future.
Financing Activities
Net cash of $10.3 million used in financing activities during the three months ended March 31, 2016 primarily relates to payments on our debt agreements and capital leases and common stock repurchases made pursuant to our Stock Repurchase Program which commenced during the first quarter of 2016. As of March 31, 2016, we have paid $36.4 million in aggregate principal of our $175.0 million Term Loan Credit Agreement. Principal payments made were $14.5 million greater than the required principal payments since the inception of the agreement, of which $4.4 million in payments were made during the first quarter. In addition, we repurchased approximately $2.7 million of the Company's outstanding common stock pursuant to our Stock Repurchase Plan during the three months ended March 31, 2016.
Our cash position, working capital, and debt obligations as of March 31, 2016 and December 31, 2015 are shown below and should be read in conjunction with our Condensed Consolidated Balance Sheets and notes thereto contained elsewhere in this report.

(In thousands)	March 31, 2016	December 31, 2015
Cash and cash equivalents	$16,793	$23,963
Working capital	$40,492	$40,031
Borrowings from term loan facility (1)	$137,147	$141,414
Other debt obligations	29,857	29,978

Total debt obligations	$167,004	$171,392

(1) Net of deferred financing fees of $1,453 and $1,586 at March 31, 2016 and December 31, 2015, respectively.
The increase of $0.5 million in working capital in 2016 was primarily due to the increase in accounts receivable of $1.3 million, an increase in inventory of $1.6 million, a reduction in accrued payroll and payroll-related expenses of $3.6 million, and a decrease

in accounts payable of $2.6 million. These variances were partially offset by a decrease in cash of $7.2 million. The increase in accounts receivable was due primarily to the timing of collections of prior quarter sales. The decrease in accounts payable and accrued expenses is primarily due to the timing of trade payables, a reduction in accrued payroll expense, the timing of payment of annual bonuses and the timing of interest payments related to our Term A Loan Facility. To manage our working capital, we chiefly focus on our DSO and monitor the aging of our accounts receivable, as receivables are the most significant element of our working capital.

We believe that our current cash and cash equivalent balance of $16.8 million, availability under our revolving credit facility, availability under our equipment lease lines, and cash flows provided by operations should be adequate to cover the next twelve months of working capital needs, debt service requirements consisting of scheduled principal and interest payments, and planned capital expenditures, to the extent such items are known or are reasonably determinable based on current business and market conditions. In addition, we may elect to finance certain of our capital expenditure requirements through borrowings under our revolving credit facility, which had no debt outstanding as of March 31, 2016, other than contingent reimbursement obligations for undrawn standby letters of credit described below that were issued under this facility. See “Debt Obligations” section for further information related to our revolving credit facility.

We generate the majority of our revenue from sales of services and products to the AEC industry. As a result, our operating results and financial condition can be significantly affected by economic factors that influence the AEC industry, such as non-residential and residential construction spending. Additionally, a general economic downturn may adversely affect the ability of our customers and suppliers to obtain financing for significant operations and purchases, and to perform their obligations under their agreements with us. We believe that credit constraints in the financial markets could result in a decrease in, or cancellation of, existing business, could limit new business, and could negatively affect our ability to collect our accounts receivable on a timely basis.

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

Debt Obligations

Term A Loan Facility

On November 20, 2014 we entered into a Credit Agreement (the “Term A Credit Agreement”) with Wells Fargo Bank, National Association, as administrative agent and the lenders party thereto.

The Term A Credit Agreement provides 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 Term Loan Credit Agreement dated as of December 20, 2013. The Credit Agreement also provides for the extension of revolving loans ("Revolving Loans") in an aggregate principal amount not to exceed $30.0 million. The Revolving Loan facility under the Term A Credit Agreement replaces the Company’s Credit Agreement dated as of January 27, 2012. The Company may request incremental commitments to the aggregate principal amount of Term Loans and Revolving Loans available under the Credit Agreement by an amount not to exceed $75.0 million in the aggregate. Unless an incremental commitment to increase the Term Loan or provide a new term loan matures at a later date, the obligations under the Credit Agreement mature on November 20, 2019.

