KVH INDUSTRIES INC \DE\
Form 10-Q
October 31, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 0-28082

KVH Industries, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware	05-0420589
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

50 Enterprise Center, Middletown, RI 02842
(Address of Principal Executive Offices) (Zip Code)
(401) 847-3327
(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 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 o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a 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	o	Accelerated filer	ý
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	ý
		Emerging growth company	o

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. o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Date	Class	Outstanding shares
October 29, 2018	Common Stock, par value $0.01 per share	17,737,431

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PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
KVH INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share and share amounts)

	September 30, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,900	$ 34,596
Marketable securities	336	8,319
Accounts receivable, net of allowance for doubtful accounts of $2,786 and $2,852 as of September 30, 2018 and December 31, 2017, respectively	28,971	28,316
Inventories	24,676	22,732
Prepaid expenses and other current assets	3,741	3,816
Current contract assets	3,460	—
Total current assets	94,084	97,779
Property and equipment, less accumulated depreciation of $55,736 and $51,099 as of September 30, 2018 and December 31, 2017, respectively	52,375	43,521
Intangible assets, less accumulated amortization of $23,757 and $20,656 as of September 30, 2018 and December 31, 2017, respectively	11,637	15,120
Goodwill	32,848	33,872
Other non-current assets	6,701	5,927
Non-current contract assets	6,626	—
Non-current deferred income tax asset	201	20
Total assets	$ 204,472	$ 196,239
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,957	$ 15,736
Accrued compensation and employee-related expenses	5,598	5,358
Accrued other	11,748	9,210
Accrued product warranty costs	2,032	2,074
Deferred revenue	—	6,919
Current portion of long-term debt	22,691	2,482
Contract liabilities	10,770	—
Liability for uncertain tax positions	1,316	1,570
Total current liabilities	69,112	43,349
Other long-term liabilities	2,060	19
Long-term contract liabilities	8,771	—
Long-term debt, excluding current portion	20,252	44,572
Non-current deferred income tax liability	2,547	2,634
Total liabilities	$ 102,742	$ 90,574
Commitments and contingencies (Note 2, 10, 12, and 19)		
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 1,000,000 shares; none issued	—	—
Common stock, $0.01 par value. Authorized 30,000,000 shares; 19,021,853 and 18,787,816 shares issued at September 30, 2018 and December 31, 2017, respectively; and 17,739,431 and 17,128,825 shares outstanding at September 30, 2018 and	190	188

December 31, 2017, respectively		
Additional paid-in capital	138,731	134,361
Accumulated deficit	(13,575)	(4,417)
Accumulated other comprehensive loss	(13,452)	(11,317)
	111,894	118,815
Less: treasury stock at cost, common stock, 1,282,422 and 1,658,991 shares as of September 30, 2018 and December 31, 2017, respectively	(10,164)	(13,150)
Total stockholders' equity	101,730	105,665
Total liabilities and stockholders' equity	$ 204,472	$ 196,239

See accompanying Notes to Unaudited Consolidated Financial Statements.

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KVH INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except earnings per share amounts, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Sales:				
Product	$16,367	$14,169	$46,521	$43,355
Service	27,150	26,281	80,489	77,755
Net sales	43,517	40,450	127,010	121,110
Costs and expenses:				
Costs of product sales	9,767	9,578	28,784	29,412
Costs of service sales	15,376	13,374	44,690	39,736
Research and development	3,789	3,990	11,288	11,698
Sales, marketing and support	8,421	8,234	25,856	25,098
General and administrative	7,084	7,075	21,679	22,805
Total costs and expenses	44,437	42,251	132,297	128,749
Loss from operations	(920)	(1,801)	(5,287)	(7,639)
Interest income	161	166	464	491
Interest expense	453	379	1,290	1,081
Other income (expense), net	199	(141)	371	(321)
Loss before income tax expense	(1,013)	(2,155)	(5,742)	(8,550)
Income tax expense	161	283	668	799
Net loss	$(1,174)	$(2,438)	$(6,410)	$(9,349)
Net loss per common share				
Basic and diluted	$(0.07)	$(0.15)	$(0.38)	$(0.57)
Weighted average number of common shares outstanding:				
Basic and diluted	17,188	16,469	17,025	16,393

See accompanying Notes to Unaudited Consolidated Financial Statements.

