

CYBEROPTICS CORP  
Form 10-Q  
August 07, 2017  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Check One)

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

For the quarterly period ended June 30, 2017

TRANSITION PURSUANT TO SECTION 13 OR 15(D)  
OF THE SECURITIES EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NO. (0-16577)

CYBEROPTICS CORPORATION  
(Exact name of registrant as specified in its charter)

Minnesota  
(State or other jurisdiction of  
incorporation or organization)

41-1472057  
(I.R.S. Employer  
Identification No.)

5900 Golden Hills Drive  
MINNEAPOLIS, MINNESOTA  
(Address of principal executive offices)

55416  
(Zip Code)

(763) 542-5000  
(Registrant's telephone number, including area code)

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. At July 31, 2017, there were 6,971,265 shares of the registrant's Common Stock, no par value, issued and outstanding.

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## CONDENSED CONSOLIDATED BALANCE SHEETS

## CYBEROPTICS CORPORATION

(Unaudited)

(In thousands, except share information)	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 7,233	\$ 10,640
Marketable securities	6,143	6,493
Accounts receivable, less allowance for doubtful accounts of \$533 at June 30, 2017 and \$547 at December 31, 2016	13,759	10,895
Inventories	16,186	11,531
Other current assets	1,644	1,535
Total current assets	44,965	41,094
Marketable securities, long-term	9,312	8,728
Equipment and leasehold improvements, net	2,339	2,438
Intangible assets, net	424	438
Goodwill	1,366	1,366
Other assets	200	193
Deferred tax assets	5,389	5,323
Total assets	\$ 63,995	\$ 59,580
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 9,580	\$ 6,217
Advance customer payments	568	328
Accrued expenses	2,444	3,756
Total current liabilities	12,592	10,301
Other liabilities	175	250
Reserve for income taxes	131	131
Total liabilities	12,898	10,682
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized, none outstanding	—	—
	33,545	32,801

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Common stock, no par value, 25,000,000 shares authorized, 6,952,861 shares issued and outstanding at June 30, 2017 and 6,901,887 shares issued and outstanding at December 31, 2016

Accumulated other comprehensive loss	(1,628 )	(1,940 )
Retained earnings	19,180	18,037
Total stockholders' equity	51,097	48,898
Total liabilities and stockholders' equity	\$ 63,995	\$ 59,580

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

## CYBEROPTICS CORPORATION

(Unaudited)

(In thousands, except per share amounts)	<b>Three Months Ended June 30,</b>		Six Months Ended June 30,	
	<b>2017</b>	<b>2016</b>	2017	2016
Revenues	\$ 16,409	\$ 18,631	\$ 28,329	\$ 37,745
Cost of revenues	8,676	10,486	15,198	21,656
Gross margin	7,733	8,145	13,131	16,089
Research and development expenses	1,995	2,110	3,945	4,140
Selling, general and administrative expenses	4,058	4,031	8,028	7,537
Amortization of intangibles	18	17	35	34
Income from operations	1,662	1,987	1,123	4,378
Interest income and other	(28 )	98	(116 )	13
Income before income taxes	1,634	2,085	1,007	4,391
Income tax provision	539	44	126	87
Net income	\$ 1,095	\$ 2,041	\$ 881	\$ 4,304
Net income per share – Basic	\$ 0.16	\$ 0.30	\$ 0.13	\$ 0.63
Net income per share – Diluted	\$ 0.15	\$ 0.29	\$ 0.12	\$ 0.62
Weighted average shares outstanding – Basic	6,944	6,803	6,928	6,790
Weighted average shares outstanding – Diluted	7,253	7,051	7,083	6,943

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

## CYBEROPTICS CORPORATION

(Unaudited)

