

ABAXIS INC  
Form 10-Q  
February 09, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2017  
or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 000-19720

ABAXIS, INC.  
(Exact name of registrant as specified in its charter)

California 77-0213001  
(State of Incorporation) (I.R.S. Employer Identification No.)

3240 Whipple Road  
Union City, California 94587  
(Address of principal executive offices)

(510) 675-6500  
(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      No

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

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

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reporting 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

As of February 7, 2018, there were 22,698,000 shares of the registrant's common stock outstanding.

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ABAXIS, INC.

Form 10-Q

For the Quarter Ended December 31, 2017

TABLE OF CONTENTS

	Page
 PART I. FINANCIAL INFORMATION	
Item 1. Condensed Consolidated Financial Statements (Unaudited):	
<u>Condensed Consolidated Balance Sheets as of December 31, 2017 and March 31, 2017</u>	3
<u>Condensed Consolidated Statements of Income for the Three and Nine Months Ended December 31, 2017 and 2016</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended December 31, 2017 and 2016</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2017 and 2016</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	50
Item 4. <u>Controls and Procedures</u>	51
 PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	52
Item 1A. <u>Risk Factors</u>	52
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	64
Item 3. <u>Defaults Upon Senior Securities</u>	64
Item 4. <u>Mine Safety Disclosures</u>	64
Item 5. <u>Other Information</u>	64
Item 6. <u>Exhibits</u>	65
 <u>SIGNATURES</u>	 66

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

## ABAXIS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

	December 31, 2017	March 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 71,902	\$ 91,332
Short-term investments	89,717	51,561
Receivables (net of allowances of \$420 at December 31, 2017 and \$272 at March 31, 2017)	40,391	40,568
Inventories	42,498	39,010
Prepaid expenses and other current assets	6,250	4,997
Net deferred tax assets, current	-	5,644
Current assets of discontinued operations	45	66
Total current assets	250,803	233,178
Long-term investments	23,333	22,171
Investment in unconsolidated affiliates	2,732	2,850
Property and equipment, net	34,902	34,260
Intangible assets, net	1,056	1,171
Net deferred tax assets, non-current	7,489	4,392
Other assets	9,224	7,624
Total assets	\$ 329,539	\$ 305,646
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 13,170	\$ 7,517
Accrued payroll and related expenses	10,285	9,606
Accrued taxes	47	2,151
Current liabilities of discontinued operations	50	85
Other accrued liabilities	15,648	11,006
Deferred revenue	1,054	1,415
Warranty reserve	2,129	1,663
Total current liabilities	42,383	33,443
Non-current liabilities:		
Deferred revenue	1,278	1,460
Warranty reserve	2,864	2,695
Net deferred tax liabilities	211	234
Notes payable, less current portion	202	278
Other non-current liabilities	1,544	1,312
Total non-current liabilities	6,099	5,979
Total liabilities	48,482	39,422
Commitments and contingencies (Note 13)		
Shareholders' equity:	-	-

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Preferred stock, no par value: 5,000,000 shares authorized; no shares issued and outstanding

Common stock, no par value: 35,000,000 shares authorized; 22,697,000 and 22,540,000 shares issued and outstanding at December 31, 2017 and March 31, 2017, respectively

	143,640	135,932
Retained earnings	137,481	130,304
Accumulated other comprehensive loss	(64	) (12 )
Total shareholders' equity	281,057	266,224
Total liabilities and shareholders' equity	\$ 329,539	\$ 305,646

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

Table of Contents

ABAXIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except share and per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Revenues	\$59,670	\$52,772	\$176,782	\$169,020
Cost of revenues	27,494	23,368	80,501	75,357
Gross profit	32,176	29,404	96,281	93,663
Operating expenses:				
Research and development	5,165	4,776	17,672	14,915
Sales and marketing	13,657	10,629	38,642	33,707
General and administrative	4,777	3,159	13,494	11,714
Total operating expenses	23,599	18,564	69,808	60,336
Income from operations	8,577	10,840	26,473	33,327
Interest and other income (expense), net	878	(52)	2,962	6,197
Income from continuing operations before income tax provision	9,455	10,788	29,435	39,524
Income tax provision	5,229	3,929	12,278	14,288
Income from continuing operations	4,226	6,859	17,157	25,236
Discontinued operations (Note 4)				
Loss from discontinued operations, net of tax	-	(15)	-	(70)
Net income	\$4,226	\$6,844	\$17,157	\$25,166
Net income per share:				
Basic				
Continuing operations	\$0.19	\$0.30	\$0.76	\$1.12
Discontinued operations	-	-	-	-
Basic net income per share	\$0.19	\$0.30	\$0.76	\$1.12
Diluted				
Continuing operations	\$0.18	\$0.30	\$0.75	\$1.11
Discontinued operations	-	-	-	-
Diluted net income per share	\$0.18	\$0.30	\$0.75	\$1.11
Shares used in the calculation of net income per share:				
Weighted average common shares outstanding - basic	22,695,000	22,535,000	22,663,000	22,508,000
Weighted average common shares outstanding - diluted	23,044,000	22,789,000	23,021,000	22,753,000
Cash dividends declared per share	\$0.16	\$0.14	\$0.44	\$0.38

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

Table of Contents

ABAXIS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Net income	\$ 4,226	\$ 6,844	\$ 17,157	\$ 25,166
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on investments	(55 )	(18 )	(87 )	(8 )
Tax provision (benefit) on other comprehensive income (loss)	(23 )	(8 )	(35 )	(4 )
Other comprehensive income (loss), net of tax	(32 )	(10 )	(52 )	(4 )
Comprehensive income	\$ 4,194	\$ 6,834	\$ 17,105	\$ 25,162

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

Table of Contents

ABAXIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended December 31,	
	2017	2016
Cash flows from operating activities:		
Net income	\$17,157	\$25,166
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,920	5,329
Investment premium amortization, net	805	439
Net loss on disposals of property and equipment	25	81
Foreign exchange (gain) loss	(907 )	755
Share-based compensation expense	10,191	8,317
Excess tax benefits from share-based awards (1)	-	(346 )
Deferred income taxes	2,559	(604 )
Equity in net loss of unconsolidated affiliate	118	34
Gain on sale of equity method investment	-	(6,053 )
Changes in assets and liabilities:		
Receivables, net	324	729
Inventories	(5,128 )	(8,121 )
Prepaid expenses and other current assets	(1,318 )	181
Other assets	(1,596 )	(4,340 )
Accounts payable	5,611	1,646
Accrued payroll and related expenses	679	(2,165 )
Accrued taxes	(2,165 )	(755 )
Other liabilities	4,793	1,704
Deferred revenue	(543 )	(713 )
Warranty reserve	635	985
Net cash provided by operating activities	37,160	22,269
Cash flows from investing activities:		
Purchases of available-for-sale investments	(68,415)	(2,991 )
Purchases of held-to-maturity investments	(33,597)	(40,772)
Proceeds from maturities and redemptions of available-for-sale investments	19,340	3,300
Proceeds from maturities and redemptions of held-to-maturity investments	42,462	29,919
Purchases of property and equipment	(4,794 )	(8,014 )
Acquisitions, net of cash acquired	-	(785 )
Cash paid for investment in unconsolidated affiliate	-	(2,999 )
Proceeds from sale of equity method investment	-	8,526
Net cash used in investing activities	(45,004)	(13,816)
Cash flows from financing activities:		
Tax withholdings related to net share settlements of restricted stock units	(2,521 )	(2,188 )
Excess tax benefits from share-based awards (1)	-	346
Dividends paid	(9,980 )	(8,559 )
Net cash used in financing activities	(12,501)	(10,401)
Effect of exchange rate changes on cash and cash equivalents	915	(722 )
Net decrease in cash and cash equivalents	(19,430)	(2,670 )
Cash and cash equivalents at beginning of period	91,332	88,323



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Cash and cash equivalents at end of period	\$71,902	\$85,653
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	\$11,598	\$14,836
Supplemental disclosure of non-cash flow information:		
Change in unrealized gain (loss) on investments, net of tax	\$(52 )	\$(4 )
Transfers of equipment between inventory and property and equipment, net	\$1,678	\$4,148
Net change in capitalized share-based compensation	\$38	\$(109 )
Common stock withheld for employee taxes in connection with share-based compensation	\$2,521	\$2,188
Repayment of notes payable by credits from municipal agency	\$76	\$76

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The Company adopted Accounting Standards Update (“ASU”) No. 2016-09, “Improvements to Employee Share-based Payment Accounting” (“ASU 2016-09”), during the first quarter of fiscal 2018. This standard eliminates (1) the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the statements of cash flows. The Company adopted the guidance prospectively effective April 1, 2017. The adoption of ASU 2016-09 is discussed further in Note 2, “Summary of Significant Accounting Policies.”