KVH INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in thousands, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	$(1,174)	$(2,438)	$(6,410)	$(9,349)
Other comprehensive (loss) income, net of tax:				
Unrealized gain (loss) on available-for-sale securities	—	2	1	(1)
Foreign currency translation adjustment	(763)	1,956	(2,185)	4,997
Unrealized gain on derivative instruments, net	12	19	49	64
Other comprehensive (loss) income, net of tax(1)	(751)	1,977	(2,135)	5,060
Total comprehensive loss	$(1,925)	$(461)	$(8,545)	$(4,289)

(1) Tax impact was nominal for all periods.

See accompanying Notes to Unaudited Consolidated Financial Statements.

KVH INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	$(6,410)	$(9,349)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for doubtful accounts	444	637
Depreciation and amortization	9,481	8,222
Deferred income taxes	22	—
Loss on sale of fixed assets	2	21
Compensation expense related to stock-based awards and employee stock purchase plan	2,452	2,621
Unrealized currency translation gain	(290)	(205)
Changes in operating assets and liabilities:		
Accounts receivable	(1,217)	1,975
Inventories	(1,907)	(896)
Prepaid expenses, other current assets, and current contract assets	(232)	(200)
Other non-current assets and non-current contract assets	(1,647)	(685)
Accounts payable	(992)	2,910
Deferred revenue, contract liabilities, and long-term contract liabilities	701	2,167
Accrued compensation, product warranty, and other	1,364	2,478
Other long-term liabilities	(10)	(305)
Net cash provided by operating activities	$1,761	$9,391
Cash flows from investing activities:		
Capital expenditures	(11,463)	(10,234)
Cash paid for acquisition of intangible asset	(22)	(55)
Purchases of marketable securities	(2,036)	(9,351)
Maturities and sales of marketable securities	10,019	26,766
Net cash (used in) provided by investing activities	$(3,502)	$7,126
Cash flows from financing activities:		
Repayments of long-term debt	(136)	(1,606)
Repayments of term note borrowings	(3,975)	(8,775)
Payment of employee restricted stock withholdings	—	(392)
Proceeds from stock options exercised and employee stock purchase plan	477	1,332
Sale of treasury stock	4,500	—
Payment of capital lease	(410)	—
Net cash provided by (used in) financing activities	$456	$(9,441)
Effect of exchange rate changes on cash and cash equivalents	(411)	1,877
Net (decrease) increase in cash and cash equivalents	(1,696)	8,953
Cash and cash equivalents at beginning of period	34,596	26,422
Cash and cash equivalents at end of period	$32,900	$35,375
Supplemental disclosure of non-cash investing activities:		
Changes in accrued other and accounts payable related to property and equipment additions	$965	$402
Deferred purchase price consideration related to asset acquisition included in accrued expenses	$—	$50

See accompanying Notes to Unaudited Consolidated Financial Statements.

KVH INDUSTRIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(1) Description of Business

KVH Industries, Inc. (together with its subsidiaries, the Company or KVH) is a leading manufacturer of solutions that provide global high-speed Internet, television, and voice services via satellite to mobile users at sea and on land. KVH is also a leading provider of commercially licensed entertainment, including news, sports, music, and movies, to commercial and leisure customers in the maritime, hotel, and retail markets. In addition, the Company develops and distributes training films and eLearning computer-based training courses to commercial maritime customers. KVH is also a premier manufacturer of high-performance navigational sensors and integrated inertial systems for defense and commercial applications. KVH's reporting segments are as follows:

- the mobile connectivity segment and
- the inertial navigation segment

KVH's mobile connectivity products enable customers to receive voice services, Internet services, and live digital television via satellite services in marine vessels, recreational vehicles, buses and automobiles. KVH's CommBox offers a range of tools designed to increase communication efficiency, reduce costs, and manage network operations. KVH sells and leases its mobile connectivity products through an extensive international network of dealers and distributors. KVH also sells and leases products directly to end users. In October 2017, KVH introduced a new 60-cm diameter TracPhone V7-HTS Ku-band antenna which is designed to deliver faster data speeds globally to the maritime market. KVH is able to offer download/upload speeds as fast as 10 Mbps/3 Mbps by combining KVH's proprietary antenna system design and industry-leading mini-VSAT Broadband network, along with partnering with Intelsat Epic satellite services for high throughput satellite (HTS) capabilities and additional capacity from SKY Perfect JSAT satellites. With the HTS network, the Company added an additional 25 million square miles to our global maritime Ku-band high-speed connectivity footprint.

