CYBEROPTICS CORP
Form 10-Q
November 06, 2018

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Check One)

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

For the quarterly period ended September 30, 2018

o 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	**41-1472057**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5900 Golden Hills Drive MINNEAPOLIS, MINNESOTA	**55416**
(Address of principal executive offices)	(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 þ No o

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 þ No o

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 o No þ

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date. At October 31, 2018, there were 7,078,190 shares of the registrant’s Common Stock, no par value, issued and outstanding.

PART I. FINANCIAL INFORMATION

ITEM 1. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS

CYBEROPTICS CORPORATION

(Unaudited)

(In thousands, except share information)	September 30, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 7,633	$ 6,944
Marketable securities	6,396	6,670
Accounts receivable, less allowance for doubtful accounts of $290 at September 30, 2018 and $473 at December 31, 2017	14,525	10,772
Inventories	13,935	14,393
Other current assets	2,314	1,593
Total current assets	44,803	40,372
Marketable securities, long-term	9,806	9,073
Equipment and leasehold improvements, net	2,326	2,307
Intangible assets, net	333	380
Goodwill	1,366	1,366
Other assets	201	261
Deferred tax assets	5,546	5,742
Total assets	$ 64,381	$ 59,501
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 5,380	$ 4,294
Advance customer payments	1,240	393
Accrued expenses	2,656	2,285
Total current liabilities	9,276	6,972
Other liabilities	156	88
Reserve for income taxes	159	159
Total liabilities	9,591	7,219
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized, none outstanding	—	—
Common stock, no par value, 25,000,000 shares authorized, 7,064,089 shares issued and	35,452	34,080

outstanding at September 30, 2018 and 6,979,686 shares issued and outstanding at December 31, 2017		
Accumulated other comprehensive loss	(1,733)	(1,409)
Retained earnings	21,071	19,611
Total stockholders’ equity	54,790	52,282
Total liabilities and stockholders’ equity	$ 64,381	$ 59,501

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

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

CYBEROPTICS CORPORATION

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Revenues	$ 16,683	$ 11,828	$ 46,657	$ 40,157
Cost of revenues	9,247	6,236	25,738	21,434
Gross margin	7,436	5,592	20,919	18,723
Research and development expenses	2,162	1,947	6,585	5,892
Selling, general and administrative expenses	3,935	3,793	12,413	11,821
Amortization of intangibles	10	15	35	50
Income (loss) from operations	1,329	(163)	1,886	960
Interest income and other	35	(25)	192	(141)
Income (loss) before income taxes	1,364	(188)	2,078	819
Income tax expense (benefit)	297	(116)	444	10
Net income (loss)	$ 1,067	$ (72)	$ 1,634	$ 809
Net income (loss) per share – Basic	$ 0.15	$ (0.01)	$ 0.23	$ 0.12
Net income (loss) per share – Diluted	$ 0.15	$ (0.01)	$ 0.23	$ 0.11
Weighted average shares outstanding – Basic	7,041	6,959	7,012	6,939
Weighted average shares outstanding – Diluted	7,299	6,959	7,176	7,041

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

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

CYBEROPTICS CORPORATION

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2018**	**2017**	**2018**	**2017**
Net income (loss)	$ 1,067	$ (72)	$ 1,634	$ 809
Other comprehensive income, before tax:				
Foreign currency translation adjustments	(50)	157	(252)	587
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses)	3	—	(33)	31
Reclassification adjustment for gains included in net income	(3)	—	(3)	—
Total unrealized gains (losses) on available-for-sale securities	—	—	(36)	31
Other comprehensive income (loss), before tax	(50)	157	(288)	618
Income tax provision (benefit), other comprehensive income	—	(35)	8	(184)
Other comprehensive income (loss), net of tax	(50)	122	(280)	434
Total comprehensive income	$ 1,017	$ 50	$ 1,354	$ 1,243

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

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

CYBEROPTICS CORPORATION

(Unaudited)