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

Table of Contents

ABAXIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

Abaxis, Inc. (“Abaxis,” the “Company,” “our,” “us,” or “we”), incorporated in California in 1989, develops, manufactures and markets portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. We conduct business worldwide and manage our business on the basis of the following two reportable segments: the medical market and the veterinary market.

Basis of Presentation

We have prepared the unaudited condensed consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim periods. The unaudited condensed consolidated financial statements included herein reflect all normal recurring adjustments, which are, in the opinion of our management, necessary to state fairly the results of operations and financial position for the periods presented. The results for the three and nine month periods ended December 31, 2017 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2018 or for any interim or future period.

These unaudited condensed consolidated financial statements and related notes should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

Principles of Consolidation. The accompanying condensed consolidated financial statements include the accounts of Abaxis and our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Discontinued Operations. On March 18, 2015, we entered into an Asset Purchase Agreement with Antech Diagnostics, Inc. (“Antech”) pursuant to which we sold substantially all of the assets of our Abaxis Veterinary Reference Laboratories (“AVRL”) business. The sale transaction closed on March 31, 2015. The operating results of our AVRL business are presented as discontinued operations in our condensed consolidated balance sheets and condensed consolidated statements of income for all periods presented. Unless noted otherwise, all discussions herein with respect to the Company’s condensed consolidated financial statements relate to the Company’s continuing operations.

Reclassifications. Certain reclassifications have been made to prior periods’ financial statements to conform to the current period presentation. These reclassifications did not result in any change in previously reported net income, total assets or shareholders’ equity.

Management Estimates. The preparation of these condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) requires our 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 condensed consolidated financial statements, the reported amounts of revenues and expenses during the reporting period, and related disclosures. Significant management estimates made in preparing the condensed consolidated financial statements relate to allowance for doubtful accounts, sales and other allowances, estimated selling price of our products, valuation of inventory, fair value of investments, fair value and useful lives of intangible assets, income taxes, valuation allowance for deferred tax assets, share-based compensation, legal

exposures and warranty reserves. Our management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Our actual results may differ materially from these estimates.

Table of Contents

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017 filed with the SEC on May 30, 2017, and other than the recently adopted accounting pronouncements discussed below, have not changed significantly since such filing.

Recently Adopted Accounting Pronouncements

**Simplifying the Measurement of Inventory:** In July 2015, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2015-11, “Simplifying the Measurement of Inventory (Topic 330)” (“ASU 2015-11”), which amends the guidelines for the measurement of inventory. Under the amendment, an entity should measure inventory valued using a first-in, first-out or average cost method at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. We adopted this guidance as of April 1, 2017, the required effective date. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

**Balance Sheet Classification of Deferred Taxes:** In November 2015, the FASB issued ASU No. 2015-17, “Balance Sheet Classification of Deferred Taxes (Topic 740)” (“ASU 2015-17”), which amends the accounting guidance related to balance sheet classification of deferred taxes. The amendment requires that deferred tax assets and liabilities be classified as non-current in the statement of financial position, thereby simplifying the current guidance that requires an entity to separate deferred tax assets and liabilities into current and non-current amounts. As of April 1, 2017, we adopted ASU 2015-17 on a prospective basis. The adoption of this accounting standard resulted in the reclassification of current net deferred tax assets to non-current net deferred tax assets on the condensed consolidated balance sheets for our three and nine months ended December 31, 2017. Other than this reclassification, the adoption of this standard did not have any other significant impact on our condensed consolidated financial statements.

**Employee Share-Based Payment Accounting:** In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting (Topic 718)” (“ASU 2016-09”) which simplifies several aspects of employee share-based payment accounting, including the income tax consequences, classification of awards as either equity or liabilities, forfeitures and classification in the statement of cash flows. Under the standard, excess tax benefits and tax deficiencies related to share-based payment awards will be recognized as income tax benefit or expense in the reporting period in which they occur (previously such amounts were recognized in additional paid-in capital). Additionally, the amendments also provide an alternative to estimate award forfeitures instead of recording at the time of forfeiture.

As of April 1, 2017, we adopted the applicable provisions of ASU 2016-09 as follows:

The guidance requires excess tax benefits and tax deficiencies to be recorded as income tax benefit or expense in the consolidated statement of income when the awards vest or are settled, and eliminates the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the statement of cash flows. We adopted the guidance prospectively effective April 1, 2017 and have not revised the classification of the excess tax benefits in the prior year’s condensed consolidated statements of cash flows. Amounts previously recorded to additional paid-in capital related to windfall tax benefits prior to April 1, 2017 remain in shareholders’ equity.

¶The guidance eliminates the requirement that excess tax benefits must be realized (through a reduction in income taxes payable) before companies can recognize them. We have applied the modified retrospective transition method

upon adoption. There were no unrecognized excess tax benefits prior to the adoption; therefore, there was no cumulative effects recorded to retained earnings as a result of the adoption.

We also excluded the related tax benefits when applying the treasury stock method for computing diluted shares outstanding on a prospective basis as required by ASU 2016-09. The amount of excess tax benefits and deficiencies recognized in our income tax provision in our condensed consolidated statement of income will fluctuate from period to period based on our future stock price in relation to the fair value of stock awards on the grant date, our future grants of stock awards and the volume of stock awards settled or vested. The impact of the tax benefits related to share-based payments may be material and may vary significantly each quarter based on the timing of actual settlement and vesting activity. The tax effects of vested awards are treated as discrete items in the reporting period in which they occur.

## Table of Contents

**Investments – Equity Method and Joint Ventures:** In March 2016, the FASB issued ASU No. 2016-07, “Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting” (“ASU 2016-07”). The amendments in this ASU eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor’s previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. We elected to early adopt ASU 2016-07 effective January 1, 2017. The impact of this amendment on our condensed consolidated financial statements was not significant. See Note 8, “Investments in Unconsolidated Affiliates” for information on equity method investments.

## Recent Accounting Pronouncements Not Yet Adopted

**Revenue from Contracts with Customers:** In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which supersedes the revenue recognition requirements in Accounting Standards Codification (“ASC”) 606, “Revenue Recognition.” ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On July 9, 2015, the FASB decided to delay the effective date of the new standard by one year. The new guidance allows for the standard and all subsequent amendments to be applied either retrospectively to each prior reporting period presented or retrospectively as a cumulative-effect adjustment as of the date of adoption. ASU 2014-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are continuing to evaluate the impact of the adoption of this standard and all subsequent amendments on our consolidated financial statements and have not elected a transition method.

