BALLANTYNE STRONG, INC.
Form 10-Q
November 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from to

Commission File Number: 1-13906

BALLANTYNE STRONG, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**47-0587703** (IRS Employer Identification Number)
11422 Miracle Hills Drive, Suite 300, Omaha, Nebraska (Address of Principal Executive Offices)	**68154** (Zip Code)

(402) 453-4444

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

Indicate by check mark whether the registrant 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 [X] 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 (check one):

Large accelerated filer	[ ]	Accelerated filer	[X]
Non-accelerated filer	[ ]	Smaller reporting company	[X]
		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 Exchange Act). Yes [ ] No [X]

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

Class	**Outstanding as of October 31, 2018**
Common Stock, $.01, par value	14,442,924 shares

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PART I. Financial Information

Item 1. Financial Statements

Ballantyne Strong, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except par values)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 5,659	$ 4,870
Restricted cash	350	-
Accounts receivable (net of allowance for doubtful accounts of $2,215 and $1,877, respectively)	14,523	10,766
Inventories:		
Raw materials and components, net	1,330	1,376
Work in process	419	362
Finished goods, net	2,194	3,083
Total inventories, net	3,943	4,821
Income tax receivable	330	495
Other current assets	1,852	1,290
Total current assets	26,657	22,242
Property, plant and equipment (net of accumulated depreciation of $9,379 and $8,780 respectively)	14,244	10,826
Equity method investments	12,017	18,053
Intangible assets, net	1,818	3,972
Goodwill	922	952
Notes receivable	3,768	2,815
Other assets	405	154
Total assets	$ 59,831	$ 59,014
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 3,558	$ 3,425
Accrued expenses	3,562	3,071
Short-term debt	2,607	500
Current portion of long-term debt	983	65
Deferred revenue and customer deposits	2,993	1,619

Income tax payable	22	-
Total current liabilities	13,725	8,680
Long-term debt, net of current portion and debt issuance costs	9,721	1,870
Deferred revenue and customer deposits, net of current portion	1,182	1,207
Deferred income taxes	2,636	2,816
Other accrued expenses, net of current portion	184	319
Total liabilities	27,448	14,892
Stockholders' equity:		
Preferred stock, par value $.01 per share; authorized 1,000 shares; none outstanding	-	-
Common stock, par value $.01 per share; authorized 25,000 shares; issued 17,237 and 17,216 shares at September 30, 2018 and December 31, 2017, respectively; outstanding 14,443 and 14,422 shares at September 30, 2018 and December 31, 2017, respectively	169	169
Additional paid-in capital	41,285	40,565
Accumulated other comprehensive loss:		
Foreign currency translation	(4,633)	(4,048)
Postretirement benefit obligations	114	99
Unrealized gain on available-for-sale securities of equity method investments	150	353
Retained earnings	13,884	25,570
	50,969	62,708
Less 2,794 of common shares in treasury, at cost	(18,586)	(18,586)
Total stockholders' equity	32,383	44,122
Total liabilities and stockholders' equity	$ 59,831	$ 59,014

See accompanying notes to condensed consolidated financial statements.

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Ballantyne Strong, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

Three and Nine Months Ended September 30, 2018 and 2017

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net product sales	$8,401	$12,808	$24,490	$38,302
Net service revenues	8,052	6,751	21,968	18,583
Total net revenues	16,453	19,559	46,458	56,885
Cost of products sold	5,076	10,112	16,308	30,929
Cost of services	7,847	4,128	22,480	10,923
Total cost of revenues	12,923	14,240	38,788	41,852
Gross profit	3,530	5,319	7,670	15,033
Selling and administrative expenses:				
Selling	1,139	1,298	3,638	4,207
Administrative	3,384	3,473	12,301	11,706
Total selling and administrative expenses	4,523	4,771	15,939	15,913
Loss on disposal of assets	(799)	-	(2,130)	-
(Loss) income from operations	(1,792)	548	(10,399)	(880)
Other income (expense):				
Interest income	-	-	-	18
Interest expense	(180)	(51)	(267)	(84)
Foreign currency transaction (loss) gain	(67)	(306)	41	(410)
Fair value adjustment to notes receivable	802	-	953	-
Other income (expense), net	6	(35)	(9)	(24)
Total other income (expense)	561	(392)	718	(500)
(Loss) income before income taxes and equity method investment income (loss)	(1,231)	156	(9,681)	(1,380)
Income tax expense	497	440	1,837	2,709
Equity method investment income (loss)	507	(753)	(244)	1,516
Net loss from continuing operations	(1,221)	(1,037)	(11,762)	(2,573)
Net loss from discontinued operations, net of tax	-	-	-	(49)
Net loss	$(1,221)	$(1,037)	$(11,762)	$(2,622)
Net loss per share - basic				
Net loss from continuing operations	$(0.08)	$(0.07)	$(0.82)	$(0.18)
Net loss from discontinued operations	-	-	-	(0.00)
Net loss	(0.08)	(0.07)	(0.82)	(0.18)
Net loss per share - diluted				