(In thousands)	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	2017	2016
Net Income	\$ 1,095	\$ 2,041	\$ 881	\$ 4,304
Other comprehensive income, before tax:				
Foreign currency translation adjustments	161	(76 )	430	194
Unrealized gains on available-for-sale securities:				
Unrealized gains	11	15	31	68
Reclassification adjustments	—	—	—	—
Total unrealized gains on available-for-sale securities	11	15	31	68
Unrealized gains on foreign exchange forward contracts:				
Unrealized gains (losses)	—	(7 )	—	53
Reclassification adjustments for losses included in net income	—	5	—	36
Total unrealized gains (losses) on foreign exchange forward contracts	—	(2 )	—	89
Other comprehensive income (loss), before tax	172	(63 )	461	351
Income tax provision related to items of other comprehensive income (loss)	(63 )	—	(149 )	—
Other comprehensive income (loss), net of tax	109	(63 )	312	351
Total comprehensive income	\$ 1,204	\$ 1,978	\$ 1,193	\$ 4,655

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

## CYBEROPTICS CORPORATION

(Unaudited)

(In thousands)	Six Months Ended June 30,	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 881	\$ 4,304
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,086	1,014
Provision for doubtful accounts	—	40
Deferred taxes	95	11
Foreign currency transaction losses (gains)	198	(21 )
Stock compensation costs	400	552
Changes in operating assets and liabilities:		
Accounts receivable	(2,864 )	(3,399 )
Inventories	(4,751 )	663
Other assets	(56 )	(575 )
Accounts payable	3,215	523
Advance customer payments	240	706
Accrued expenses	(1,403 )	1,427
Net cash provided by (used in) operating activities	(2,959 )	5,245
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities of available-for-sale marketable securities	3,531	1,631
Proceeds from sales of available-for-sale marketable securities	—	1,402
Purchases of available-for-sale marketable securities	(3,746 )	(2,069 )
Additions to equipment and leasehold improvements	(523 )	(656 )
Additions to patents	(72 )	(43 )
Net cash provided by (used in) investing activities	(810 )	265
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	321	258
Net cash provided by financing activities	321	258
Effects of exchange rate changes on cash and cash equivalents	41	40
Net increase (decrease) in cash and cash equivalents	(3,407 )	5,808
Cash and cash equivalents – beginning of period	10,640	4,274
Cash and cash equivalents – end of period	\$ 7,233	\$ 10,082

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.



## NOTES TO THE UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## CYBEROPTICS CORPORATION

## 1. INTERIM REPORTING:

The interim condensed consolidated financial statements presented herein as of June 30, 2017, and for the three and six month periods ended June 30, 2017 and 2016, are unaudited, but in the opinion of management, include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented.

The results of operations for the three and six month period ended June 30, 2017 do not necessarily indicate the results to be expected for the full year. The December 31, 2016 consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2016.

## 2. MARKETABLE SECURITIES:

Our investments in marketable securities are classified as available-for-sale and consist of the following:

(In thousands)	June 30, 2017			Fair Value
	Cost	Unrealized Gains	Unrealized Losses	
<b>Short-Term</b>				
U.S. government and agency obligations	\$ 5,235	\$ —	\$ (7 )	\$ 5,228
Corporate debt securities and certificates of deposit	916	—	(1 )	915
Marketable securities – short-term	\$ 6,151	\$ —	\$ (8 )	\$ 6,143
<b>Long-Term</b>				
U.S. government and agency obligations	\$ 4,143	\$ —	\$ (12 )	\$ 4,131
Corporate debt securities and certificates of deposit	1,971	1	(9 )	1,963
Asset backed securities	3,136	1	(5 )	3,132
Equity security	42	44	—	86
Marketable securities – long-term	\$ 9,292	\$ 46	\$ (26 )	\$ 9,312