**Recognition and Measurement of Financial Assets and Financial Liabilities:** In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)” (“ASU 2016-01”), which changes accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, it clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. ASU 2016-01 is effective beginning in the first quarter of fiscal year 2019. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Leases:** In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which amends a number of aspects of lease accounting, including requiring lessees to recognize almost all leases with a term greater than one year as a right-of-use asset and corresponding liability, measured at the present value of the lease payments. ASU 2016-02 is effective for us beginning in the first quarter of fiscal year 2020 and is required to be adopted using a modified retrospective approach. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Financial Instruments - Credit Losses:** In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326)” (“ASU 2016-13”), which will change the impairment model for most financial assets and

require additional disclosures. The amended guidance requires financial assets that are measured at amortized cost be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets. The amended guidance also requires us to consider historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount in estimating credit losses. ASU 2016-13 is effective for us commencing in the first quarter of fiscal 2019 and will be applied through a cumulative-effect adjustment to retained earnings at the beginning of the year of adoption. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments:** In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230)" ("ASU 2016-15"), to provide clarification on cash flow classification related to eight specific issues including contingent consideration payments made after a business combination and distributions received from equity method investees. ASU 2016-15 is effective beginning in the first quarter of fiscal year 2019 on a retrospective basis. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Compensation - Stock Compensation:** In May 2017, the FASB issued ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09"), which is applied to any company that changes the terms or conditions of a share-based award, considered a modification. Modification accounting would be applied unless certain conditions were met related to the fair value of the award, the vesting conditions and the classification of the modified award. ASU 2017-09 is effective for us beginning in the first quarter of fiscal year 2019, with early adoption permitted. The standard should be applied prospectively to an award modified on or after the adoption date. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

Table of Contents

## NOTE 3. ACQUISITIONS

In November 2014, we entered into Share Purchase Agreements, through our wholly-owned subsidiary, pursuant to which, we acquired 100% of the outstanding stock of Quality Clinical Reagents Limited (“QCR”) and Trio Diagnostics (Ireland) Ltd (“Trio”), both based in the United Kingdom. QCR and Trio are distributors of laboratory instrumentation and consumables to the veterinary profession in the United Kingdom. Our primary reason for the acquisitions was to continue servicing and supplying Abaxis veterinary products to our customer base. The acquisition date fair value of the purchase consideration was \$6.5 million, which included the following (in thousands):

Cash	\$3,196
Installment payment obligations (1)	2,336
Settlement of preexisting business relationship at fair value	931
Total	\$6,463

(1) The installment payment obligation is denominated in British pounds (“GBP”) and the amount in the table above is based on the GBP to U.S. dollar exchange rate at the acquisition date.

During the third quarter of fiscal 2016, we paid the first installment obligation of GBP 750,000, or \$1.1 million, based on the GBP to U.S. dollar exchange rate on the date of payment. We paid the remaining installment obligation of GBP 750,000 less post-closing indemnification obligations of certain of the sellers totaling \$0.8 million during the third quarter of fiscal 2017, based on the GBP to U.S. dollar exchange rate on the date of payment. Additionally, the post-closing indemnification obligations totaled \$0.1 million, based on the GBP to U.S. dollar exchange rate at the obligation date, which we recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income. The Share Purchase Agreements contain certain customary representations and warranties. Additionally, in connection with the acquisition, we recorded a settlement of the preexisting business relationship related to accounts receivable due from QCR and Trio that existed on the acquisition date. The book value of the accounts receivable approximated their fair value due to their short-term nature and no gain or loss was recorded. Our condensed consolidated financial statements include the operating results of our business combination and the consolidation of our acquired entities from the date of acquisition.

## NOTE 4. DISCONTINUED OPERATIONS

On March 18, 2015, we entered into an asset purchase agreement (“APA”) with Antech pursuant to which we sold substantially all of the assets of our AVRL business. The sale transaction closed on March 31, 2015. The AVRL business represents a separate asset group and the sale of assets in this business qualifies as a discontinued operation and accordingly, we reported the results of operations of this business in discontinued operations within the condensed consolidated statements of income for all periods presented as applicable.

The results from discontinued operations during the three and nine months ended December 31, 2017 and 2016 were as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
Discontinued operations:	2017	2016	2017	2016
Revenues	\$ 189	\$ 178	\$ 510	\$ 524
Cost of revenues	189	178	510	524
Gross profit	-	-	-	-
Operating expenses	-	24	-	111
Loss before income tax benefit	-	(24 )	-	(111 )



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Income tax benefit	-	(9 )	-	(41 )
Net loss of discontinued operations	\$ -	\$ (15 )	\$ -	\$ (70 )

The current assets and liabilities of discontinued operations as of December 31, 2017 and March 31, 2017 were as follows (in thousands):

	December 31, 2017	March 31, 2017
Receivables, net	\$ 45	\$ 66
Total current assets of discontinued operations	\$ 45	\$ 66
Other current liabilities	\$ 50	\$ 85
Total current liabilities of discontinued operations	\$ 50	\$ 85

Table of Contents

## NOTE 5. INVESTMENTS

Our investments are classified as either available-for-sale or held-to-maturity. The following table summarizes available-for-sale and held-to-maturity investments as of December 31, 2017 and March 31, 2017 (in thousands).

Available-for-Sale Investments				
	Gross		Gross	
	Amortized	Unrealized	Unrealized	Fair
December 31, 2017	Cost	Gain	(Loss)	Value
Commercial paper	\$9,960	\$ -	\$ (6	) \$9,954
Corporate bonds	45,323	-	(97	) 45,226
Municipal bonds	660	-	(4	) 656
Total available-for-sale investments	\$55,943	\$ -	\$ (107	) \$55,836
Held-to-Maturity Investments				
	Gross		Gross	
	Amortized	Unrecognized	Unrecognized	Fair
December 31, 2017	Cost	Gain	(Loss)	Value
Certificates of deposit	\$14,397	\$ -	\$ (18	) \$14,379
Corporate bonds	42,467	-	(235	) 42,232
Municipal bonds	350	-	(1	) 349
Total held-to-maturity investments	\$57,214	\$ -	\$ (254	) \$56,960
Available-for-Sale Investments				
	Gross		Gross	
	Amortized	Unrealized	Unrealized	Fair
March 31, 2017	Cost	Gain	(Loss)	Value
Corporate bonds	\$6,381	\$ -	\$ (4	) \$6,377
Municipal bonds	678	-	(16	) 662
Total available-for-sale investments	\$7,059	\$ -	\$ (20	) \$7,039
Held-to-Maturity Investments				
	Gross		Gross	
	Amortized	Unrecognized	Unrecognized	Fair
March 31, 2017	Cost	Gain	(Loss)	Value
Certificates of deposit	\$3,735	\$ 1	\$ (1	) \$3,735
Commercial paper	5,588	-	(3	) 5,585
Corporate bonds	57,009	-	(186	) 56,823
Municipal bonds	361	-	(1	) 360
Total held-to-maturity investments	\$66,693	\$ 1	\$ (191	) \$66,503

During the three months ended December 31, 2017 and 2016, redemptions of investments in accordance with callable provisions were \$0.9 million and \$0, respectively. During the nine months ended December 31, 2017 and 2016, redemptions of investments in accordance with callable provisions were \$0.9 million and \$0, respectively. As of December 31, 2017 and March 31, 2017, we had unrealized loss on available-for-sale investments, net of related income taxes, of \$64,000 and \$12,000, respectively. The amortized cost of our held-to-maturity investments approximates their fair value.

The following table summarizes the amortized cost and fair value of our investments, classified by stated maturity as of December 31, 2017 and March 31, 2017 (in thousands).

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	December 31, 2017		December 31, 2017	
	Available-for-Sale Investments		Held-to-Maturity Investments	
	Amortized		Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in less than one year	\$ 49,251	\$ 49,191	\$ 40,526	\$ 40,420
Due in 1 to 3 years	6,692	6,645	16,688	16,540
Total investments	\$ 55,943	\$ 55,836	\$ 57,214	\$ 56,960

	March 31, 2017		March 31, 2017	
	Available-for-Sale Investments		Held-to-Maturity Investments	
	Amortized		Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in less than one year	\$ 6,381	\$ 6,377	\$ 45,184	\$ 45,124
Due in 1 to 3 years	678	662	21,509	21,379
Total investments	\$ 7,059	\$ 7,039	\$ 66,693	\$ 66,503

Table of Contents

The following tables present gross unrealized losses and fair values for those investments that were in an unrealized loss position as of December 31, 2017 and March 31, 2017, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position (in thousands).