Net loss from continuing operations	$(0.08)	$(0.07)	$(0.82)	$(0.18)
Net loss from discontinued operations	-	-	-	(0.00)
Net loss	(0.08)	(0.07)	(0.82)	(0.18)

See accompanying notes to condensed consolidated financial statements.

Ballantyne Strong, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Loss

Three and Nine Months Ended September 30, 2018 and 2017

(In thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	$(1,221)	$(1,037)	$(11,762)	$(2,622)
Adjustment to postretirement benefits	6	-	15	-
Currency translation adjustment:				
Unrealized net change arising during period	245	689	(585)	1,507
Unrealized (loss) gain on available-for-sale securities of equity method investments, net of tax	(33)	34	(203)	215
Total other comprehensive income (loss)	218	723	(773)	1,722
Comprehensive loss	$(1,003)	$(314)	$(12,535)	$(900)

See accompanying notes to condensed consolidated financial statements.

Ballantyne Strong, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2018 and 2017

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	$(11,762)	$(2,622)
Net loss from discontinued operations, net of tax	-	(49)
Net loss from continuing operations	(11,762)	(2,573)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Provision for doubtful accounts	381	712
Provision for obsolete inventory	412	(160)
Provision for warranty	83	319
Depreciation and amortization	1,953	1,563
Equity method investment loss (income)	244	(1,516)
Fair value adjustment to notes receivable	(953)	-
Deferred income taxes	(146)	715
Amortization of contract acquisition costs	29	-
Impairment of contract acquisition costs	59	-
Stock-based compensation expense	648	498
Impairment of operating lease	209	-
Loss on disposal of assets	2,130	-
Dividends received from investee	817	-
Changes in operating assets and liabilities:		
Accounts receivable	(4,244)	385
Inventories	413	(134)
Other current assets	(629)	(41)
Other assets	(392)	(85)
Accounts payable	171	1,197
Accrued expenses	244	(763)
Deferred revenue and customer deposits	1,359	(1,204)
Current income taxes	178	174
Net cash flows used in operating activities - continuing operations	(8,796)	(913)
Net cash flows used in operating activities - discontinued operations	-	(147)
Net cash used in operating activities	(8,796)	(1,060)

(Continued on following page)

See accompanying notes to condensed consolidated financial statements.

Ballantyne Strong, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows - Continued

Nine Months Ended September 30, 2018 and 2017

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from investing activities:		
Proceeds from sale of equity securities	$4,531	$-
Purchase of equity securities	-	(2,525)
Dividends received from investee in excess of cumulative earnings	69	230
Capital expenditures	(1,220)	(2,949)
Proceeds from sale of business	-	60
Net cash provided by (used in) investing activities	3,380	(5,184)
Cash flows from financing activities:		
Proceeds from sale-leaseback financing	7,000	-
Proceeds from issuance of short-term debt	3,205	500
Proceeds from issuance of long-term debt	-	2,000
Principal payments on long-term debt	(2,278)	(17)
Principal payments on short-term debt	(1,097)	-
Payment of debt issuance costs	(22)	(46)
Payments on capital lease obligations	(147)	(188)
Purchase of treasury stock	-	(102)
Proceeds from exercise of stock options	-	71
Other	(8)	-
Net cash provided by financing activities	6,653	2,218
Effect of exchange rate changes on cash and cash equivalents	(98)	304
Net increase (decrease) in cash and cash equivalents and restricted cash	1,139	(3,722)
Discontinued operations activity included above:		
Add: Cash balance included in assets held for sale at beginning of period	-	175
Less: Cash balance included in assets held for sale at end of period	-	-
Cash and cash equivalents and restricted cash at beginning of period	4,870	7,596
Cash and cash equivalents and restricted cash at end of period	$6,009	$4,049
Components of cash and cash equivalents and restricted cash:		
Cash and cash equivalents	$5,659	$4,049
Restricted cash	350	-
Total cash and cash equivalents and restricted cash	$6,009	$4,049
Supplemental disclosure of non-cash investing and financing activities:		