December 31, 2016

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(In thousands)	Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>Short-Term</b>				
U.S. government and agency obligations	\$ 5,005	\$ 4	\$ (1 )	\$ 5,008
Corporate debt securities and certificates of deposit	1,476	1	(1 )	1,476
Asset backed securities	9	—	—	9
Marketable securities – short-term	\$ 6,490	\$ 5	\$ (2 )	\$ 6,493
<b>Long-Term</b>				
U.S. government and agency obligations	\$ 4,815	\$ 1	\$ (12 )	\$ 4,804
Corporate debt securities and certificates of deposit	2,161	—	(17 )	2,144
Asset backed securities	1,732	—	(5 )	1,727
Equity security	42	11	—	53
Marketable securities – long-term	\$ 8,750	\$ 12	\$ (34 )	\$ 8,728

Net pre-tax unrealized gains for marketable securities of \$12,000 at June 30, 2017 and net pre-tax unrealized losses for marketable securities of \$19,000 at December 31, 2016 were recorded as a component of accumulated other comprehensive loss in stockholders' equity. No marketable securities were sold in the six months ended June 30, 2017. We received proceeds from the sale of marketable securities in the three and six months ended June 30, 2016 of \$625,000 and \$1.4 million, respectively. No gain or loss was recognized on the sale of marketable securities in the three and six months ended June 30, 2016.

Our investments in marketable debt securities all have maturities of less than five years. At June 30, 2017, marketable debt securities valued at \$2.5 million were in an unrealized gain position totaling \$2,000, and marketable debt securities valued at \$12.9 million were in an unrealized loss position totaling \$34,000 (all of these securities had been in an unrealized loss position for less than 12 months). At December 31, 2016, marketable debt securities valued at \$6.4 million were in an unrealized gain position totaling \$6,000, and marketable debt securities valued at \$8.8 million were in an unrealized loss position totaling \$36,000 (all of these securities had been in an unrealized loss position for less than 12 months).

Investments in marketable securities classified as cash equivalents of \$4.4 million at June 30, 2017 and \$5.2 million at December 31, 2016 consist of the following:

	June 30, 2017			
(In thousands)	Cost	Unrealized Gains	Unrealized Losses	Recorded Basis
Money market and certificates of deposit	\$ 4,402	\$ —	\$ —	\$ 4,402
	\$ 4,402	\$ —	\$ —	\$ 4,402
	December 31, 2016			
(In thousands)	Cost	Unrealized Gains	Unrealized Losses	Recorded Basis
Money market and certificates of deposit	\$ 5,195	\$ —	\$ —	\$ 5,195
	\$ 5,195	\$ —	\$ —	\$ 5,195

Cash and marketable securities held by foreign subsidiaries totaled \$307,000 at June 30, 2017 and \$614,000 at December 31, 2016.

### 3. DERIVATIVES:

We may enter into foreign exchange forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies associated with our subsidiary in Singapore. These transactions are designated as cash flow hedges and are recorded in the accompanying consolidated balance sheet at fair value. The effective portion of the gain or loss on these derivatives is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period during which the hedged transaction affects earnings. Gains and losses on the derivatives representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. The maximum length of time over which we hedge our exposure to the variability in future cash flows is 12 months.

There were no open cash flow hedges at December 31, 2016 or at any time during the six months ended June 30, 2017. In the three and six months ended June 30, 2016, hedge ineffectiveness and the amounts excluded from effectiveness testing recognized in earnings on cash flow hedges were not material.

Reclassifications of amounts from accumulated other comprehensive income (loss) into earnings for cash flow hedges include accumulated gains (losses) at the time earnings were impacted by the hedged transaction. The location in the consolidated statements of operations and consolidated statements of comprehensive income and amounts of gains and losses related to derivative instruments designated as cash flow hedges are as follows:

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(In thousands)	Three Months Ended June 30, 2016	
	Pretax Loss Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Loss Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Loss
Cost of revenues	\$ (4 )	\$ (2 )
Research and development	(2 )	(2 )
Selling, general and administrative	(1 )	(1 )
Total	\$ (7 )	\$ (5 )

(In thousands)	Six Months Ended June 30, 2016	
	Pretax Gain Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Loss Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Loss
Cost of revenues	\$ 32	\$ (27 )
Research and development	14	(6 )
Selling, general and administrative	7	(3 )
Total	\$ 53	\$ (36 )

At June 30, 2017 and December 31, 2016, there were no amounts recorded in accumulated other comprehensive loss for cash flow hedging instruments. Additional information with respect to the impact of derivative instruments on other comprehensive income (loss) is included in Note 11.