	As of December 31, 2017					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Certificates of deposit	\$13,133	\$ (18 )	\$ -	\$ -	\$13,133	\$ (18 )
Commercial paper	9,954	(6 )	-	-	9,954	(6 )
Corporate bonds	65,280	(217 )	22,178	(115 )	87,458	(332 )
Municipal bonds	656	(4 )	349	(1 )	1,005	(5 )
Total investments in an unrealized loss position	\$89,023	\$ (245 )	\$ 22,527	\$ (116 )	\$111,550	\$ (361 )

	As of March 31, 2017					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Certificates of deposit	\$2,738	\$ (1 )	\$ -	\$ -	\$2,738	\$ (1 )
Commercial paper	2,989	(3 )	-	-	2,989	(3 )
Corporate bonds	44,387	(177 )	16,108	(13 )	60,495	(190 )
Municipal bonds	1,021	(17 )	-	-	1,021	(17 )
Total investments in an unrealized loss position	\$51,135	\$ (198 )	\$ 16,108	\$ (13 )	\$67,243	\$ (211 )

We periodically review our investments for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. For debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. During the three and nine months ended December 31, 2017 and 2016, we did not recognize any other-than-temporary impairment loss. As of December 31, 2017 and March 31, 2017, we did not have other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity or available-for-sale.

**NOTE 6. FAIR VALUE MEASUREMENTS**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the

financial instrument.

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

12

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Table of Contents

The following table summarizes financial assets, measured at fair value on a recurring basis, by level of input within the fair value hierarchy as of December 31, 2017 and March 31, 2017 (in thousands).

As of December 31, 2017				
	Quoted Prices in Active Markets for Identical Assets Level 1	Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets				
Cash equivalents	\$7,098	\$ -	\$ -	\$7,098
Available-for-sale investments:				
Commercial paper	-	9,954	-	9,954
Corporate bonds	-	45,226	-	45,226
Municipal bonds	-	656	-	656
Total assets at fair value	\$7,098	\$ 55,836	\$ -	\$62,934

As of March 31, 2017				
	Quoted Prices in Active Markets for Identical Assets Level 1	Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets				
Cash equivalents	\$584	\$ -	\$ -	\$584
Available-for-sale investments:				
Corporate bonds	-	6,377	-	6,377
Municipal bonds	-	662	-	662
Total assets at fair value	\$584	\$ 7,039	\$ -	\$7,623

As of December 31, 2017 and March 31, 2017, our Level 1 financial assets consisted of money market mutual funds. Our cash equivalents are highly liquid instruments with original or remaining maturities of three months or less at the time of purchase that are readily convertible into cash. The fair value of our Level 1 financial assets is based on quoted market prices of the underlying security.

As of December 31, 2017 and March 31, 2017, our Level 2 financial assets consisted primarily of commercial paper, corporate bonds and municipal bonds. For our Level 2 financial assets, we review trading activity and pricing for these investments as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from third party data providers. These inputs represent quoted prices for similar assets in active markets or these inputs have been derived

from observable market data.

As of December 31, 2017 and March 31, 2017, we did not have any Level 1 and Level 2 financial liabilities or Level 3 financial assets or liabilities measured at fair value on a recurring basis. We did not have any transfers between Level 1 and Level 2 or transfers in or out of Level 3 during the three and nine months ended December 31, 2017 and 2016.

#### NOTE 7. INVENTORIES

Inventories include material, labor and manufacturing overhead, and are stated at the lower of cost (first-in, first-out method) or net realizable value. Components of inventories as of December 31, 2017 and March 31, 2017 were as follows (in thousands):

	December 31, 2017	March 31, 2017
Raw materials	\$ 19,679	\$ 16,567
Work-in-process	6,205	4,212
Finished goods	16,614	18,231
Inventories	\$ 42,498	\$ 39,010

Table of Contents

## NOTE 8. INVESTMENT IN UNCONSOLIDATED AFFILIATES

In June 2016, we invested a total of \$3.0 million in a privately-held company. Our investment was initially recorded under the cost method as we did not exercise significant influence over the investee's operating or financial activities. The carrying value of our cost method investment was reviewed quarterly for changes in circumstances or the occurrence of events that suggest our investment may not be recoverable. The fair value of cost method investments was not adjusted if there were no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment.

In January 2017, we entered into a letter agreement with the privately-held company. Under the terms of the letter agreement, the privately-held company will, pending negotiation and execution of a definitive agreement, commence chemistry development activities for us using its intellectual product and technology. As consideration for these development efforts, we agreed to pay a total of up to \$1.5 million to the privately-held company, which includes an upfront payment of \$0.3 million that we paid in January 2017, and any remaining obligation to the investee is contingent upon the achievement of certain development milestones. As a result of our ability to exercise significant influence over operating and financial policies in our investment, which we do not control, we accounted for our investment in the privately-held company using the equity method on a prospective basis beginning in January 2017 based on our early adoption of ASU 2016-07. Our allocated portion of net loss in our equity method investment in the privately-held company during the three months ended December 31, 2017 and 2016, was \$46,000 and \$0, respectively, and during the nine months ended December 31, 2017 and 2016, were \$0.1 million and \$0, respectively. Our proportionate share of the privately-held company's net income or loss is recorded in "Interest and other income (expense), net" on the condensed consolidated statements of income. As of December 31, 2017 and March 31, 2017, the carrying value of our equity method investment in this privately-held company was \$2.7 million and \$2.9 million, respectively. See Note 20, "Subsequent Events," for information regarding additional investment in the privately-held company after December 31, 2017.

In February 2011, we purchased a 15% equity ownership interest in Scandinavian Micro Biodevices APS ("SMB"), a developer and manufacturer of point-of-care diagnostic products for veterinary use, for \$2.8 million in cash. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. We accounted for our investment in SMB using the equity method due to our significant influence over SMB's operations. In August 2016, we sold our 15% equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB. The total purchase price paid to us for our equity method investment in SMB was approximately \$9.7 million in cash, subject to a holdback for certain adjustments that may occur. The holdback payment is expected to be released 18 months following the closing date. In connection with the sale, we received an initial cash payment of \$8.5 million and recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the period ended September 30, 2016. Our allocated portion of SMB's net loss during the three months ended December 31, 2017 and 2016 was \$0 in each period and during the nine months ended December 31, 2017 and 2016 was \$0 and \$34,000, respectively. Our proportionate share of SMB's net income or loss is recorded in "Interest and other income (expense), net" on the condensed consolidated statements of income. As of December 31, 2017 and March 31, 2017, the carrying value of our equity method investment in SMB was \$0. We have been notified that the holdback will be released in full and expect to receive payment of the holdback amount of approximately \$1.2 million in February 2018.

## NOTE 9. OTHER NON-CURRENT ASSETS

Other non-current assets as of December 31, 2017 and March 31, 2017 were as follows (in thousands):

	December 31, 2017	March 31, 2017
Non-current lease receivables	\$ 9,090	\$ 7,476



Other assets	134	148
Total other non-current assets	\$ 9,224	\$ 7,624

Non-current lease receivables represent sales-type leases resulting from the sale of our products and are typically collateralized by a security interest in certain of the underlying assets. Starting in fiscal 2016, we entered into sales contracts as the lessor of instruments with end users for monthly payments of instrument and consumable purchases over a term of six years. As of December 31, 2017, the current and non-current portion of lease receivables, including accrued interest, was \$2.3 million and \$9.1 million, respectively. Our current and non-current lease receivables are recorded within “Receivables” and “Other assets,” respectively, on our condensed consolidated balance sheets. Interest income is recognized monthly over the lease term using the effective-interest method.

Table of Contents

Future minimum lease payments to us on lease receivables as of December 31, 2017 are summarized as follows (in thousands):

Fiscal Year	Amount
2018 (remaining three months)	\$ 564
2019	2,320
2020	2,320
2021	2,286
2022	2,292
Thereafter	1,604
Total	11,386
Less: Current portion	(2,296 )
Non-current lease receivable	\$ 9,090

## NOTE 10. WARRANTY RESERVES

We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments and reagent discs.

**Instruments.** Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service experience. The estimated accrual for warranty exposure is based on historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. Total current and non-current accrued warranty reserve related to instruments as of December 31, 2017 and March 31, 2017 was \$4.4 million and \$3.8 million, respectively.

**Reagent Discs.** We record a provision for defective reagent discs when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. The warranty cost includes the replacement costs and freight of a defective reagent disc. The balance of accrued warranty reserve related to replacement of defective reagent discs as of December 31, 2017 and March 31, 2017 was \$0.6 million and \$0.6 million, respectively, which was classified as a current liability on the condensed consolidated balance sheets.