Term loan borrowings to finance equipment purchases	$4,121	$-

See accompanying notes to condensed consolidated financial statements.

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Ballantyne Strong, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Nature of Operations

Ballantyne Strong, Inc. (“Ballantyne” or the “Company”), a Delaware corporation, is a holding company with diverse business activities focused on serving the cinema, retail, financial, advertising and government markets. The Company, and its wholly owned subsidiaries Strong Technical Services, Inc., Strong/MDI Screen Systems, Inc. (“Strong/MDI”), Convergent Media Systems Corporation (“Convergent”) and Strong Digital Media, LLC design, integrate and install technology solutions for a broad range of applications; develop and deliver out-of-home messaging, advertising and communications; manufacture projection screens; and provide managed services including monitoring of networked equipment to our customers.

2. Discontinued Operations

In May 2017, the Company sold the operational assets of Strong Westrex, Inc. for total proceeds of $60 thousand. The summary financial results of discontinued operations for the three and nine months ended September 30, 2017 were as follows (in thousands):

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
Total net revenues	$ -	$ 24
Total cost of revenues	-	48
Total selling and administrative expenses	-	53
Loss from operations of discontinued operations	-	(77)
Loss before income taxes	-	(49)
Income tax expense	-	-
Net loss from discontinued operations, net of tax	$ -	$ (49)

There was no depreciation and amortization related to discontinued operations recorded for the three and nine month periods ended September 30, 2017. There were no capital expenditures related to discontinued operations during the three and nine month periods ended September 30, 2017.

3. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and all majority owned and controlled domestic and foreign subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The condensed consolidated financial statements included in this report are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America (also referred to as "GAAP") for annual reporting purposes or those made in the Company's Annual Report on Form 10-K. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

The condensed consolidated balance sheet as of December 31, 2017 was derived from the Company's audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary to present a fair statement of the financial position and the results of operations and cash flows for the respective interim periods. The results for interim periods are not necessarily indicative of trends or results expected for a full year.

Use of Management Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results and changes in facts and circumstances may alter such estimates and affect results of operations and financial position in future periods.

Restricted Cash

Restricted cash represents amounts held in a collateral account for the Company's corporate travel and purchasing credit card program.

Accounts and Notes Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company determines the allowance for doubtful accounts based on several factors, including overall customer credit quality, historical write-off experience and a specific analysis that projects the ultimate collectability of the account. As such, these factors may change over time causing the allowance level and bad debt expense to be adjusted accordingly.

Equity Method Investments

We apply the equity method of accounting to investments when we have significant influence, but not controlling interest, in the investee. Judgment regarding the level of influence over each equity method investment includes considering key factors such as ownership interest, representation on the board of directors, participation in policy-making decisions and material intercompany transactions. The Company's proportionate share of the net income (loss) resulting from these investments is reported under the line item captioned "equity method investment income (loss)" in our condensed consolidated statements of operations. The carrying value of our equity method investments is reported in "equity method investments" in the condensed consolidated balance sheets. The Company's equity method investments are reported at cost and adjusted each period for the Company's share of the investee's income or loss and dividend paid, if any. The Company's share of the investee's income or loss is recorded on a one quarter lag for all equity method investments. The Company classifies distributions received from equity method investments using the cumulative earnings approach on the condensed consolidated statements of cash flows. The

Company assesses investments for impairment whenever events or changes in circumstances indicate that the carrying value of an investment may not be recoverable. The Company recorded an other-than-temporary impairment charge related to its equity method investments of $0.7 million in equity method investment loss on its condensed consolidated statements of operations during the nine month period ended September 30, 2018. The Company did not record any impairments related to its equity method investments during the three month period ended September 30, 2018 or three and nine month periods ended September 30, 2017. Note 6 contains additional information on our equity method investments.