(In thousands)	Nine Months Ended September 30, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,634	$ 809
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,876	1,659
Provision for doubtful accounts	(159)	(15)
Deferred taxes	261	(27)
Foreign currency transaction (gains) losses	(140)	139
Stock based compensation	701	640
Unrealized loss on available-for-sale equity security	24	—
Realized gain on available-for-sale marketable securities	(3)	—
Changes in operating assets and liabilities:		
Accounts receivable	(3,594)	(1,022)
Inventories	(387)	(5,260)
Other assets	(692)	(133)
Accounts payable	1,124	866
Advance customer payments	638	(3)
Accrued expenses	382	(1,906)
Net cash provided by (used in) operating activities	1,665	(4,253)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities of available-for-sale marketable securities	6,018	5,187
Proceeds from sales of available-for-sale marketable securities	480	—
Purchases of available-for-sale marketable securities	(7,006)	(5,604)
Additions to equipment and leasehold improvements	(1,079)	(851)
Additions to patents	(76)	(107)
Net cash used in investing activities	(1,663)	(1,375)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	452	330
Proceeds from issuance of common stock under Employee Stock Purchase Plan	219	258
Net cash provided by financing activities	671	588
Effects of exchange rate changes on cash and cash equivalents	16	(7)
Net increase (decrease) in cash and cash equivalents	689	(5,047)

Cash and cash equivalents – beginning of period	6,944	10,640
Cash and cash equivalents – end of period	$ 7,633	$ 5,593

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 of CyberOptics Corporation ("we", "us" or "our") presented herein as of September 30, 2018, and for the three and nine month periods ended September 30, 2018 and 2017, 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 nine month periods ended September 30, 2018 do not necessarily indicate the results to be expected for the full year. The December 31, 2017 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, 2017.

2. REVENUE RECOGNITION:

Change in Revenue Accounting

Effective January 1, 2018, we adopted ASU No. 2014-9, “*Revenue from Contracts with Customers*” and the related amendments (“Topic 606”) using the modified retrospective method. Topic 606 was applied to all uncompleted contracts by recognizing the cumulative effect of initially applying Topic 606 as an adjustment to the opening balance of retained earnings at January 1, 2018. Therefore, the comparative financial information for the three and nine months ended September 30, 2017 has not been adjusted and continues to be reported under Topic 605, “*Revenue Recognition*”.

Accounting for contracts recognized over time involves the use of various techniques to estimate total contract revenue and costs. Contract estimates are based on various assumptions to project the outcome of future events that may span multiple years. We review and update our contract-related estimates regularly, and record adjustments as needed.

The adoption of Topic 606 caused changes for (1) the impact of volume discounts that represent a material right which will now be estimated and recognized over the contract life rather than on a prospective basis, and (2) revenue will be recognized over time as the products are manufactured under certain contracts where our product is customized rather than at shipment. These changes increased our revenues in the three and nine months ended September 30, 2018 by $123,000 and $232,000, respectively, when compared to revenue recognition under Topic 605 (see Note 16).

Performance Obligations

Under Topic 606, revenue is measured based on consideration specified in the contract with a customer. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in Topic 606. Revenue from all customers, including distributors, is recognized when a performance obligation is satisfied by transferring control of a product or service to a customer. Amounts billed to customers for shipping and handling are included in revenue. Taxes collected from customers and remitted to governmental authorities are excluded from revenue on the net basis of accounting. Accounts receivable are due under normal trade terms, typically 90 days or less.

Sales involving multiple performance obligations typically include the sale of an inspection system or metrology product, installation and training, and in some cases, an extended warranty. When a sale involves multiple performance obligations, we account for individual products and services separately if the customer can benefit from the product or service on its own or with other resources that are readily available to the customer and the product or service are separately identifiable from other promises in the arrangement. The consideration is allocated between separate performance obligations in proportion to their estimated stand-alone selling price. If the stand-alone selling price is not directly observable, we use the cost plus margin approach to estimate stand-alone selling price. Costs related to products delivered are recognized in the period revenue is recognized, including product warranties for periods ranging from 1 to 3 years (see Note 7).

Our performance obligations are satisfied at a point in time or over time as work progresses. Revenue from products and services transferred to customers at a point in time in the three and nine months ended September 30, 2018 totaled $15.4 million and $43.4 million, respectively, which represented 93% of our total revenue in both periods. Revenue from these contracts is recognized when obligations under the terms of the contract with our customer are satisfied; generally with the transfer of control upon shipment. Sales of some products may require customer acceptance due to performance or other acceptance criteria that is considered more than a formality. For these product sales, revenue is recognized upon notification of customer acceptance.