We evaluate our estimates for warranty reserves on an ongoing basis and believe we have the ability to reasonably estimate warranty costs. However, unforeseeable changes in factors may impact the estimate for warranty and such changes could cause a material change in our warranty reserve accrual in the period in which the change was identified.

The change in our accrued warranty reserve during the three and nine months ended December 31, 2017 and 2016 is summarized as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Balance at beginning of period	\$ 4,759	\$ 3,950	\$ 4,358	\$ 3,208

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Provision for warranty expense	811	568	2,273	2,068
Warranty costs incurred	(577 )	(325 )	(1,638 )	(1,083 )
Balance at end of period	4,993	4,193	4,993	4,193
Non-current portion of warranty reserve	2,864	2,616	2,864	2,616
Current portion of warranty reserve	\$ 2,129	\$ 1,577	\$ 2,129	\$ 1,577

15

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Table of Contents

## NOTE 11. BORROWINGS

Notes Payable. We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City (the “Agency”) whereby the Agency provides us with an unsecured loan of up to \$1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of December 31, 2017, our short-term and long-term notes payable balances were \$0.1 million and \$0.2 million, respectively, and as of March 31, 2017, our short-term and long-term notes payable balances were \$0.1 million and \$0.3 million, respectively. The short-term balance was recorded in “Other accrued liabilities” on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date Abaxis ceases operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon an event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of December 31, 2017.

In accordance with the terms of the loan agreement, the Agency will provide Abaxis with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by Abaxis to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income.

## NOTE 12. OTHER CURRENT ACCRUED LIABILITIES

Other current accrued liabilities as of December 31, 2017 and March 31, 2017 were as follows (in thousands):

	December 31, 2017	March 31, 2017
Accrued liabilities for customer sales incentive programs	\$ 11,326	\$ 7,181
Other current accrued liabilities	4,322	3,825
Total other current accrued liabilities	\$ 15,648	\$ 11,006

As of December 31, 2017 and March 31, 2017, accrued liabilities for customer sales incentive programs consisted primarily of (i) a liability to distributors or end-users for cash rebates upon meeting certain requirements during a qualifying period and (ii) a liability to resellers for incentives that we estimate at the time of initial sale and adjust as earned by end-users during a specified promotional period.

Other current accrued liabilities included notes payable and various expenses that we accrued for transaction taxes and professional costs.

## NOTE 13. COMMITMENTS AND CONTINGENCIES

## Commitments

We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately \$2.2 million as of December 31, 2017. These purchase order commitments primarily include our purchase obligations to purchase from Diatron of Hungary through fiscal 2018.

In April 2017, we entered into a joint development agreement with the diagnostics division of a medical products company, whereby we were subject to payments of up to \$10.2 million, in consideration of development efforts, over

an estimated period of four years. Our payment obligations were contingent upon the achievement of certain development milestones. In November 2017, prior to the achievement of any such development milestones, both parties agreed to terminate the joint development agreement and as of December 31, 2017, we had no outstanding obligations under this agreement.

See Note 8, "Investments in Unconsolidated Affiliates," for information on commitments due in connection with our investment in a privately-held company.

#### Litigation

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

Table of Contents

NOTE 14. EQUITY COMPENSATION PLANS AND SHARE-BASED COMPENSATION

Equity Compensation Plans

Our share-based compensation plans are described below.

**2014 Equity Incentive Plan.** Our 2014 Equity Incentive Plan, as amended (the “2014 Plan”), which was approved by our shareholders on October 22, 2014, is the successor to and continuation of the 2005 Equity Incentive Plan (the “2005 Plan”). The terms of the 2014 Plan provide for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, other stock awards and performance awards that may be settled in cash, stock or other property. At its October 22, 2014 effective date, the total number of shares of the Company’s common stock available for issuance under the 2014 Plan was 1,712,409 shares, which was equal to the sum of (i) the shares remaining available for issuance pursuant to the exercise of options or issuance or settlement of stock awards that had not previously been granted under the 2005 Plan, as of the effective date of the 2014 Plan and (ii) the Returning Shares (as defined below), as of the effective date of the 2014 Plan. The “Returning Shares” are shares subject to outstanding stock awards granted under the 2005 Plan (the “2005 Available Pool”), as of the effective date of the 2014 Plan, (i) expire or terminate for any reason prior to exercise or settlement, (ii) are forfeited, cancelled or otherwise returned to us because of the failure to meet a contingency or condition required for the vesting of such shares, or (iii) are reacquired or withheld (or not issued) by us to satisfy a tax withholding obligation in connection with a stock award or to satisfy the purchase price or exercise price of a stock award.

On October 26, 2016, our shareholders approved an amendment to the 2014 Plan to, among other things, (i) increase the aggregate number of shares of common stock reserved for issuance under the 2014 Plan by 900,000 shares and (ii) update the means of adjustment when calculating the attainment of performance goals for performance awards under the 2014 Plan for purposes of the requirements of Section 162(m) of the Internal Revenue Code.

**2005 Equity Incentive Plan.** Our 2005 Plan was originally approved by our shareholders in October 2005 and restated and amended our 1998 Stock Option Plan. Our 2005 Plan allowed for the grant of stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance cash awards, performance shares, performance units, deferred compensation awards or other share-based awards to employees, directors and consultants. Our 2005 Plan was succeeded by our 2014 Plan upon adoption of our 2014 Plan on October 22, 2014, and no additional awards may be made under our 2005 Plan. However, as described above, the 2005 Available Pool became available for issuance under the 2014 Plan and Returning Shares may become available under the 2014 Plan from time to time.

As of December 31, 2017, the 2014 Plan provided for the issuance of a maximum of 2,612,409 shares, of which 989,000 shares of common stock were available for future issuance under the 2014 Plan pursuant to stock awards that had not previously been granted. Shares that are canceled or forfeited from an award and shares withheld in satisfaction of tax withholding obligations are again available for issue under the 2014 Plan.

We issue new shares of common stock from our authorized shares for share-based awards upon the exercise of stock options or vesting of restricted stock units.

Table of Contents

## Share-Based Compensation

Share-based compensation expense and related restricted stock unit award activity is presented on a consolidated basis, unless otherwise presented as continuing or discontinued operations.

The following table summarizes total share-based compensation expense, net of tax, related to restricted stock units, and represents our results from continuing operations, during the three and nine months ended December 31, 2017 and 2016, which is included in our condensed consolidated statements of income (in thousands, except per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Cost of revenues	\$ 375	\$ 360	\$ 1,126	\$ 1,326
Research and development	691	602	2,234	1,880
Sales and marketing	1,087	797	3,419	2,218
General and administrative	1,419	673	3,412	2,893
Share-based compensation expense before income taxes	3,572	2,432	10,191	8,317
Income tax benefit	(906 )	(839 )	(3,183 )	(2,881 )
Total share-based compensation expense after income taxes	\$ 2,666	\$ 1,593	\$ 7,008	\$ 5,436
Net impact of share-based compensation on:				
Basic net income per share	\$ 0.12	\$ 0.07	\$ 0.31	\$ 0.24
Diluted net income per share	\$ 0.12	\$ 0.07	\$ 0.30	\$ 0.24

Share-based compensation has been classified in the condensed consolidated statements of income or capitalized on the condensed consolidated balance sheets in the same manner as cash compensation paid to employees. Capitalized share-based compensation costs as of December 31, 2017 and March 31, 2017 were \$0.2 million and \$0.2 million, respectively, which were included in “Inventories” on our condensed consolidated balance sheets. The income tax benefit for the three and nine months ended December 31, 2017 includes the reduction of the United States federal tax rate from 35% to 21% as a result of the Tax Cuts and Jobs Act (“the Tax Act”) enacted on December 22, 2017 resulting in a blended federal rate of 31.5% for the fiscal year ending March 31, 2018. The income tax rate in the income tax benefit was 25% and 34%, respectively, during the three months ended December 31, 2017 and 2016, and 31% and 35%, during the nine months ended December 31, 2017 and 2016, respectively.