KVH's mobile connectivity service sales primarily represent sales earned from satellite voice and Internet airtime services. KVH provides, for monthly fixed and usage fees, satellite connectivity services, including broadband Internet, data and VoIP services, to its TracPhone V-series customers. In the second quarter of 2017, the Company launched a new mini-VSAT Broadband service offering, AgilePlans, which is a monthly subscription model providing global connectivity to commercial maritime customers, including hardware, installation, broadband Internet, Voice over Internet Protocol (VoIP), entertainment and training content and global support for a monthly fee with no minimum commitment. KVH offers AgilePlans customers a variety of airtime data plans with varying data speeds and fixed data usage levels with overage charges per megabyte, which is similar to the plans that the Company offers to its other customers. The Company recognizes the monthly subscription fee as service revenue over the service delivery period. The Company retains ownership of the hardware that it provides to AgilePlans customers, who must return the hardware to KVH if they decide to terminate the service. Because KVH does not sell the hardware under AgilePlans, the Company does not recognize any product revenue when the hardware is deployed to an AgilePlans customer. KVH records the cost of the hardware used by AgilePlans customers as revenue-generating assets and depreciates the cost over an estimated useful life of five years. Since the Company is retaining ownership of the hardware, it does not accrue any warranty costs for AgilePlans hardware; however, any maintenance costs on the hardware are expensed in the period these costs are incurred. Mobile connectivity service sales also include the distribution of commercially licensed entertainment, including news, sports, music, and movies to commercial and leisure customers in the maritime, hotel, and retail markets through KVH Media Group, and the distribution of training films and eLearning computer-based training courses to commercial customers in the maritime market through Super Dragon Limited and Videotel Marine Asia Limited (together referred to as Videotel). KVH also earns monthly usage fees from third-party satellite connectivity services, including voice, data and Internet services, provided to its Inmarsat and Iridium customers who choose to activate their subscriptions with KVH. Mobile connectivity service sales also include engineering services provided under development contracts, sales from product repairs, and extended warranty sales.

KVH's inertial navigation products offer precision fiber optic gyro (FOG)-based systems that enable platform and optical stabilization, navigation, pointing and guidance. KVH’s inertial navigation products also include tactical navigation systems that provide uninterrupted access to navigation and pointing information in a variety of military vehicles, including tactical trucks and light armored vehicles. KVH’s inertial navigation products are sold directly to U.S. and foreign governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, KVH's inertial navigation technology is used in numerous commercial products, such as navigation and positioning systems for various applications including precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

KVH’s inertial navigation service sales include product repairs, engineering services provided under development contracts and extended warranty sales.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements of KVH Industries, Inc. and its wholly owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company has evaluated all subsequent events through the date of this filing. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have not been audited by the Company’s independent registered public accounting firm and include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These consolidated financial statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company’s consolidated financial statements and related notes included in the Company’s annual report on Form 10-K for the year ended December 31, 2017 filed on March 2, 2018 with the Securities and Exchange Commission. The results for the three and nine months ended September 30, 2018 are not necessarily indicative of operating results for the remainder of the year.

Significant Estimates and Assumptions and Other Significant Non-Recurring Transactions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of sales and expenses during the reporting periods. As described in the Company’s annual report on Form 10-K, the most significant estimates and assumptions by management affect the Company’s revenue recognition, valuation of accounts receivable, valuation of inventory, valuations and deferred purchase price consideration related to asset acquisition, expected future cash flows including growth rates, discount rates, terminal values and other assumptions and estimates used to evaluate the recoverability of long-lived assets and goodwill, estimated fair values of long-lived assets, including goodwill, amortization methods and periods, certain accrued expenses and other related charges, stock-based compensation, contingent liabilities, key valuation assumptions for its share-based awards, estimated fulfillment costs for warranty obligations, tax reserves and recoverability of the Company’s net deferred tax assets and related valuation allowance. The Company has reviewed these estimates and determined that these remain the most significant estimates for the nine months ended September 30, 2018.

Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances.

The only material change to the significant accounting policies disclosed in the Company’s annual report on Form 10-K for the year ended December 31, 2017 was the Company’s adoption of Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers effective January 1, 2018. Please see footnote 16 for further discussion.

On February 27, 2018, the Company entered into a stock purchase agreement with SKY Perfect JSAT Corporation, or SJC, pursuant to which the Company agreed to sell 377 shares of treasury stock to SJC for a purchase price of $11.95 per share, or an aggregate of $4,500, in a private placement. The transaction closed on February 28, 2018.

During the first quarter of 2018, the Company entered into a five-year capital lease for three satellite hubs for the HTS network. Please see footnote 19 for further discussion.

(3) Accounting Standards Issued and Not Yet Adopted

ASC Update No. 2016-02, No. 2018-10 and No. 2018-11

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASC Update No. 2016-02, Leases (Topic 842). It is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. Update No. 2016-02 creates new accounting and reporting guidelines for leasing arrangements. The new guidance requires organizations that lease assets to recognize assets and liabilities on the balance sheet related to the rights and obligations created by those leases, regardless of whether they are classified as finance or operating leases. Consistent with current guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease primarily will depend on its classification as a finance or operating lease. The guidance also requires new disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The new standard is to be applied using a modified retrospective approach.

In July 2018, the FASB issued Update No. 2018-10, Codification Improvements to Topic 842, Leases. Update No. 2018-10 made corrections to and further clarified Topic 842.

In July 2018, the FASB issued Update No. 2018-11, Leases-Targeted Improvements (Topic 842). Update No. 2018-11 allows companies to use the effective date of the new lease standard as the date of initial application on transition and not to apply the new lease standard in the comparative prior periods included in their financial statements in the year of adoption. The new guidance also gives entities the option not to separate non-lease components from the associated lease components when certain criteria are met.

The Company will adopt Topic 842 effective January 1, 2019. The Company established an implementation team to assist with its assessment of the impact of the lease guidance on its operations, consolidated financial statements and related disclosures. To date, this assessment has included (1) identifying the population of lease agreements and currently assessing the impact of other arrangements for embedded leases, (2) performing detailed analyses of the contracts to assess the impact of the noted differences in recognition and measurement that may result from adopting this new standard, and (3) evaluating and designing the necessary changes to its business processes, systems and controls to support recognition and disclosures under the new standard. Based on its current assessment, upon adoption the Company expects to recognize significant right-to-use assets and corresponding lease liabilities on its balance sheet related to leased facilities and equipment. We do not expect a material impact on our consolidated statements of operations or statement of cash flows.

ASC Update No. 2016-13

In June 2016, the FASB issued ASC Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The update is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2018. The purpose of Update No. 2016-13 is to replace the current incurred loss impairment methodology for financial assets measured at amortized cost with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information, including forecasted information, to develop credit loss estimates. The adoption of Update No. 2016-13 is not expected to have a material impact on the Company's financial position or results of operations.

ASC Update No. 2017-12

In August 2017, the FASB issued ASC Update No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The update is effective for annual periods beginning after December 15, 2018. Early adoption is permitted. The purpose of Update No. 2017-12 is to improve the presentation and disclosure requirements for, and simplify the application and increase transparency of hedge accounting. The adoption of Update No. 2017-12 is not expected to have a material impact on the Company's financial position or results of operations.

ASC Update No. 2018-07

In June 2018, the FASB issued ASC Update No. 2018-07, Compensation-Stock Compensation (Topic 718) Improvements to Nonemployee Share-Based Payment Accounting. The update is effective for annual periods beginning on or after December 15, 2018. Early adoption is permitted. The purpose of Update No. 2018-07 is to expands the scope of the employee share-based payments guidance to include share-based payments issued to nonemployees. The Company expects that the adoption of this standard will only affect, on a prospective basis, the manner in which the Company evaluates any changes to the terms or conditions of its share-based payment awards.