## 4. FAIR VALUE MEASUREMENTS:

We determine the fair value of our assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (i.e., the exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. We use a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last is considered unobservable, to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1). The next highest priority is based on quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in non-active markets or other observable inputs (Level 2). The lowest priority is given to unobservable inputs (Level 3). The following provides information regarding fair value measurements for our marketable securities as of June 30, 2017 and December 31, 2016 according to the three-level fair value hierarchy:

(In thousands)	Fair Value Measurements at June 30, 2017 Using			
	Balance June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable securities:				
U.S. government and agency obligations	\$ 9,359	\$ —	\$ 9,359	\$ —
Corporate debt securities and certificates of deposit	2,878	—	2,878	—
Asset backed securities	3,132	—	3,132	—
Equity security	86	86	—	—
Total marketable securities	\$ 15,455	\$ 86	\$ 15,369	\$ —
(In thousands)	Fair Value Measurements at December 31, 2016 Using			
	Balance December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable securities:				
U.S. government and agency obligations	\$ 9,812	\$ —	\$ 9,812	\$ —
Corporate debt securities and certificates of deposit	3,620	—	3,620	—
Asset backed securities	1,736	—	1,736	—
Equity security	53	53	—	—
Total marketable securities	\$ 15,221	\$ 53	\$ 15,168	\$ —

During the six months ended June 30, 2017 and the year ended December 31, 2016, there were no transfers within the three level hierarchy. A significant transfer is recognized when the inputs used to value a security have been changed sufficiently to merit a transfer between the disclosed levels of the valuation hierarchy.

The fair value for our U.S. government and agency obligations, corporate debt securities and certificates of deposit and asset backed securities are determined based on valuations provided by external investment managers which obtain them from a variety of industry standard data providers. The fair value for our equity security is based on a quoted market price obtained from an active market.

The carrying amounts of financial instruments such as cash equivalents, accounts receivable, other assets, accounts payable, advance customer payments, accrued expenses and other liabilities are approximately equal to their related fair values due to their short-term maturities. Non-financial assets such as equipment and leasehold improvements, goodwill and intangible assets are subject to non-recurring fair value measurements if they are deemed impaired. We had no re-measurements of non-financial assets to fair value in the six months ended June 30, 2017 or the six months ended June 30, 2016.

## 5. ACCOUNTING FOR STOCK-BASED COMPENSATION:

We have three stock-based compensation plans that are administered by the Compensation Committee of the Board of Directors. We have an Employee Stock Incentive Plan for officers, other employees, consultants and independent contractors under which we have granted options and restricted stock units to officers and other employees, an Employee Stock Purchase Plan under which shares of our common stock may be acquired by employees at discounted prices, and a Non-Employee Director Stock Plan that provides for automatic grants of shares of our common stock to non-employee directors. New shares of our common stock are issued upon stock option exercises, vesting of restricted stock units, issuances of shares to board members and issuances of shares under the Employee Stock Purchase Plan.

### Employee Stock Incentive Plan

As of June 30, 2017, there were 427,739 shares of common stock reserved in the aggregate for issuance pursuant to future awards under our Employee Stock Incentive Plan and 531,424 shares of common stock reserved in the aggregate for issuance pursuant to outstanding awards under our Employee Stock Incentive Plan. Although our Compensation Committee has authority to issue options, restricted stock, restricted stock units, share grants and other share based benefits under our Employee Stock Incentive Plan, to date only restricted stock units and stock options have been granted under the plan. Options have been granted at an option price per share equal to the market value of our common stock on the date of grant, vest over a four-year period and expire seven years after the date of grant. Restricted stock units vest over a four year period and entitle the holders to one share of our common stock for each restricted stock unit. Reserved shares underlying outstanding awards, including options and restricted shares, that are forfeited are available under the Employee Stock Incentive Plan for future grant.