During the first quarter of fiscal 2018, we adopted ASU 2016-09, and as a result of adoption, during the three and nine months ended December 31, 2017, we recognized \$16,000 and \$0.2 million, respectively of excess tax benefits related to share-based payments in our income tax provision. These items were historically recorded in common stock. In addition, effective April 1, 2017, cash flows related to excess tax benefits are classified as an operating activity along with other income tax cash flows, and as a result, were classified as such during the three and nine months ended December 31, 2017. Our compensation expense each period continues to reflect estimated forfeitures.

## Restricted Stock Units

Since fiscal 2007, we have granted restricted stock unit awards to employees and directors as part of our share-based compensation program. Restricted stock unit awards to consultants were not significant. Awards of restricted stock units are issued at no cost to the recipient and may have time-based vesting criteria, or a combination of time-based and performance-based vesting criteria, as described below. From time to time, restricted stock unit awards granted to employees may be subject to accelerated vesting upon achieving certain performance-based milestones.

The Compensation Committee of our Board of Directors (the “Compensation Committee”) in its discretion, may provide in the event of a change in control for the acceleration of vesting and/or settlement of the restricted stock unit held by

a participant upon such conditions and to such extent as determined by the Compensation Committee. Our Board of Directors has adopted an executive change in control severance plan, which it may terminate or amend at any time, that provides that awards granted to executive officers will accelerate fully on a change of control. The vesting of non-employee director and officer awards granted under the 2014 Plan automatically will also accelerate in full upon a change in control. Beginning in fiscal 2015, the Compensation Committee discontinued the practice of granting such “single trigger” acceleration of vesting benefits to new executive officers pursuant to which an executive officer’s outstanding stock option(s) and other unvested equity-based instruments would accelerate in full upon the occurrence of a change of control. Starting in fiscal 2015, we grant “double-trigger” acceleration arrangements to new executive officers, which requires both the occurrence of a change of control and the termination by us (or our successor) for any reason other than cause, death or disability within 18 months following such change of control date, with the termination constituting a separation in service and subject to execution of a valid and effective release of claims against us, for the acceleration of vesting of the executive officer’s equity awards in full.



## Table of Contents

### Restricted Stock Unit Awards (Time Vesting)

We grant restricted stock unit awards with only time-based vesting terms, which we refer to as RSUs. The RSUs entitle holders to receive shares of common stock at the end of a specified period of time. For RSUs, vesting is based on continuous employment or service of the holder. Upon vesting, the equivalent number of common shares are typically issued net of tax withholdings. If the service vesting conditions are not met, unvested RSUs will be forfeited. Generally, RSUs vest according to one of the following time-based vesting schedules:

**RSU awards to employees:** Four-year time-based vesting as follows: 5% vesting after the first year; additional 10% after the second year; additional 15% after the third year; and the remaining 70% after the fourth year of continuous employment with the Company.

**RSU awards to non-employee directors:** 100% vesting after one year of continuous service to the Company.

The fair value of RSUs used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Such value is recognized as an expense over the corresponding requisite service period. The share-based compensation expense is reduced for an estimate of the RSU awards that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. As of December 31, 2017, the total unrecognized compensation expense related to RSU awards granted amounted to \$21.8 million, which is expected to be recognized over a weighted average service period of 2.2 years.

### Restricted Stock Unit Awards (Performance Vesting)

We grant restricted stock unit awards subject to performance vesting criteria, which we refer to as PSUs to our executive officers and to certain of our other employees. The PSUs vest only if both of the following criteria are satisfied: (1) achievement of financial target during the fiscal year in which the grant occurred, as determined and certified by the Compensation Committee and (2) the recipient remains in the continuous service of the Company until the applicable vesting date.

**Fiscal 2017 Performance RSUs.** In April 2016, the Compensation Committee approved the grant of PSUs for 152,000 shares of common stock to our executive officers and to certain of our other employees (the “FY2017 PSUs”). These FY2017 PSUs, as originally granted to our executive officers and other employees other than our Chief Executive Officer, vested only if both of the following criteria are satisfied: (1) our consolidated income from operations during the fiscal year 2017, as certified by the Compensation Committee, was in excess of the applicable target amount described below; and (2) the recipient remains in the continuous service of the Company until the applicable vesting date set forth as follows:

- 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;
- 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;
- 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and
- 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

The FY2017 PSUs as originally granted to our Chief Executive Officer, Mr. Clinton Severson, vest as follows:

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approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;  
approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;  
approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and  
approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

Of the aggregate shares of common stock issuable upon settlement of the FY2017 PSUs, 84,000 and 68,000 shares of common stock, respectively, were granted with performance conditions subject to vesting in full upon achieving 100% and 90%, respectively, of the financial targets described above. The aggregate estimated grant date fair value of the FY2017 PSUs was \$6.8 million based on the closing market price of our common stock on the date of grant. On January 25, 2017, the Compensation Committee approved an amendment to our FY2017 PSUs so the performance vesting condition refers to the Company's consolidated income from continuing operations before income tax provision, rather than consolidated income from operations. The service vesting condition and all other terms and conditions of our FY2017 PSUs were not changed.

## Table of Contents

On December 31, 2016, we reviewed each of the underlying performance targets related to the outstanding FY2017 PSUs and determined that it was not probable that the performance targets of the FY2017 PSUs would be met for the 84,000 shares of common stock. Consequently, upon our determination of non-achievement of the performance condition, with respect to achievement of 100% of the financial target in fiscal 2017, we reversed the cumulative share-based compensation expense related to the original awards in the third quarter of fiscal 2017, resulting in no share-based compensation expense recorded for these awards through December 31, 2016. Additional share-based compensation of \$0.6 million would have been recorded during the nine months ended December 31, 2016 had the achievement of performance targets been deemed probable for the 84,000 shares of common stock.

On January 25, 2017, we evaluated the modification of the performance conditions for the FY2017 PSUs and determined that the performance conditions for the 84,000 shares of common stock was a Type III modification or “Improbable to Probable” pursuant to ASC 718 as the awards, on the date of modification, were no longer probable of being achieved in fiscal 2017. Because the 84,000 shares of common stock of the FY2017 PSUs granted were improbable of vesting prior to the modification of the performance conditions, the original grant date fair value is no longer used to measure compensation cost for the awards. In accordance with ASC 718, the fair value of the 84,000 shares of common stock of the modified FY2017 PSUs was re-measured with a measurement date of January 25, 2017, and an aggregate grant date fair value of \$4.0 million. As we determined that the performance conditions of the modified award would be met for the 84,000 shares of common stock as of March 31, 2017, we recorded share-based compensation expense during fiscal 2017, ratably, beginning on January 25, 2017 over the vesting terms of the modified FY2017 PSUs.

For the remaining 68,000 shares of common stock issuable upon settlement of the FY2017 PSUs, we evaluated the modification of the performance conditions for the FY2017 PSUs and determined it was a Type I modification or “Probable to Probable” pursuant to ASC 718. Accordingly, we record share-based compensation expense, ratably, beginning on the original grant date over the vesting terms of the PSUs, as we determined that the performance targets approved by the Compensation Committee in April 2016 would be met.

Fiscal 2018 Performance RSUs. In April 2017, the Compensation Committee approved the grant of PSUs for 137,000 shares of common stock to our executive officers and to certain of our other employees that contained the foregoing time-based and performance-based vesting terms (the “FY2018 PSUs”).

50% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations before income tax provision target described above and continuous service until the third anniversary of the date of grant; and

50% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations before income tax provision target described above and continuous service until the fourth anniversary of the date of grant.

We recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of PSUs used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously recognized compensation expense is reversed. The share-based compensation expense is reduced for an estimate of the PSUs that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. If the service vesting conditions are not met, unvested PSUs will be forfeited. Upon vesting on the third and fourth anniversary date of grant of the PSUs, the equivalent number of common shares are typically issued net of tax withholdings.

For the PSUs granted in fiscal 2015, 2016 and 2017, we determined that the performance targets (including as adjusted to reflect the modified performance conditions for the FY2017 PSUs discussed above) were met in each respective fiscal year of grant and we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2017. For the FY2018 PSUs, we determined that it was probable that the performance targets would be met and accordingly, we recorded share-based compensation expense ratably over the vesting the terms of the FY2018 PSUs during the three and nine months ended December 31, 2017. We will assess the probability of the performance targets at the end of each quarter.