ASC Update No. 2018-13

In August 2018, the FASB issued ASC Update No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement. The update is effective for annual periods beginning on or after December 15, 2019. Early adoption is permitted upon issuance of this update. The purpose of Update No. 2018-13 is to modify and eliminate some of the disclosure requirements on fair value measurements found in Topic 820, Fair Value Measurement, for both public and nonpublic entities. Through the inclusion of this update, FASB aims to facilitate a clear communication of the information required by GAAP that is most important to users of each entity's financial statements, thus helping to improve the effectiveness of disclosures in the notes to financial statements. Update No. 2018-13 is not expected to have a material impact on the Company's financial position or results of operations.

ASC Update No. 2018-15

In August 2018, the FASB issued ASC Update No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Topic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The update is effective for annual periods beginning on or after December 15, 2019. Early adoption of the amendments in this update is permitted, including adoption in any interim period, for all entities. The purpose of Update No. 2018-15 is to provide a new guideline to the accounting of a customer of a cloud computing arrangement hosted by a vendor when the customer incurs costs associated with the implementation, set-up, and other upfront costs. Specifically, customers will follow the same criteria found in an arrangement with a software license when they capitalize the implementation costs. The new guidance also affects the classification of the capitalized implementation costs and related amortization expense found in a company's balance sheet, income statement, and cash flow statement, and the update also requires additional quantitative and qualitative disclosures. Update No. 2018-15 is not expected to have a material impact on the Company's financial position or results of operations.

There are no other recent accounting pronouncements issued by the FASB that are expected to have a material impact on the Company's financial statements.

(4) Marketable Securities

Marketable securities as of September 30, 2018 and December 31, 2017 consisted of the following:

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market mutual funds	$ 336	$ —	$ —	$ 336
Total marketable securities designated as available-for-sale	$ 336	$ —	$ —	$ 336

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value

Money market mutual funds	$ 7,318	$ —	$ —	$7,318
Certificates of deposit	1,002	—	(1)	1,001
Total marketable securities designated as available-for-sale	$ 8,320	$ —	$ (1)	$8,319

The amortized costs and fair value of marketable securities as of September 30, 2018 and December 31, 2017 are shown below by effective maturity. Effective maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

September 30, 2018	Amortized Cost	Fair Value
Due in less than one year	$ —	$—

December 31, 2017	Amortized Cost	Fair Value
Due in less than one year	$ 1,002	$1,001

Interest income from marketable securities was $2 and $25 during the three months ended September 30, 2018 and 2017, respectively, and $17 and $86 during the nine months ended September 30, 2018 and 2017, respectively.

(5) Stockholder's Equity

(a) Stock Equity and Incentive Plan

The Company recognizes stock-based compensation in accordance with the provisions of ASC Topic 718, Compensation-Stock Compensation. Stock-based compensation expense, excluding compensation charges related to our employee stock purchase plan, or the ESPP, was $849 and $785 for the three months ended September 30, 2018 and 2017, respectively, and $2,417 and $2,577 for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, there was $2,621 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 3.00 years. As of September 30, 2018, there was $4,192 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.26 years.

Stock Options

During the three months ended September 30, 2018, 22 stock options were exercised for common stock. Additionally, during the three months ended September 30, 2018, no stock options were granted and 65 stock options expired, were canceled or were forfeited.

During the nine months ended September 30, 2018, 35 stock options were exercised for common stock, none of which was delivered to the Company as payment for the exercise price or related minimum tax withholding obligations. Additionally, during the nine months ended September 30, 2018, 401 stock options were granted with a weighted average grant date fair value of $3.82 per share and 152 stock options expired, were canceled or were forfeited. The Company has estimated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. The weighted average assumptions utilized to determine the fair value of options granted during the nine months ended September 30, 2018 and 2017 were as follows:

	Nine Months Ended September 30,	
	2018	2017
Risk-free interest rate	2.81 %	1.96 %
Expected volatility	36.60%	35.53%
Expected life (in years)	4.29	4.22
Dividend yield	0 %	0 %

As of September 30, 2018, there were 1,281 options outstanding with a weighted average exercise price of $10.27 per share and 343 options exercisable with a weighted average exercise price of $10.89 per share.