Loans borrowed under the 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 1.50% to 2.50%, based on the Company’s Total Leverage Ratio (as defined in the Term A Credit Agreement). Loans borrowed under the 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 0.50% to 1.50%, based on our Company’s Total Leverage Ratio.

We will pay 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 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 Term A Credit Agreement); the net proceeds from certain issuances of equity securities; and net proceeds of certain insurance recoveries and condemnation events of our Company.

The 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 our 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 our 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 Term A Credit Agreement contains financial covenants which requires us to maintain (i) at all times, a Total Leverage Ratio in an amount not to exceed 3.25 to 1.00 through the Company's fiscal quarter ending September 30, 2016, and thereafter, in an amount not to exceed 3.00 to 1.00; and (ii) a Fixed Charge Coverage Ratio (as defined in the Term A Credit Agreement), as of the last day of each fiscal quarter, in an amount not less than 1.25 to 1.00. The Company was in compliance with its covenants as of March 31, 2016.

On February 5, 2016, the Term A Credit Agreement was amended to exclude up to $15.0 million of stock repurchases from the calculation of the Company's Fixed Charge Coverage Ratio, provided that those stock repurchases are consummated in accordance with the other terms and conditions of the agreement.

The 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 Credit Agreement are guaranteed by the Company and each other United States domestic subsidiary of the Company. The 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).

Capital Leases

As of March 31, 2016, we had $29.8 million of capital lease obligations outstanding, with a weighted average interest rate of 5.7% and maturities between 2016 and 2020.

Other Notes Payable

As of March 31, 2016, we had $0.1 million of notes payable outstanding, with an interest rate of 9.3% and maturities through 2019. These notes are collateralized by equipment previously purchased.

Off-Balance Sheet Arrangements

As of March 31, 2016, we did not have any off-balance-sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

Contractual Obligations and Other Commitments

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

Contingent Transaction Consideration. We have entered into earnout obligations in connection with prior acquisitions. If the acquired businesses generate sales and/or operating profits in excess of predetermined targets, we are obligated to make additional cash payments in accordance with the terms of such earnout obligations. As of March 31, 2016, we recorded liabilities related to future earnout payments consummated subsequent to the adoption of ASC 805, Business Combinations, of $0.9 million. Liabilities related to future earnout payments are carried at fair value, and any changes in fair value at each reporting period, are recognized in our consolidated statement of operations.

Legal Proceedings. On October 21, 2010, a former employee—individually and on behalf of a purported class consisting of all non-exempt employees who work or worked for American Reprographics Company, LLC and American Reprographics Company in the State of California at any time from October 21, 2006 through the present, filed an action against us in the Superior Court of California for the County of Orange. The complaint alleges, among other

things, that the Company violated the California Labor Code by failing to (i) provide meal and rest periods, or compensation in lieu thereof, (ii) timely pay wages due at termination, and (iii) that those practices also violate the California Business and Professions Code. The relief sought includes damages, restitution, penalties, interest, costs, and attorneys' fees and such other relief as the court deems proper. On March 15, 2013, we participated in a private mediation session with claimants' counsel which did not result in resolution of the claim. Subsequent to the mediation session, the mediator issued a proposal that was accepted by both parties. A final approval order was issued by the court on March

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15, 2016 and the effective date of settlement will be May 19, 2016. We recorded a liability of $1.0 million as of March 31, 2016 related to the claim, which represents management's best estimate of the probable outcome based on information available. As such, the ultimate resolution of the claim could result in a loss different than the estimated loss recorded.

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

Critical Accounting Policies

Critical accounting policies are those accounting policies that we believe are important to the portrayal of our financial condition and results and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our 2015 Annual Report on Form 10-K includes a description of certain critical accounting policies, including those with respect to goodwill, revenue recognition, and income taxes. There have been no material changes to our critical accounting policies described in our 2015 Annual Report on Form 10-K.

Goodwill Impairment

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

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

At September 30, 2015, we performed our assessment and determined that goodwill was not 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.