### Non-Employee Director Stock Plan

As of June 30, 2017, there were 68,000 shares of common stock reserved in the aggregate for issuance pursuant to future awards under our Non-Employee Director Stock Plan and 16,000 shares of common stock reserved in the aggregate for issuance pursuant to outstanding stock option awards under our Non-Employee Director Stock Plan. Under the terms of the plan, each non-employee director will automatically be granted 2,000 shares of our common stock on the date of each annual meeting at which such director is elected to serve on the board. At our May 11, 2017 annual meeting, our shareholders, upon recommendation of the Board of Directors, approved amendments to the Non-Employee Director Stock Plan that eliminated annual stock option grants for non-employee directors and provide that share grants under the Non-Employee Director Stock Plan will vest in four equal quarterly installment during the year after the grant date provided the non-employee director is still serving as a director on the applicable vesting date.



Pursuant to the plan, on the date of our 2017 annual meeting, we issued a total of 8,000 shares of our common stock to our non-employee directors. The shares had an aggregate fair market value on the date of grant equal to \$167,000 (grant date fair value of \$20.90 per share). As of June 30, 2017, none of these shares were vested. The aggregate fair value of the outstanding unvested shares based on the closing share price of our common stock on June 30, 2017 was \$165,000.

Pursuant to the plan, on the date of our 2016 annual meeting, we issued a total of 8,000 shares of our common stock and stock options to acquire 16,000 shares of our common stock to our non-employee directors. Both the shares and the options were fully vested on the date of grant. The shares had an aggregate fair market value on the date of grant equal to \$136,000 (grant date fair value of \$16.97 per share) and the options had an aggregate fair market value on the date of grant using the Black-Scholes model equal to \$139,000 (grant date fair value of \$8.71 per option to acquire one share of our common stock).

#### Stock Option Activity

The following is a summary of stock option activity in the six months ended June 30, 2017:

	Options Outstanding	Weighted Average Exercise Price Per Share
Outstanding, December 31, 2016	547,625	\$ 9.39
Granted	—	—
Exercised	(40,750 )	9.31
Expired	—	—
Forfeited	—	—
Outstanding, June 30, 2017	506,875	\$ 9.40
Exercisable, June 30, 2017	246,313	\$ 8.27

The intrinsic value of an option is the amount by which the market price of the underlying stock exceeds the option's exercise price. For options outstanding at June 30, 2017, the weighted average remaining contractual term of all outstanding options was 4.4 years and their aggregate intrinsic value was \$5.9 million. At June 30, 2017, the weighted average remaining contractual term of options that were exercisable was 3.9 years and their aggregate intrinsic value was \$3.0 million. The aggregate intrinsic value of stock options exercised in the six months ended June 30, 2017 was \$668,000. We received proceeds from stock option exercises of \$321,000 in the six months ended June 30, 2017 and \$258,000 in the six months ended June 30, 2016. The total fair value of options that vested in the six months ended June 30, 2017 was \$117,000.

### Restricted Stock Units

Restricted stock units are granted under our Employee Stock Incentive Plan. There were no restricted stock units granted in the six months ended June 30, 2017. The aggregate fair value of outstanding restricted stock units based on the closing share price of our common stock on June 30, 2017 was \$837,000. The aggregate fair value of restricted stock units that vested, based on the closing share price of our common stock on the vesting date, in the six months ended June 30, 2017 was \$170,000.