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Restricted Stock

During the three months ended September 30, 2018, 45 shares of restricted stock were granted with a weighted average grant date fair value of $12.65 per share and no shares of restricted stock were forfeited. Additionally, during the three months ended September 30, 2018, 10 shares of restricted stock vested, of which no shares of common stock were surrendered to the Company as payment by employees in lieu of cash to satisfy minimum tax withholding obligations in connection with the vesting of restricted stock.

During the nine months ended September 30, 2018, 199 shares of restricted stock were granted with a weighted average grant date fair value of $11.47 per share and 19 shares of restricted stock were forfeited. Additionally, during the nine months ended September 30, 2018, 247 shares of restricted stock vested, of which no shares of common stock were surrendered to the Company as payment by employees in lieu of cash to satisfy minimum tax withholding obligations in connection with the vesting of restricted stock.

As of September 30, 2018, there were 538 shares of restricted stock outstanding still subject to service-based vesting conditions.

As of September 30, 2018, the Company had no shares of restricted stock that were subject to performance-based or market-based vesting conditions.

(b) Employee Stock Purchase Plan

The Company's Amended and Restated 1996 Employee Stock Purchase Plan (ESPP) affords eligible employees the right to purchase common stock, via payroll deductions, through various offering periods at a purchase price equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. During the three and nine months ended September 30, 2018, 17 shares were issued under the ESPP plan. During the three and nine months ended September 30, 2017, 0 and 26 shares were issued under the ESPP plan, respectively. The Company recorded compensation charges related to the ESPP of $11 and $24 for the three months ended September 30, 2018 and 2017, respectively, and $35 and $44 for the nine months ended September 30, 2018 and 2017, respectively.

(c) Stock-Based Compensation Expense

The following table presents stock-based compensation expense, including expense for the ESPP, in the Company's consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of product sales	$40	$68	$122	$222
Cost of service sales	—	—	—	1
Research and development	177	155	496	514
Sales, marketing and support	138	190	485	679
General and administrative	505	396	1,349	1,205
	$860	$809	$2,452	$2,621

(d) Accumulated Other Comprehensive Loss

Comprehensive income (loss) includes net income (loss), unrealized gains and losses from foreign currency translation, unrealized gains and losses from available for sale marketable securities and changes in fair value related to interest rate swap derivative instruments, net of tax attributes, which were not material. The components of the Company’s comprehensive income (loss) and the effect on earnings for the periods presented are detailed in the accompanying consolidated statements of comprehensive income (loss).

The balances for the three months ended September 30, 2018 and 2017 are as follows:

	Foreign Currency Translation	Unrealized Gain (Loss) on Available for Sale Marketable Securities	Interest Rate Swaps	Total Accumulated Other Comprehensive Loss
Balance, June 30, 2018	$ (12,669)	$ —	$ (32)	$ (12,701)
Other comprehensive loss before reclassifications	(763)	—	—	(763)
Amounts reclassified from AOCI to Other income, net	—	—	12	12
Net other comprehensive (loss) income, September 30, 2018	(763)	—	12	(751)
Balance, September 30, 2018	$ (13,432)	$ —	$ (20)	$ (13,452)

	Foreign Currency Translation	Unrealized Gain (Loss) on Available for Sale Marketable Securities	Interest Rate Swaps	Total Accumulated Other Comprehensive Loss
Balance, June 30, 2017	$ (13,610)	$ (3)	$ (113)	$ (13,726)
Other comprehensive income before reclassifications	1,956	2	1	1,959
Amounts reclassified from AOCI to Other income, net	—	—	18	18
Net other comprehensive income, September 30, 2017	1,956	2	19	1,977
Balance, September 30, 2017	$ (11,654)	$ (1)	$ (94)	$ (11,749)

The balances for the nine months ended September 30, 2018 and 2017 are as follows:

	Foreign Currency Translation	Unrealized Gain (Loss) on Available for Sale Marketable Securities	Interest Rate Swaps	Total Accumulated Other Comprehensive Loss
Balance, December 31, 2017	$ (11,247)	$ (1)	$ (69)	$ (11,317)
Other comprehensive (loss) income before reclassifications	(2,185)	1	11	(2,173)
Amounts reclassified from AOCI to Other income, net	—	—	38	38
Net other comprehensive (loss) income, September 30, 2018	(2,185)	1	49	(2,135)
Balance, September 30, 2018	$ (13,432)	$ —	$ (20)	$ (13,452)

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	Foreign Currency Translation	Unrealized Gain (Loss) on Available for Sale Marketable Securities	Interest Rate Swaps	Total Accumulated Other Comprehensive Loss
Balance, December 31, 2016	$ (16,651)	$ —	$ (158)	$ (16,809)
Other comprehensive income (loss) before reclassifications	4,997	(1)	5	5,001
Amounts reclassified from AOCI to Other income, net	—	—	59	59
Net other comprehensive income (loss), September 30, 2017	4,997	(1)	64	5,060
Balance, September 30, 2017	$ (11,654)	$ (1)	$ (94)	$ (11,749)

For additional information, see Note 4, "Marketable Securities," and Note 17, "Derivative Instruments and Hedging Activities."

(6) Net Loss per Common Share

Basic net loss per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net loss per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury stock accounting method. For the three and nine months ended September 30, 2018, since there was a net loss, the Company excluded all 932 and 739, respectively, in outstanding stock options and non-vested restricted shares from its diluted loss per share calculation, as inclusion of these securities would have reduced the net loss per share. For the three and nine months ended September 30, 2017, since there was a net loss, the Company excluded all 597 and 995, respectively, in outstanding stock options and non-vested restricted shares from its diluted loss per share calculation, as inclusion of these securities would have reduced the net loss per share.

A reconciliation of the basic and diluted weighted average common shares outstanding is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted average common shares outstanding—basic	17,188	16,469	17,025	16,393
Dilutive common shares issuable in connection with stock plans	—	—	—	—
Weighted average common shares outstanding—diluted	17,188	16,469	17,025	16,393

(7) Inventories

Inventories are stated at the lower of cost and net realizable value using the first-in first-out costing method. Inventories as of September 30, 2018 and December 31, 2017 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	September 30, 2018	December 31, 2017
Raw materials	$ 14,667	$ 13,347
Work in process	3,172	2,137

Finished goods	6,837	7,248
	$ 24,676	$ 22,732

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(8) Property and Equipment

Property and equipment, net, as of September 30, 2018 and December 31, 2017 consist of the following:

	September 30, 2018	December 31, 2017
Land	$ 3,828	$ 3,828
Building and improvements	24,087	24,038
Leasehold improvements	480	429
Machinery and equipment	25,208	24,764
Revenue-generating assets	40,543	28,453
Office and computer equipment	13,914	13,057
Motor vehicles	51	51
	108,111	94,620
Less accumulated depreciation	(55,736)	(51,099)
	$ 52,375	$ 43,521

Depreciation expense was $2,235 and $1,649 for the three months ended September 30, 2018 and 2017, respectively, and $6,380 and $4,956 for the nine months ended September 30, 2018 and 2017, respectively.

Certain revenue-generating hardware assets are utilized by the Company in the delivery of the Company's airtime services, media, and other content. These revenue-generating assets were previously included in machinery and equipment and are now presented separately.

(9) Product Warranty

The Company’s products carry standard limited warranties that range from one to two years and vary by product. The warranty period begins on the date of retail purchase or lease by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company’s warranty liability include the number of units sold or leased, historical and anticipated rates of warranty repairs and the cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying consolidated statements of operations. As of September 30, 2018 and December 31, 2017, the Company had accrued product warranty costs of $2,032 and $2,074, respectively.

The following table summarizes product warranty activity during 2018 and 2017:

	Nine Months Ended September 30,	
	2018	2017
Beginning balance	$2,074	$2,280
Charges to expense	1,592	845
Costs incurred	(1,634)	(810)
Ending balance	$2,032	$2,315

(10) Debt

Long-term debt consisted of the following:

	September 30, 2018	December 31, 2017
2014 term note	$ 40,300	$ 44,275
Mortgage loan	2,643	2,779
Total	42,943	