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

We determine the fair value of our reporting units using an income approach. Under the income approach, we determined fair value based on estimated discounted future cash flows of each reporting unit. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and EBITDA margins, discount rates and future market conditions, among others.

Our projections are driven, in part, by industry data gathered from third parties, including projected growth rates of the AEC industry by segment (i.e., residential and non-residential) and anticipated GDP growth rates, as well as company-specific data such as estimated composition of our customer base (i.e. non-AEC vs. AEC, residential vs. non- residential), historical revenue trends, and EBITDA margin performance of our reporting units. Our revenue projections for each of ARC’s reporting units include the estimated respective customer composition for each reporting unit, year-to-date revenue at the time of the goodwill impairment analysis, and projected growth rates for the related customer types. Although we rely on a variety of internal and external sources in projecting revenue, our relative reliance on each source or trend changes from year to year. In 2012 and into 2013, we noted a continued divergence between our historic revenue growth rates and AEC non-residential construction growth rates, as well as the “dilution” of traditional reprographics as the Company’s dominant business line. Therefore, we increased our reliance upon internal sources for our short-term and long-term revenue forecasts. Once the forecasted revenue was established for

each of the reporting units based on the process noted above, using the current year EBITDA margin as a base line, we forecasted future EBITDA margins. In general, our EBITDA margins are significantly affected by (1) revenue trends and (2) cost management initiatives. Revenue trends impact our EBITDA margins because a significant portion of our cost of sales are considered relatively fixed therefore an increase in forecasted revenue (particularly when combined with any cost management or productivity

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enhancement initiatives) would result in meaningful gross margin expansion. Similarly, a significant portion of our selling, general, and administrative expenses are considered fixed. Hence, in forecasting EBITDA margins, significant reliance was placed on the historical impact of revenue trends on EBITDA margin.
The estimated fair values of our reporting units were based upon their respective projected EBITDA margins, which were anticipated to vary from a slight decline to a 90 basis point increase from 2015 to 2016, followed by year-over-year increases of less than 100 basis points in 2017 and beyond. These cash flows were discounted using a weighted average cost of capital ranging from 10% to 12%, depending upon the size and risk profile of the reporting unit. We considered market information in assessing the reasonableness of the fair value under the income approach described above.
The results of step one of the goodwill impairment test, as of September 30, 2015, were as follows:

(Dollars in thousands)	Number of Reporting Units	Representing Goodwill of
No goodwill balance	1	$ —
Reporting units failing step one that continue to carry a goodwill balance	1	7,285
Fair value of reporting unit exceeds its carrying value by 15%-30%	2	45,946
Fair value of reporting unit exceeds its carrying value by more than 70%	3	159,377
	7	$ 212,608

Based on the Company's analysis, one of its reporting units that carried a goodwill balance at September 30, 2015 failed step one. The shortfall in step one of the analysis for the reporting unit was primarily related to the increase in its carrying amount driven by the reversal of the Company's valuation allowance against certain of its deferred tax assets at September 30, 2015.
Based upon a sensitivity analysis, a reduction of approximately 50 basis points of projected EBITDA in 2015 and beyond, assuming all other assumptions remain constant, would result in no additional reporting units proceeding to step two of the analysis, and no impairment for the reporting unit failing step one of the analysis.
Based upon a separate sensitivity analysis, a 50 basis point increase to the weighted average cost of capital would result in no additional reporting units proceeding to step two of the analysis, and no impairment for the reporting unit failing step one of the analysis.
Given the current economic environment and the changing document and printing needs of our customers and the uncertainties regarding the effect on our business, there can be no assurance that the estimates and assumptions made for purposes of our goodwill impairment testing in 2015 will prove to be accurate predictions of the future. If our assumptions, including forecasted EBITDA of certain reporting units, are not achieved, we may be required to record additional goodwill impairment charges in future periods, whether in connection with our next annual impairment testing in the third quarter of 2016, or on an interim basis, if any such change constitutes a triggering event (as defined under ASC 350, Intangibles - Goodwill and Other) outside of the quarter when we regularly perform our annual goodwill impairment test. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.
Income Taxes

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

In accordance with ASC 740-10, Income Taxes, we evaluate 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. We consider 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.