A summary of activity for non-vested restricted stock units in the six months ended June 30, 2017 is as follows:

Non-vested restricted stock units	Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2016	45,549	\$ 11.93
Granted	—	—
Vested	(5,000 )	6.97
Forfeited	—	—
Non-vested at June 30, 2017	40,549	\$ 12.54

### Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan available to eligible U.S. employees. Under terms of the plan, eligible employees may designate from 1% to 10% of their compensation to be withheld through payroll deductions, up to a maximum of \$6,500 in each plan year, for the purchase of common stock at 85% of the lower of the market price on the first or last day of the offering period. There were no shares issued under this plan in either the six months ended June 30, 2017 or the six months ended June 30, 2016. As of June 30, 2017, 59,276 shares remain available for future issuance under the Employee Stock Purchase Plan.

## Stock Based Compensation Information

All equity-based compensation awarded to our employees and non-employee directors, representing grants of shares, stock options and restricted stock units are recognized as an expense in our consolidated statement of operations based on the grant date fair value of the award. We utilize the straight-line method of expense recognition over the vesting period for our options subject to time-based vesting restrictions. The fair value of stock options granted has been determined using the Black-Scholes model. Prior to January 1, 2017, stock compensation expense for all equity based awards was recognized based on the number of awards that were expected to vest. On January 1, 2017, we adopted the provisions of Accounting Standards Update (ASU) No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which permits accounting for the impact of stock option forfeitures on stock compensation expense when the forfeitures occur. In the six months ended June 30, 2017, the impact of the change in accounting for stock option forfeitures was inconsequential. We have classified equity-based compensation expenses within our statement of operations in the same manner as our cash based compensation costs.

Equity-based compensation expense in the three months ended June 30, 2017 totaled \$212,000, and included \$115,000 for stock options, \$26,000 for our Employee Stock Purchase Plan, \$48,000 for unvested restricted stock units and \$23,000 for unvested restricted shares. Equity-based compensation expense in the six months ended June 30, 2017 totaled \$400,000, and included \$229,000 for stock options, \$52,000 for our Employee Stock Purchase Plan, \$96,000 for unvested restricted stock units and \$23,000 for unvested restricted shares.

Equity based compensation expense in the three months ended June 30, 2016 totaled \$409,000, and included \$226,000 for stock options, \$16,000 for our Employee Stock Purchase Plan, \$31,000 for unvested restricted stock units and \$136,000 for shares issued without restriction. Equity based compensation expense in the six months ended June 30, 2016 totaled \$552,000, and included \$321,000 for stock options, \$32,000 for our Employee Stock Purchase Plan, \$63,000 for unvested restricted stock units and \$136,000 for shares issued without restriction.

At June 30, 2017, the total unrecognized compensation cost related to non-vested equity based compensation arrangements was \$1.4 million, and the related weighted average period over which it is expected to be recognized is 1.51 years.

**6. CHANGES IN STOCKHOLDERS' EQUITY:**

A reconciliation of the changes in our stockholders' equity is as follows:

(In thousands)	Common Stock		Accumulated		Total Stockholders' Equity
	Shares	Amount	Other Comprehensive Income (Loss)	Retained Earnings	
Balance, December 31, 2016	6,902	\$ 32,801	\$ (1,940)	\$ 18,037	\$ 48,898
Increase related to adoption of ASU 2016-09	—	23	—	262	285
Exercise of stock options, vesting of restricted stock units, net of shares exchanged as payment	51	321	—	—	321
Stock-based compensation	—	400	—	—	400
Other comprehensive income, net of tax	—	—	312	—	312
Net income	—	—	—	881	881
Balance, June 30, 2017	6,953	\$ 33,545	\$ (1,628)	\$ 19,180	\$ 51,097

See Note 14 for further discussion regarding the impact of our adoption of ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting* on our consolidated financial statements.