As of December 31, 2017, the total unrecognized compensation expense related to PSU awards granted and expected to vest amounted to \$9.5 million, which is expected to be recognized over a weighted average service period of 1.6 years.

Table of Contents

## Restricted Stock Unit Activity

The following table summarizes restricted stock unit activity for the nine months ended December 31, 2017.

	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value (1)	Number of Shares	Weighted Average Grant Date Fair Value (1)
Nonvested at March 31, 2017	535,000	\$ 46.62	439,000	\$ 47.40
Granted	241,000	46.41	137,000	45.84
Vested (2)	(149,000 )	43.52	(62,000 )	40.82
Canceled and forfeited	(5,000 )	46.98	-	-
Nonvested at December 31, 2017	622,000	\$ 47.27	514,000	\$ 47.78

(1) The weighted average grant date fair value of restricted stock units is based on the number of shares and the closing market price of our common stock on the date of grant.

(2) The number of restricted stock units vested includes shares that we withheld on behalf of our employees to satisfy the statutory tax withholding requirements.

Total intrinsic value of restricted stock units vested during the three months ended December 31, 2017 and 2016 was \$0.4 million and \$0.3 million, respectively, and during the nine months ended December 31, 2017 and 2016 was \$9.8 million and \$8.1 million, respectively.

The total grant date fair value of restricted stock units vested during the three months ended December 31, 2017 and 2016 was \$0.3 million and \$0.2 million, respectively, and during the nine months ended December 31, 2017 and 2016 was \$9.0 million and \$7.3 million, respectively.

## NOTE 15. SHAREHOLDERS' EQUITY

## Share Repurchase Program

Between August 2011 and July 2016, our Board of Directors authorized the repurchase of up to a total of \$97.3 million of our common stock. In October 2017, our Board of Directors approved a \$21.0 million increase to our existing share repurchase program. As of December 31, 2017, \$75.0 million was available to purchase common stock under our share repurchase program.

Since the share repurchase program began, through December 31, 2017, we have repurchased 1.6 million shares of our common stock at a total cost of \$43.3 million, including commission expense. During the three and nine months ended December 31, 2017 and 2016, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

## Dividend Payments

During the three months ended December 31, 2017 and 2016, our total quarterly dividend payout was \$3.6 million and \$3.2 million, respectively. During the nine months ended December 31, 2017 and 2016, our total quarterly dividend payout was \$10.0 million and \$8.6 million, respectively. Our dividend payouts were made from retained earnings.

See Note 20, “Subsequent Events,” for information regarding cash dividends declared by our Board of Directors after December 31, 2017.

NOTE 16. NET INCOME PER SHARE

Basic net income per share is computed by dividing the net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income by the weighted average number of common shares that would have been outstanding during the period assuming the issuance of common shares for all potential dilutive common shares outstanding using the treasury stock method. The treasury stock method assumes that proceeds, including the total unrecognized compensation expense for unvested share-based compensation awards and, prior to our adoption of the new accounting standard related to share-based compensation on April 1, 2017, the tax benefits resulting from share-based compensation tax deductions in excess of the related expense recognized for financial reporting purposes, would be used to purchase our common stock at the average market price during the period. The adoption of ASU 2016-09 is discussed further in Note 2, “Summary of Significant Accounting Policies.” Dilutive potential common shares outstanding include outstanding restricted stock units.

Table of Contents

The computations for basic and diluted net income per share for the three and nine months ended December 31, 2017 and 2016 are as follows (in thousands, except share and per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Income from continuing operations	\$4,226	\$6,859	\$17,157	\$25,236
Loss from discontinued operations, net of tax	-	(15)	-	(70)
Net income	\$4,226	\$6,844	\$17,157	\$25,166
Weighted average common shares outstanding:				
Basic	22,695,000	22,535,000	22,663,000	22,508,000
Effect of dilutive securities:				
Restricted stock units	349,000	254,000	358,000	245,000
Diluted	23,044,000	22,789,000	23,021,000	22,753,000
Net income per share:				
Basic				
Continuing operations	\$0.19	\$0.30	\$0.76	\$1.12
Discontinued operations	-	-	-	-
Basic net income per share	\$0.19	\$0.30	\$0.76	\$1.12
Diluted				
Continuing operations	\$0.18	\$0.30	\$0.75	\$1.11
Discontinued operations	-	-	-	-
Diluted net income per share	\$0.18	\$0.30	\$0.75	\$1.11

For our PSUs, if the performance criteria are achieved during the period, these awards will be considered outstanding for the purpose of computing diluted net income per share if the effect is dilutive. Because the performance criteria for FY2018 PSUs were not achieved during the three and nine months ended December 31, 2017, these awards were not included in the diluted net income per share calculation.

Restricted stock units for 78,000 and 0 shares during the three months ended December 31, 2017 and 2016, respectively, and 5,000 and 2,000 shares during the nine months ended December 31, 2017 and 2016, respectively, were outstanding but not included in the computation of diluted net income per share because the effect would be antidilutive.

**NOTE 17. INCOME TAXES**

The following table provides details of income taxes for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Income from continuing operations before income tax provision	\$9,455	\$10,788	\$29,435	\$39,524
Income tax provision	\$5,229	\$3,929	\$12,278	\$14,288
Effective tax rate	55 %	36 %	42 %	36 %

The Company's effective tax rate during the three and nine months ended December 31, 2017 was impacted by the Tax Act. Income tax effects resulting from changes in tax laws are accounted for by the Company in accordance with the authoritative guidance, which requires that these tax effects be recognized in the period in which the law is enacted and the effects are recorded as a component of provision for income taxes from continuing operations. As a result, the Company made an additional provision for income tax resulting from the enactment of the Tax Act during the three and nine months ended December 31, 2017.

The Tax Act includes significant changes to the U.S. income tax system. The Tax Act, among other changes, reduces the U.S. federal corporate tax rate from 35% to 21% as of January 1, 2018, eliminates the federal benefit for qualified production activities, expands the deduction limitation for executive compensation, creates a territorial system which will generally allow companies to repatriate future foreign earnings without incurring additional U.S. income taxes, subjects foreign earnings on which U.S. income tax is currently deferred to a one time transition tax, creates a "minimum tax" on certain intangible foreign earnings and creates an incentive for U.S. companies to sell goods and services abroad. The decrease in the U.S. federal corporate tax rate from 35% to 21% results in a blended statutory tax rate of 31.5% for the fiscal year ending March 31, 2018.

The dollar increase in the income tax provision during the three months ended December 31, 2017, as compared to the same period last year, was attributable to a one-time non-cash charge of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the federal tax rate from 35% to 21% effective January 1, 2018, partially offset by the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5%.



## Table of Contents

The dollar decrease in the income tax provision during the nine months ended December 31, 2017, as compared to the same period last year, was attributable to lower pre-tax income and the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5%, partially offset by a one-time non-cash charge of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the federal tax rate from 35% to 21% effective January 1, 2018.

The increase in the effective tax rate during the three and nine months ended December 31, 2017, as compared to the same period last year, was primarily attributable to an additional provision for income tax resulting from the enactment of the Tax Act during the three and nine months ended December 31, 2017, as described above. The increase in the effective tax rate was partially offset by the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5% and the recognition of excess tax benefits as a discrete item in the three and nine months ended December 31, 2017 pursuant to ASU 2016-09, which we adopted effective the first quarter of fiscal 2018. The adoption of ASU 2016-09 is discussed further in Note 2, "Summary of Significant Accounting Policies."

As of December 31, 2017, the Company had not fully completed its accounting for the tax effects of the enactment of the Tax Act. The Company's provision for income taxes during the three and nine months ended December 31, 2017 is based on a reasonable estimate of the effects on its transition tax and existing deferred tax balances. The Company estimates it will incur no transition tax and has recorded a one-time non-cash charge of \$2.9 million due to an estimated reduction in deferred tax assets as a result of the reduction of the federal rate from 35% to 21%. The computation of the transition tax could be impacted by further interpretations from the U.S. and state governments and regulatory organizations. The reduction of the deferred tax assets may be impacted by changes in the timing for the reversal of existing deferred tax assets and liabilities.