It is difficult to conclude a valuation allowance is not required when there is significant objective and verifiable negative evidence, such as cumulative losses in recent years. We utilize a rolling three years of actual and current year anticipated results as the primary measure of cumulative losses in recent years. The evaluation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns and future profitability. Our accounting for deferred tax consequences represents our best estimate of those future events. Changes in our current estimates, due to unanticipated events or otherwise, could have a material effect on our financial condition and results of operations. At September 30, 2015 as a result of sustained profitability in the U.S. evidenced by three years of earnings and forecasted continuing profitability, we determined it was more likely than not future earnings will be sufficient to realize deferred tax assets in the U.S. Accordingly we reversed most of our U.S. valuation allowance resulting in non-cash income tax benefit of $80.7 million for the year ended December 31, 2015. We continue to carry a $1.4 million valuation allowance against certain deferred tax assets as of March 31, 2016.

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

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

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

The amount of taxable income or loss we report to the various tax jurisdictions is subject to ongoing audits by federal, state and foreign tax authorities. Our estimate of the potential outcome of any uncertain tax issue is subject to management’s assessment of relevant risks, facts, and circumstances existing at that time. We use a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. We record a liability for the difference between the benefit recognized and measured and tax position taken or expected to be taken on our tax return. To the extent that our assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. We had no unrecognized tax benefits as of March 31, 2016. We report tax-related interest and penalties as a component of income tax expense.

For further information regarding the accounting policies that we believe to be critical accounting policies and that affect our more significant judgments and estimates used in preparing our interim condensed consolidated financial statements see our 2015 Annual Report on Form 10-K.

Recent Accounting Pronouncements

See Note 1, “Description of Business and Basis of Presentation” to our interim condensed consolidated financial statements for disclosure on recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our primary exposure to market risk is interest rate risk associated with our debt instruments. We use both fixed and variable rate debt as sources of financing. In 2014, we entered into a $175.0 million Term A Credit Agreement.

Borrowings under the Term A Credit Agreement bear interest at a rate equal to an applicable margin plus a variable rate. As such, our Term A Credit Agreement exposes us to market risk for changes in interest rates. To manage our exposure to interest rate volatility associated with borrowings under our Term A Credit Agreement, we entered into interest rate cap agreements in the first quarter of 2015. We have not, and do not plan to, enter into any derivative financial instruments for trading or speculative purposes.

As of March 31, 2016, we had $168.5 million of total debt and capital lease obligations, of which approximately 18% was at a fixed rate, with the remainder at variable rates. Given our outstanding indebtedness at March 31, 2016, the effect of a 100 basis point increase in LIBOR on our interest expense would be approximately $1.0 million annually.

Although we have international operating entities, our exposure to foreign currency rate fluctuations is not significant to our financial condition or results of operations.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, or the Exchange Act, are recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2016. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that as of March 31, 2016, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes to internal control over financial reporting during the three months ended March 31, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Information concerning certain risks and uncertainties appears in Part I, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. You should carefully consider those risks and uncertainties, which could materially affect our business, financial condition and results of operations. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

Issuer Purchases of Equity Securities

(In thousands, except for price per share)	(a) Total Number of Shares Purchased (1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares That May Yet Be Purchased Under The Plans or Programs (1)
Period				
January 1, 2016—January 31, 2016	—	$ —	—	$ —
February 1, 2016—February 29, 2016	4	$ 3.41	4	$ 14,988
March 1, 2016—March 31, 2016	700	$ 3.88	700	$ 12,255
Total	704		704	

(1) On February 8, 2016, we announced that the Company's Board of Directors 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.

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Item 6. Exhibits

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

* Filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 4, 2016

ARC DOCUMENT SOLUTIONS, INC.

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

/s/ JORGE AVALOS
Jorge Avalos
Chief Financial Officer

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