**7. OTHER FINANCIAL STATEMENT DATA:**

The components of our inventories are as follows:

(In thousands)	June 30, 2017	December 31, 2016
Raw materials and purchased parts	\$ 8,301	\$ 6,475
Work in process	2,643	826
Finished goods	5,242	4,230
Total inventories	\$ 16,186	\$ 11,531

The components of our accrued expenses are as follows:

(In thousands)	June 30, 2017	December 31, 2016
Wages and benefits	\$ 1,233	\$ 2,673
Warranty liability	709	717
Other	502	366
	\$ 2,444	\$ 3,756

Warranty costs:

We provide for the estimated cost of product warranties, which cover products for periods ranging from one to three years, at the time revenue is recognized. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of component suppliers, warranty obligations are affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. If actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required and could be material. At the end of each reporting period, we revise our estimated warranty liability based on these factors. The current portion of our warranty liability is included as a component of accrued expenses. The long-term portion of our warranty liability is included as a component of other liabilities.

A reconciliation of the changes in our estimated warranty liability is as follows:

(In thousands)	Six Months Ended June 30,	
	2017	2016
Balance at beginning of period	\$ 790	\$ 645
Accrual for warranties	250	447
Warranty revision	(24 )	(25 )
Settlements made during the period	(260 )	(295 )
Balance at end of period	756	772
Current portion of estimated warranty liability	(709 )	(685 )
Long-term estimated warranty liability	\$ 47	\$ 87

Deferred warranty revenue:

The current portion of our deferred warranty revenue is included as a component of advance customer payments. The long-term portion of our deferred warranty revenue is included as a component of other liabilities. A reconciliation of the changes in our deferred warranty revenue is as follows:

(In thousands)	Six Months Ended June 30,	
	2017	2016
Balance at beginning of period	\$ 346	\$ 199
Revenue deferrals	204	203
Amortization of deferred revenue	(209 )	(226 )
Total deferred warranty revenue	341	176
Current portion of deferred warranty revenue	(300 )	(171 )
Long-term deferred warranty revenue	\$ 41	\$ 5

## 8. INTANGIBLE ASSETS:

Intangible assets consist of the following:

(In thousands)	June 30, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$ 2,639	\$ (2,402 )	\$ 237	\$ 2,567	\$ (2,351 )	\$ 216
Software	206	(98 )	108	206	(82 )	124
Marketing assets and customer relationships	101	(39 )	62	101	(33 )	68
Non-compete agreements	101	(84 )	17	101	(71 )	30

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\$ 3,047    \$ (2,623 )    \$ 424    \$ 2,975    \$ (2,537 )    \$ 438

Amortization expense in the three and six months ended June 30, 2017 and 2016 is as follows:

(In thousands)	<b>Three Months Ended June 30,</b>		Six Months Ended June 30,	
	<b>2017</b>	<b>2016</b>	2017	2016
Patents	\$ 26	<b>\$ 26</b>	\$ 51	\$ 52
Software	8	8	16	15
Marketing assets and customer relationships	3	3	6	6
Non-compete agreements	7	6	13	13
	\$ 44	\$ 43	\$ 86	\$ 86

Amortization of patents has been classified as research and development expense in our statements of operations. Estimated aggregate amortization expense based on current intangibles for the next five years is expected to be as follows: \$82,000 for the remainder of 2017; \$130,000 in 2018; \$97,000 in 2019; \$75,000 in 2020; \$20,000 in 2021; and \$20,000 in 2022.

Intangible and other long lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss would be recognized when future undiscounted cash flows expected to result from use of the asset and eventual disposition are less than the carrying amount.

#### 9. REVENUE CONCENTRATIONS, SIGNIFICANT CUSTOMERS AND GEOGRAPHIC AREAS:

Export sales as a percentage of total sales in the three and six months ended June 30, 2017 were 74% and 76%, respectively. Export sales as a percentage of total sales in the three and six months ended June 30, 2016 were 81% and 83%, respectively. Virtually all of our export sales are negotiated, invoiced and paid in U.S. dollars. Export sales by geographic area are summarized as follows:

(In thousands)	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Americas	\$ 397	\$ 29	\$ 817	\$ 770
Europe	3,756	5,756	6,571	9,871
Asia	7,813	9,262	13,974	20,647
Other	105	19	144	34
Total export sales	\$ 12,071	\$ 15,066	\$ 21,506	\$ 31,322

In the six months ended June 30, 2017, sales to one significant customer accounted for 12% of our total revenue. As of June 30, 2017, accounts receivable from this customer were \$1.4 million.