Revenue from products and services transferred to customers over time in the three and nine months ended September 30, 2018 totaled $1.2 million and $3.3 million, respectively, which represented 7% of our total revenue in both periods. Periodically, sensor product arrangements with our original equipment manufacturers (OEMs) will create an asset with no alternative use and include an enforceable right to payment for cost plus margin. For these arrangements, control is transferred over the manufacturing process; therefore, revenue is recognized over time utilizing an input method based on actual costs incurred in the manufacturing process to date relative to total expected production costs. For certain longer duration 3D scanning service projects, we progress bill as the services are performed. These arrangements create an asset with no alternative use and include an enforceable right to payment. For these arrangements, control is transferred over the hours incurred to complete the scanning project; therefore, revenue is recognized over time utilizing an input method based on actual hours incurred relative to total projected project hours. For maintenance and extended warranty contracts, revenue is recognized over time on a straight-line basis over the term of the contract as the customer simultaneously receives and consumes the benefits of the coverage.

Contract Balances

Contract assets consist of unbilled amounts from sales where we recognize the revenue over time and the revenue recognized exceeds the amount billed to the customer at a point in time. Accounts receivable are recorded when the right to payment becomes unconditional. Contract liabilities consist of payments received in advance of performance under the contract. Contract liabilities are recognized as revenue when we perform under the contract. The following summarizes our contract assets and contract liabilities:

(In thousands)	**September 30, 2018**	**January 1, 2018**
Contract assets, included in other current assets	$ 170	$ —
Contract liabilities, included in advance customer payments/other liabilities	$ 918	$ 443

Changes in contract assets in the nine months ended September 30, 2018 resulted from unbilled amounts under sensor product arrangements in which revenue is recognized over time. Changes in contract liabilities primarily resulted from reclassification of beginning contract liabilities to revenue as performance obligations were satisfied or for cash received in advance and not recognized as revenue. Amounts reclassified from beginning contract liabilities to revenue in the three and nine months ended September 30, 2018 totaled $39,000 and $262,000, respectively. See Note 7 for changes in contractual obligations related to deferred warranty revenue. Unsatisfied performance obligations are generally expected to be recognized as revenue over the next one to three years. There were no impairment losses for contract assets in the nine months ended September 30, 2018.

Practical Expedients

We generally expense the incremental costs of obtaining a contract when incurred because the amortization period for these costs would be less than one year. These costs primarily relate to sales commissions and are recorded in selling, general and administrative expense in our consolidated statements of operations.

We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. We do not adjust the promised amount of consideration for the effects of a significant financing component if we expect, at contract inception, that the period between when we transfer a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

3. MARKETABLE SECURITIES:

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

(In thousands)	September 30, 2018 Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-Term				
U.S. government and agency obligations	$ 3,611	$ —	$ (20)	$ 3,591
Corporate debt securities and certificates of deposit	2,163	—	(8)	2,155
Asset backed securities	654	—	(4)	650
Marketable securities – short-term	$ 6,428	$ —	$ (32)	$ 6,396
Long-Term				
U.S. government and agency obligations	$ 6,399	$ —	$ (55)	$ 6,344
Corporate debt securities and certificates of deposit	230	—	(3)	227
Asset backed securities	3,184	—	(22)	3,162
Equity security	42	31	—	73
Marketable securities – long-term	$ 9,855	$ 31	$ (80)	$ 9,806

(In thousands)	December 31, 2017 Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-Term				
U.S. government and agency obligations	$ 4,381	$ —	$ (13)	$ 4,368
Corporate debt securities and certificates of deposit	1,792	—	(4)	1,788
Asset backed securities	515	—	(1)	514
Marketable securities – short-term	$ 6,688	$ —	$ (18)	$ 6,670
Long-Term				
U.S. government and agency obligations	$ 4,801	$ —	$ (33)	$ 4,768
Corporate debt securities and certificates of deposit	1,189	—	(10)	1,179
Asset backed securities	3,045	—	(16)	3,029
Equity security	42	55	—	97
Marketable securities – long-term	$ 9,077	$ 55	$ (59)	$ 9,073