Fair Value of Financial Instruments

Assets and liabilities measured at fair value are categorized into a fair value hierarchy based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. Inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1 – inputs to the valuation techniques are quoted prices in active markets for identical assets or liabilities
Level 2 – inputs to the valuation techniques are other than quoted prices but are observable for the assets or liabilities, either directly or indirectly
Level 3 – inputs to the valuation techniques are unobservable for the assets or liabilities

The following tables present the Company's financial assets measured at fair value based upon the level within the fair value hierarchy in which the fair value measurements are classified, as of September 30, 2018 and December 31, 2017.

Fair values measured on a recurring basis at September 30, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$5,659	$ -	$-	$5,659
Restricted cash	350	-	-	350
Notes receivable	-	-	3,768	3,768
Total	$6,009	$ -	$3,768	$9,777

Fair values measured on a recurring basis at December 31, 2017 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$4,870	$ -	$-	$4,870
Notes receivable	-	-	2,815	2,815
Total	$4,870	$ -	$2,815	$7,685

Quantitative information about the Company's level 3 fair value measurements at September 30, 2018 is set forth below:

	Fair value at 9/30/18 (in thousands)	Valuation technique	Unobservable input	Range
Notes receivable	$ 3,768	Discounted cash flow	Default percentage	15 %

Discount rate	18 %

During 2011, the Company entered into certain unsecured notes receivable arrangements with CDF2 Holdings, LLC pertaining to the sale and installation of digital projection equipment. The notes receivable accrue interest at a rate of 15% per annum. Interest not paid in any particular year is added to the principal and also accrues interest at 15%. The notes receivable are recorded at estimated fair value. In order to estimate the fair value, the Company reviews the financial position and estimated cash flows of the debtor of the notes receivable on a quarterly basis. During 2018, the Company updated its estimated future cash flow assumptions. This resulted in an increase to the fair value of the notes receivable of approximately $1.0 million recorded in other income in the Company's condensed consolidated statement of operations during the nine months ended September 30, 2018. There was no adjustment to the estimated fair value of the notes receivable during the nine months ended September 30, 2017.

The significant unobservable inputs used in the fair value measurement of the Company's notes receivable are discount rate and percentage of default. Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

The Company's short-term and long-term debt is recorded at historical cost. As of September 30, 2018, the Company's long-term debt, including current maturities, had a carrying value of $10.7 million. Based on discounted cash flows using current quoted interest rates (Level 2 of the fair value hierarchy), the estimated fair value at September 30, 2018 was $10.7 million.

The carrying values of all other financial assets and liabilities, including accounts receivable, accounts payable, accrued expenses and short-term debt, reported in the condensed consolidated balance sheets equal or approximate their fair values due to the short-term nature of these instruments. Note 6 includes fair value information related to our equity method investments. All non-financial assets that are not recognized or disclosed at fair value in the financial statements on a recurring basis, which include non-financial long-lived assets, are measured at fair value in certain circumstances (for example, when there is evidence of impairment). During the three and nine months ended September 30, 2018, the Company recorded impairment charges of $0.8 million and $2.1 million, respectively, related to the abandonment of internally developed software intangible assets as a loss on disposal of assets in the condensed consolidated statement of operations. Other than the intangible asset impairment, the Company did not have any significant non-recurring measurements of non-financial assets or liabilities during the three and nine months ended September 30, 2018 and 2017.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" "(ASC 606)". The ASU replaced most existing revenue recognition guidance in U.S. GAAP. The Company adopted ASC 606 effective January 1, 2018 using the modified retrospective method. The Company recorded a transition adjustment of approximately $76 thousand increasing the opening balance of retained earnings, primarily related to the deferral and amortization of direct and incremental costs of obtaining contracts. See Note 4 for further information about the nature and pattern of revenue recognition for the different types of contracts with customers.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires equity investments that do not result in consolidation and are not accounted under the equity method to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets; and modifies certain fair value disclosure requirements. The Company adopted ASU 2016-01 prospectively on January 1, 2018. The adoption of this ASU did not significantly impact the Company's results of operations and financial position.