#### 10. NET INCOME PER SHARE:

Net income per basic share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Net income per diluted share is computed by dividing net income by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of common shares to be issued upon exercise of stock options, the vesting of restricted shares and restricted stock units and from the purchase of shares under our Employee Stock Purchase Plan, as calculated using the treasury stock method. The components of net income per basic and diluted share are as follows:



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(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Three Months Ended June 30, 2017			
Basic	\$ 1,095	6,944	\$ 0.16
Dilutive effect of common equivalent shares	—	309	(0.01 )
Dilutive	\$ 1,095	7,253	\$ 0.15

(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Three Months Ended June 30, 2016			
Basic	\$ 2,041	6,803	\$ 0.30
Dilutive effect of common equivalent shares	—	248	(0.01 )
Dilutive	\$ 2,041	7,051	\$ 0.29

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(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Six Months Ended June 30, 2017			
Basic	\$ 881	6,928	\$ 0.13
Dilutive effect of common equivalent shares	—	155	(0.01 )
Dilutive	\$ 881	7,083	\$ 0.12

(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Six Months Ended June 30, 2016			
Basic	\$ 4,304	6,790	\$ 0.63
Dilutive effect of common equivalent shares	—	153	(0.01 )
Dilutive	\$ 4,304	6,943	\$ 0.62

Potentially dilutive shares excluded from the calculations of net income per diluted share due to their anti-dilutive effect were as follows: 47,700 shares in the three months ended June 30, 2017; 329,350 shares in the six months ended June 30, 2017; 16,000 shares in the three months ended June 30, 2016; and 197,500 shares in the six months ended June 30, 2016.

#### 11. OTHER COMPREHENSIVE INCOME (LOSS):

Reclassification adjustments are made to avoid double counting for items included in comprehensive income that are also recorded as part of net income. Reclassifications to earnings related to cash flow hedging instruments are discussed in Note 3.

(In thousands)	Three Months Ended June 30, 2017			Three Months Ended June 30, 2016		
	Before Tax	Tax Effect	Net of Tax Amount	Before Tax	Tax Effect	Net of Tax Amount
Foreign currency translation adjustments	\$ 161	\$ (59)	\$ 102	\$ (76)	\$ —	\$ (76)
Net changes related to available-for-sale securities:						
Unrealized gains	11	(4)	7	15	—	15
Reclassification adjustments	—	—	—	—	—	—
Total net changes related to available-for-sale securities	11	(4)	7	15	—	15
Net changes related to foreign exchange forward contracts:						

\$

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Unrealized losses	—	—	—	(7	)	—	(7	)				
Reclassification adjustments:												
Cost of revenues	—	—		—	2	—		2				
Research and development expenses	—	—	—	2		—		2				
Selling, general and administrative expenses	—	—	—	1		—		1				
Total net change related to foreign exchange forward contracts	—	—	—	(2	)	—		(2	)			
Other comprehensive income (loss)	\$	172	\$	(63)	\$	109	\$	(63)	\$	—	\$	(63)

(In thousands)	Six Months Ended June 30, 2017			Six Months Ended June 30, 2016		
	Before Tax	Tax Effect	Net of Tax Amount	Before Tax	Tax Effect	Net of Tax Amount
Foreign currency translation adjustments	\$ 430	\$ (138)	\$ 292	\$ 194	\$	-\$ 194
Net changes related to available-for-sale securities:						
Unrealized gains	31	(11)	20	68		