	In Unrealized Loss Position For Less Than 12 Months		In Unrealized Loss Position For Greater Than 12 Months	
(In thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2018				
U.S. government and agency obligations	$ 5,185	$ (36)	$ 4,327	$ (39)

Corporate debt securities and certificates of deposit	628	(3)	1,324	(8)
Asset backed securities	2,343	(14)	1,469	(12)
Marketable securities	$ 8,156	$ (53)	$ 7,120	$ (59)
December 31, 2017				
U.S. government and agency obligations	$ 5,593	$ (29)	$ 3,543	$ (17)
Corporate debt securities and certificates of deposit	478	(2)	1,991	(12)
Asset backed securities	2,312	(9)	1,232	(8)
Marketable securities	$ 8,383	$ (40)	$ 6,766	$ (37)

Effective January 1, 2018, we adopted ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Liabilities,* which impacted the accounting for our marketable equity security (see Note 16). Our investments in marketable debt securities all have maturities of less than five years. Net pre-tax unrealized losses for marketable securities of $112,000 at September 30, 2018 and $22,000 at December 31, 2017 have been recorded as a component of accumulated other comprehensive loss in stockholders' equity. We have determined that the net pre-tax unrealized losses for marketable debt securities at September 30, 2018 and December 31, 2017 were caused by fluctuations in interest rates and are temporary in nature. We review our marketable securities to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which the fair value of the investment has been less than the cost basis, the credit quality of the investment and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. We received proceeds from sales of marketable securities of $480,000, and recognized a $3,000 gain on the sales, in the three and nine months ended September 30, 2018. No marketable securities were sold in the nine months ended September 30, 2017.

Investments in marketable securities classified as cash equivalents of $2.3 million at September 30, 2018 and $1.6 million at December 31, 2017 consist of corporate debt securities and certificates of deposit. There were no unrealized gains or losses associated with any of these securities at September 30, 2018 or December 31, 2017.

Cash and marketable securities held by foreign subsidiaries totaled $532,000 at September 30, 2018 and $187,000 at December 31, 2017.

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 to measure fair value, of which the first two are considered observable and the last is considered unobservable. 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 table provides information regarding fair value measurements for our marketable securities as of September 30, 2018 and December 31, 2017 according to the three-level fair value hierarchy:

	Fair Value Measurements at September 30, 2018 Using			
(In thousands)	**Balance September 30, 2018**	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**

		(Level 1)		
Marketable securities:				
U.S. government and agency obligations	$ 9,935	$ —	$ 9,935	$ —
Corporate debt securities and certificates of deposit	2,382	—	2,382	—
Asset backed securities	3,812	—	3,812	—
Equity security	73	73	—	—
Total marketable securities	$ 16,202	$ 73	$ 16,129	$ —

	Fair Value Measurements at December 31, 2017 Using			
(In thousands)	**Balance December 31, 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	$ 9,136	$ —	$ 9,136	$ —
Corporate debt securities and certificates of deposit	2,967	—	2,967	—
Asset backed securities	3,543	—	3,543	—
Equity security	97	97	—	—
Total marketable securities	$ 15,743	$ 97	$ 15,646	$ —

During the nine months ended September 30, 2018 and the year ended December 31, 2017, there were no transfers of assets between the different levels of 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 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 the valuations 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 nine months ended September 30, 2018 or the nine months ended September 30, 2017.

5. ACCOUNTING FOR STOCK-BASED COMPENSATION:

We have stock-based compensation plans that are administered by the Compensation Committee of the Board of Directors. We have (1) 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, (2) an Employee Stock Purchase Plan under which shares of our common stock may be acquired by employees at discounted prices, and (3) a Non-Employee Director Stock Plan that provides for automatic grants of restricted 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 September 30, 2018, there were 336,489 shares of common stock reserved in the aggregate for issuance pursuant to future awards under our Employee Stock Incentive Plan and 534,087 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. Shares reserved for issuance under outstanding awards, including options and restricted stock units, that are forfeited become available under the Employee Stock Incentive Plan for future grants.

Non-Employee Director Stock Plan

As of September 30, 2018, there were 60,000 shares of common stock reserved in the aggregate for issuance pursuant to future restricted share 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 provided for annual restricted share grants of 2,000 shares of common stock which vest in four equal quarterly installments during the year after the grant date, provided the non-employee director is still serving as a director on the applicable vesting date.