In May 2017, the FASB issued ASU 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting." The new guidance describes the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. The Company adopted this ASU effective January 1, 2018. The adoption of this ASU did not significantly impact the Company's results of operations and financial position.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which was further clarified by ASU 2018-11, “Leases – Targeted Improvements,” issued in July 2018. ASU 2016-02 requires lessees to recognize a lease liability and a right-to-use asset for all leases, including operating leases, with a term greater than twelve months, on its balance sheet. This ASU is effective in fiscal years beginning after December 15, 2018, with early adoption permitted, and initially required a modified retrospective transition method under which entities would initially apply Topic 842 at the beginning of the earliest period presented in the financial statements. ASU 2018-11 added an additional optional transition method allowing entities to apply Topic 842 as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company plans to adopt ASU 2016-02 using the optional transition method from ASU 2018-11 on January 1, 2019. The Company is evaluating the requirements of Topic 842 and its potential impact on its financial statements. The Company has leases primarily for property and equipment and is in the process of identifying and evaluating these leases for purposes of adopting ASU 2016-02. For each of these leases, the term will be evaluated, including extension and renewal options as well as the lease payments. While the Company has not yet quantified the impact that the adoption of ASU 2016-02 will have on its consolidated financial statements, the Company expects to record assets and liabilities on its balance sheet upon adoption of this standard, which may be material. In addition, the Company expects that the sale-leaseback of Convergent’s Alpharetta, Georgia office facility described in Note 10, which did not qualify for sale-leaseback accounting under the current lease accounting standard, will qualify for sale-leaseback accounting under Topic 842, as Topic 842 eliminates the concept of continuing involvement by the seller-lessee precluding sale-leaseback accounting. The Company will continue to provide enhanced disclosures as it continues its assessment.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This ASU will require the measurement of all expected credit losses for financial assets, including trade receivables, held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those fiscal years. The Company believes its adoption will not significantly impact the Company’s results of operations and financial position.

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” The new guidance eliminates Step 2 of the goodwill impairment testing which requires the fair value of individual assets and liabilities of a reporting unit to be determined when measuring goodwill impairment. The new guidance may result in different amounts of impairment that could be recognized compared to existing guidance. In addition, failing step 1 of the impairment test may not result in impairment under existing guidance. However, under the revised guidance, failing step 1 will always result in a goodwill impairment. ASU 2017-04 is to be applied prospectively for goodwill impairment testing performed in years beginning after December 15, 2019. The Company does not believe its adoption will significantly impact the Company’s results of operations or financial position.

In August 2018, the Securities and Exchange Commission (the “SEC”) adopted the final rule under SEC Release No. 33-10532, “Disclosure Update and Simplification,” amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders’ equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders’ equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. The final rule is effective for all filings made on and after November 5, 2018. Given the effective date and proximity to most filers’ quarterly reports, the SEC is not objecting to filers deferring the presentation of changes in stockholders’ equity in their quarterly reports on Forms 10-Q until the quarter that begins after November 5, 2018. The Company anticipates its first presentation of changes in stockholders’ equity will be included in its quarterly report on Form 10-Q for the quarter ended March 31, 2019.

4. Revenue

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all contracts not completed as of the date of adoption. Results for reporting periods beginning on or after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period.