On the date of our 2018 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 $130,000 (grant date fair value of $16.25 per share). As of September 30, 2018, 2,000 of these shares were vested. The aggregate fair value of the outstanding unvested shares based on the closing price of our common stock on September 30, 2018 was $121,000.

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).

Stock Option Activity

The following is a summary of stock option activity in the nine months ended September 30, 2018:

	Options Outstanding	Weighted Average Exercise Price Per Share
Outstanding, December 31, 2017	568,525	$ 10.24
Granted	—	—
Exercised	(55,000)	8.20
Expired	—	—
Forfeited	(8,650)	14.10
Outstanding, September 30, 2018	504,875	$ 10.39
Exercisable, September 30, 2018	311,813	$ 8.61

The intrinsic value of an option is the amount by which the market price of the underlying common stock exceeds the option's exercise price. For options outstanding at September 30, 2018, the weighted average remaining contractual term of all outstanding options was 3.8 years and their aggregate intrinsic value was $5.2 million. At September 30, 2018, the weighted average remaining contractual term of options that were exercisable was 3.0 years and their aggregate intrinsic value was $3.7 million. The aggregate intrinsic value of stock options exercised in the nine months ended September 30, 2018 was $572,000. We received proceeds from stock option exercises of $452,000 in the nine months ended September 30, 2018 and $330,000 in the nine months ended September 30, 2017. The aggregate fair value of options that vested in the nine months ended September 30, 2018 was $204,000.

Restricted Shares and Restricted Stock Units

Restricted shares are granted under our Non-Employee Director Stock Plan. There were 8,000 restricted shares granted in the nine months ended September 30, 2018 (weighted average grant date fair value of $16.25 per share). Restricted stock units are granted under our Employee Stock Incentive Plan. No restricted stock units were granted in the nine months ended September 30, 2018. The aggregate fair value of outstanding restricted shares and restricted stock units based on the closing share price of our common stock on September 30, 2018 was $1.0 million. The aggregate fair value of restricted shares and restricted stock units that vested in the

A summary of activity for non-vested restricted shares and restricted stock units in the nine months ended September 30, 2018 is as follows:

Non-vested restricted stock units and restricted shares	Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2017	54,212	$ 14.86

Granted	8,000	16.25
Vested	(11,000)	13.72
Forfeited	—	—
Non-vested at September 30, 2018	51,212	$ 15.32

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 16,403 shares issued under this plan in the nine months ended September 30, 2018. At our 2018 annual meeting, our shareholders adopted amendments to the plan increasing the number of shares authorized for issuance under the plan by 150,000 and extending the expiration date of the plan to August 1, 2028. As of September 30, 2018, 174,469 shares remain available for future issuance under the Employee Stock Purchase Plan.

Stock Based Compensation Information

All stock based compensation awarded to our employees and non-employee directors, representing grants of restricted 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. We have classified equity-based compensation expenses within our statement of operations in the same manner as our cash-based compensation costs.

Stock-based compensation expense in the three months ended September 30, 2018 totaled $217,000, and included $94,000 for stock options, $31,000 for our Employee Stock Purchase Plan, $59,000 for unvested restricted stock units and $33,000 for unvested restricted shares. Stock-based compensation expense in the nine months ended September 30, 2018 totaled $701,000, and included $328,000 for stock options, $86,000 for our Employee Stock Purchase Plan, $176,000 for unvested restricted stock units and $111,000 for unvested restricted shares.

Stock-based compensation expense in the three months ended September 30, 2017 totaled $240,000, and included $116,000 for stock options, $33,000 for our Employee Stock Purchase Plan, $49,000 for unvested restricted stock units and $42,000 for unvested restricted shares. Stock-based compensation expense in the nine months ended September 30, 2017 totaled $640,000, and included $345,000 for stock options, $85,000 for our Employee Stock Purchase Plan, $145,000 for unvested restricted stock units and $65,000 for unvested restricted shares.

At September 30, 2018, the total unrecognized compensation cost related to outstanding non-vested stock-based compensation arrangements was $1.5 million, and the related weighted average period over which this cost is expected to be recognized was 2.36 years.