Under ASC 606, the Company accounts for revenue using the following steps:

Identify the contract, or contracts, with a customer
Identify the performance obligations in the contract
Determine the transaction price
Allocate the transaction price to the identified performance obligations
Recognize revenue when, or as, the Company satisfies the performance obligations

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The Company combines contracts with the same customer into a single contract for accounting purposes when the contracts are entered into at or near the same time and the contracts are negotiated as a single commercial package, consideration in one contract depends on the other contract, or the services are considered a single performance obligation. If an arrangement involves multiple performance obligations, the items are analyzed to determine the separate units of accounting, whether the items have value on a standalone basis and whether there is objective and reliable evidence of their standalone selling price. The total contract transaction price is allocated to the identified performance obligations based upon the relative standalone selling prices of the performance obligations. The standalone selling price is based on an observable price for services sold to other comparable customers, when available, or an estimated selling price using a cost plus margin approach. The Company estimates the amount of total contract consideration it expects to receive for variable arrangements by determining the most likely amount it expects to earn from the arrangement based on the expected quantities of services it expects to provide and the contractual pricing based on those quantities. The Company only includes some or a portion of variable consideration in the transaction price when it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The Company considers the sensitivity of the estimate, its relationship and experience with the client and variable services being performed, the range of possible revenue amounts and the magnitude of the variable consideration to the overall arrangement.

As discussed in more detail below, revenue is recognized when a customer obtains control of promised goods or services under the terms of a contract and is measured as the amount of consideration the Company expects to receive in exchange for transferring goods or providing services. The Company does not have any material extended payment terms as payment is due at or shortly after the time of the sale. Observable prices are used to determine the standalone selling price of separate performance obligations, or a cost plus margin approach is used when observable prices are not available. Sales, value-added and other taxes collected concurrently with revenue producing activities are excluded from revenue.

The Company recognizes contract assets or unbilled receivables related to revenue recognized for services completed but not yet invoiced to the clients. Unbilled receivables are recorded as accounts receivable when the Company has an unconditional right to contract consideration. A contract liability is recognized as deferred revenue when the Company invoices clients in advance of performing the related services under the terms of a contract. Deferred revenue is recognized as revenue when the Company has satisfied the related performance obligation.

Deferred contract acquisition costs are included in other assets. Beginning January 1, 2018, with the adoption of ASC 606, the Company defers costs to acquire contracts, including commissions, incentives and payroll taxes, if they are incremental and recoverable costs of obtaining a customer contract with a term exceeding one year. Deferred contract costs are reported within other assets and amortized to selling expense over the contract term, which generally ranges from one to five years. The Company has elected to recognize the incremental costs of obtaining a contract with a term of less than one year as a selling expense when incurred. Prior to 2018, all contract acquisition costs were expensed as incurred. The Company recorded a transition adjustment of approximately $76 thousand increasing the opening balance of retained earnings, primarily related to the deferral and amortization of direct and incremental costs of obtaining contracts. The following table summarizes the changes in the Company’s contract asset balance during the nine months ended September 30, 2018 (in thousands):

Deferred contract acquisition costs as of January 1, 2018	$76
Costs capitalized	12
Amortization	(29)
Impairment	(59)
Deferred contract acquisition costs as of September 30, 2018	$-

During the three months ended September 30, 2018, the Company recorded an impairment charge of $59 thousand for the remaining deferred contract acquisition costs, as they are no longer considered recoverable based on the customer's recent credit history.

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The following tables summarize the impact the adoption of ASC 606 had on the Company's consolidated financial statements (in thousands, except per share data):

Condensed Consolidated Balance Sheet:

	As reported September 30, 2018	Adjustments	Balances without adoption of ASC 606
Total current assets	$ 26,657	$ 68	$ 26,725
Total noncurrent assets	33,174	-	33,174
Total assets	$ 59,831	$ 68	$ 59,899
Total current liabilities	$ 13,725	$ 83	$ 13,808
Total noncurrent liabilities	13,723	-	13,723
Total liabilities	27,448	83	27,531
Retained earnings	13,884	(15)	13,869
Other stockholders' equity	18,499	-	18,499
Total stockholders' equity	32,383	(15)	32,368
Total liabilities and stockholders' equity	$ 59,831	$ 68	$ 59,899

Condensed Consolidated Statements of Operations:

	As reported for the three months ended September 30, 2018	Adjustments	Balances without adoption of ASC 606
Total net revenues	$ 16,453	$ 102	$ 16,555
Total cost of revenues	12,923	81	13,004
Gross profit	3,530	21	3,551
Total selling and administrative expenses	4,523	(60)	4,463
Loss on disposal of assets			