6. CHANGES IN STOCKHOLDERS' EQUITY:

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

(In thousands)	**Common Stock Shares**	**Common Stock Amount**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Total Stockholders' Equity**
Balance, December 31, 2017	6,980	$ 34,080	$ (1,409)	$ 19,611	$ 52,282
Increase related to adoption of ASU 2016-01	—	—	(44)	44	—
Decrease related to adoption of ASU 2014-09	—	—	—	(218)	(218)
Exercise of stock options, vesting of restricted stock units and grants of restricted shares, net of shares exchanged as payment	68	452	—	—	452
Stock-based compensation	—	701	—	—	701
Issuance of common stock under Employee Stock Purchase Plan	16	219	—	—	219
Other comprehensive income, net of tax	—	—	(280)	—	(280)
Net income	—	—	—	1,634	1,634

Balance, September 30, 2018	7,064	$35,452	$(1,733)	$21,071	$54,790

See Note 16 for further discussion regarding the impact of our adoption of ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities,* on our consolidated financial statements. See Note 2 and Note 16 for further discussion regarding the impact of our adoption of ASU No. 2014-09, *Revenue from Contracts with Customers,* on our consolidated financial statements.

7. OTHER FINANCIAL STATEMENT DATA:

The components of our inventories were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Raw materials and purchased parts	$ 7,383	$ 7,383
Work in process	1,633	1,666
Finished goods	4,919	5,344
Total inventories	$ 13,935	$ 14,393

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The components of our accrued expenses were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Wages and benefits	$ 1,607	$ 1,328
Warranty liability	713	713
Other	336	244
	$ 2,656	$ 2,285

Warranty costs:

We provide for the estimated cost of product warranties, which cover products for periods ranging from 1 to 3 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 components provided by suppliers, warranty obligations do arise. These obligations are affected by product failure rates, the costs of materials used and service delivery expenses incurred in correcting a product failure. If actual product failure rates and material or service delivery costs differ from our estimates, revisions to the estimated warranty liability are 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:

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Balance at beginning of period	$ 767	$ 790
Accrual for warranties	399	362
Warranty revision	(30)	(23)
Settlements made during the period	(368)	(413)
Balance at end of period	768	716
Current portion of estimated warranty liability	(713)	(691)
Long-term estimated warranty liability	$ 55	$ 25

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:

	Nine Months Ended September 30,	
(In thousands)	**2018**	**2017**
Balance at beginning of period	$ 259	$ 346
Revenue deferrals	289	321
Amortization of deferred revenue	(310)	(325)
Total deferred warranty revenue	238	342
Current portion of deferred warranty revenue	(228)	(301)
Long-term deferred warranty revenue	$ 10	$ 41

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8. INTANGIBLE ASSETS:

Intangible assets consist of the following:

	September 30, 2018			December 31, 2017		
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**
Patents	$ 2,727	$ (2,515)	$ 212	$ 2,687	$ (2,463)	$ 224
Software	206	(134)	72	206	(111)	95
Marketing assets and customer relationships	101	(52)	49	101	(45)	56
Non-compete agreements	101	(101)	—	101	(96)	5
	$ 3,135	$ (2,802)	$ 333	$ 3,095	$ (2,715)	$ 380

Amortization expense for our intangible assets in the three and nine months ended September 30, 2018 and 2017 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2018**	**2017**	**2018**	**2017**
Patents	$ 28	$ 31	$ 84	$ 82
Software	8	6	23	22
Marketing assets and customer relationships	2	3	7	9
Non-compete agreements	—	5	5	18
	$ 38	$ 45	$ 119	$ 131

Amortization of patents has been classified as research and development expense in our statements of operations. Estimated aggregate amortization expense based on current intangible assets for the next five years is expected to be as follows: $38,000 for the remainder of 2018; $137,000 in 2019; $106,000 in 2020; $32,000 in 2021; $9,000 in 2022; and $9,000 in 2023.

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 is recognized when future undiscounted cash flows expected to result from use of the asset and its eventual disposition are less than the carrying amount.

9. REVENUE CONCENTRATIONS, SIGNIFICANT CUSTOMERS AND GEOGRAPHIC AREAS:

The following table summarizes our revenue by product line:

(In thousands)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
High Precision 3D and 2D Sensors	$ 5,388	$ 4,030	$ 15,696	$ 13,569
Semiconductor Sensors	3,463	2,228	10,564	7,698
Inspection and Metrology Systems	7,832	5,570	20,397	18,890
Total	$ 16,683	$ 11,828	$ 46,657	$ 40,157

Export sales as a percentage of total sales in the three and nine months ended September 30, 2018 were 71% and 72%, respectively. Export sales as a percentage of total sales in the three and nine months ended September 30, 2017 were 66% and 73%, respectively. Virtually all of our export sales are negotiated, invoiced and paid in U.S. dollars. Export sales by geographic area are summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Americas	$ 355	$ 159	$ 568	$ 976
Europe	4,093	2,543	9,360	9,114
Asia	7,090	4,959	22,948	18,933
Other	348	103	548	247
Total export sales	$ 11,886	$ 7,764	$ 33,424	$ 29,270

In the nine months ended September 30, 2018, sales to significant customer A accounted for 11% of our total revenue and sales to significant customer B accounted for 10% of our total revenue. As of September 30, 2018, accounts receivable from significant customer A were $677,000 and accounts receivable from significant customer B were $1.2 million.

10. NET INCOME (LOSS) PER SHARE:

Basic net income (loss) per share is computed by dividing net income (loss) 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, upon vesting of restricted stock units, upon vesting of restricted shares and from purchases of shares under our Employee Stock Purchase Plan, as calculated using the treasury stock method. All common equivalent shares were excluded from the calculation of net loss per diluted share due to their anti-dilutive effect. The components of net income (loss) per basic and diluted share were as follows:

(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Three Months Ended September 30, 2018			
Basic	$ 1,067	7,041	$ 0.15
Dilutive effect of common equivalent shares	—	258	—
Dilutive	$ 1,067	7,299	$ 0.15

(In thousands except per share amounts)	Net Loss	Weighted Average Shares Outstanding	Per Share Amount
Three Months Ended September 30, 2017			
Basic	$ (72)	6,959	$ (0.01)
Dilutive effect of common equivalent shares	—	—	—
Dilutive	$ (72)	6,959	$ (0.01)

(In thousands except per share amounts)	Net Income		Weighted Average Shares Outstanding	Per Share Amount	
Nine Months Ended September 30, 2018					
Basic	$	1,634	7,012	$	0.23
Dilutive effect of common equivalent shares	—		164	—	
Dilutive	$	1,634	7,176	$	0.23

(In thousands except per share amounts)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
Nine Months Ended September 30, 2017			
Basic	$ 809	6,939	$ 0.12
Dilutive effect of common equivalent shares	—	102	(0.01)
Dilutive	$ 809	7,041	$ 0.11

Potentially dilutive shares excluded from the calculations of net income (loss) per diluted share due to their anti-dilutive effect were as follows: 118,000 shares in the three months ended September 30, 2018; 285,000 shares in the nine months ended September 30, 2018; 575,000 shares in the three months ended September 30, 2017; and 411,000 shares in the nine months ended September 30, 2017.

11. OTHER COMPREHENSIVE INCOME (LOSS):

Reclassification adjustments are made to avoid double counting for items included in other comprehensive income (loss) that are also recorded as part of net income. Other comprehensive income (loss) consisted of the following:

(In thousands)	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017		
	Before Tax	Tax Effect	Net of Tax Amount	Before Tax	Tax Effect	Net of Tax Amount
Foreign currency translation adjustments	$ (50)	$ —	$ (50)	$ 157	$ (35)	$ 122
Net changes related to available-for-sale securities:						
Unrealized losses	3	—	3	—	—	—
Reclassification adjustments for gain included in interest income and other	(3)	—	(3)	—	—	—
Net changes related to available-for-sale securities	—	—	—	—	—	—
Other comprehensive income (loss)	$ (50)	$ —	$ (50)	$ 157	$ (35)	$ 122

(In thousands)	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Before Tax	Tax Effect	Net of Tax Amount	Before Tax	Tax Effect	Net of Tax Amount
Foreign currency translation adjustments	$ (252)	$ —	$ (252)	$ 587	$ (173)	$ 414
Net changes related to available-for-sale securities:						
Unrealized gains (losses)	(33)	8	(25)	31	(11)	20
Reclassification adjustments for gain	(3)	—	(3)	—	—	—

included in interest income and other	
Net changes related to available-for-sale securities	(36)