The Tax Act also includes provisions for Global Intangible Low-Taxed Income ("GILTI") wherein taxes on foreign income are imposed in excess of a deemed return on tangible assets of foreign corporations which applies after the fiscal year ending March 31, 2018. Because of the complexity of the new provisions, we are continuing to evaluate how the provisions will be accounted for under GAAP wherein companies are allowed to make an accounting policy election to either (i) account for GILTI as a component of tax expense in the period in which they are subject to the rules or (ii) account for GILTI in our measurement of deferred taxes. Prior to the reporting period in which the Tax Act was enacted, our policy was to reinvest earnings of their foreign subsidiaries unless such earnings are subject to U.S. taxation. As of March 31, 2017, there were no earnings that have not been subject to U.S. taxation. We do not have sufficient information available to finalize our analysis of the impact of the Tax Act on our repatriation policy, and therefore, the policy has not changed as of December 31, 2017. We expect to finalize our analysis during the fourth quarter ending March 31, 2018 which may include a change in our repatriation policy.

We did not have any unrecognized tax benefits as of December 31, 2017 and March 31, 2017. During the three and nine months ended December 31, 2017 and 2016, we did not recognize any interest or penalties related to unrecognized tax benefits.

We are subject to income taxes in the United States and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. In the third quarter of fiscal 2017, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015, which was completed in the second quarter of fiscal 2018 and there have not been any proposed assessments as a result of this examination. Our foreign subsidiary income tax returns for fiscal 2013 through 2015 are subject to examination by German tax authorities. The German tax examination commenced in the third quarter of fiscal 2018. As of December 31, 2017, there had been no proposed assessments by such authorities in Germany and we are unable to estimate the range of possible outcomes at this time.

## NOTE 18. SEGMENT REPORTING INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by our chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

Abaxis develops, manufactures and markets portable blood analysis systems for use in human or veterinary patient care setting to provide clinicians with rapid blood constituent measurements. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenue or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold by market and customer group. For the products that we manufacture and sell, each reportable segment has similar manufacturing processes, technology and shared infrastructures. The accounting policies for segment reporting are the same as for the Company as a whole. We do not segregate assets by segments since our chief operating decision maker, or decision making group, does not use assets as a basis to evaluate a segment's performance.

#### Medical Market

In the medical market reportable segment, we serve a worldwide customer group consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines. The products manufactured and sold in this segment primarily consist of Piccolo chemistry analyzers and medical reagent discs.

Table of Contents

## Veterinary Market

In the veterinary market reportable segment, we serve a worldwide customer group consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables, urinalysis instruments and related consumables and VetScan rapid tests. Financial information pertaining to our AVRL business is presented as a discontinued operation. See Note 4, "Discontinued Operations."

## Total Revenues, Cost of Revenues and Gross Profit by Segment

The table below summarizes revenues, cost of revenues and gross profit from our two operating segments and from certain unallocated items and represents our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands).

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Revenues:				
Medical Market	\$ 10,193	\$ 8,652	\$28,337	\$27,130
Veterinary Market	48,424	43,198	145,328	139,219
Other (1)	1,053	922	3,117	2,671
Total revenues	59,670	52,772	176,782	169,020
Cost of revenues:				
Medical Market	5,425	4,498	15,490	14,485
Veterinary Market	21,982	18,845	64,800	60,729
Other (1)	87	25	211	143
Total cost of revenues	27,494	23,368	80,501	75,357
Gross profit:				
Medical Market	4,768	4,154	12,847	12,645
Veterinary Market	26,442	24,353	80,528	78,490
Other (1)	966	897	2,906	2,528
Gross profit	\$ 32,176	\$ 29,404	\$96,281	\$93,663

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(1) Represents unallocated items, not specifically identified to any particular business segment.

#### NOTE 19. REVENUES BY PRODUCT CATEGORY AND GEOGRAPHIC REGION AND SIGNIFICANT CONCENTRATIONS

##### Revenue Information

The following is a summary of our revenues by product category and represents our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands).

	Three Months Ended December 31,		Nine Months Ended December 31,	
Revenues by Product Category	2017	2016	2017	2016

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Instruments (1)	\$ 10,468	\$ 9,349	\$28,395	\$29,271
Consumables (2)	45,475	40,353	137,884	130,554
Other products (3)	3,727	3,070	10,503	9,195
Product sales, net	\$ 59,670	\$ 52,772	\$ 176,782	\$ 169,020

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(1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers, i STAT analyzers and urinalysis instruments.

(2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i STAT cartridges, urinalysis tests and rapid tests.

(3) Other products include products using the Orbo process and extended maintenance agreements.

Table of Contents

The following is a summary of our revenues by geographic region based on customer location and represents our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands).

Revenues by Geographic Region	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
North America	\$ 46,442	\$ 41,538	\$ 140,331	\$ 135,328
Europe	9,589	7,999	26,232	24,390
Asia Pacific and rest of the world	3,639	3,235	10,219	9,302
Total revenues	\$ 59,670	\$ 52,772	\$ 176,782	\$ 169,020

## Significant Concentrations

During the three months ended December 31, 2017, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc. accounted for 21%, 16%, 11% and 10%, respectively, of our total worldwide revenues. During the nine months ended December 31, 2017, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc., accounted for 22%, 15%, 11% and 10%, respectively, of our total worldwide revenues.

During the three months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc. accounted for 21%, 14%, 10% and 10%, respectively, of our total worldwide revenues. During the nine months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc. accounted for 20%, 14%, 11% and 10%, respectively, of our total worldwide revenues.

Concentration of credit risk with respect to accounts receivable is primarily limited to certain distributors to whom we make significant sales. Three distributors accounted for 25%, 16% and 10%, respectively, of our total receivable balance as of December 31, 2017. Three distributors accounted for 26%, 13% and 10%, respectively, of our total receivable balance as of March 31, 2017.

## NOTE 20. SUBSEQUENT EVENTS

In January 2018, our Board of Directors declared a cash dividend of \$0.16 per share on our outstanding common stock to be paid on March 15, 2018 to all shareholders of record as of the close of business on March 1, 2018.

In January 2018, we invested an additional \$1.2 million with the privately-held company in which we had invested \$3.0 million in June 2016 and recorded the investment in "Investment in unconsolidated affiliates," on the condensed consolidated balance sheets, resulting in an aggregate equity ownership interest of 32%.

In January 2018, we entered into an amendment related to a lease for additional warehousing space consisting of approximately of 26,130 rentable square feet, commencing on the later of March 2018 and the date certain leasehold improvements are substantially complete, and ending in March 2026. Our total commitments under the amended lease are approximately \$2.2 million.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements that reflect our current views with respect to future events and financial performance. In this report, the words "will," "anticipates," "believes," "expects," "intends," "plans," "future," "projects," "estimates," "would," "should," "might" and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties, including but not limited to those discussed below, in Part II, Item 1A of this report and in Part I, Item 1A of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC"), that could cause actual results to differ materially from historical results or those anticipated. Such risks and uncertainties relate to our manufacturing operations, including the vulnerability of our manufacturing operations to potential interruptions and delays and our ability to manufacture products free of defects, fluctuations in our quarterly results of operations and difficulty in predicting future results, our dependence on Abbott Point of Care, Inc. ("Abbott") for our U.S. medical sales, the performance of our independent distributors and our ability to manage their inventory levels effectively, market acceptance of our existing and future products, our dependence on certain sole or limited source suppliers, expansion of our sales, marketing and distribution efforts, the effect of exchange rate fluctuations on international operations, fluctuations in our effective tax rate, including those resulting from changes in tax laws, dependence on key personnel, the protection of our intellectual property and claims of infringement of intellectual property asserted by third parties, competition and other risks detailed under "Risk Factors" in this Quarterly Report on Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any forward-looking statements as circumstances change.

Business Overview

Abaxis, Inc. is a worldwide developer, manufacturer and marketer of portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. Until March 2015, Abaxis also provided veterinary reference laboratory diagnostic and consulting services for veterinarians through AVRL. See the section below entitled "Discontinued Operations" for further information.

Our corporate headquarters are located in Union City, California, from which we conduct our manufacturing, warehousing, research and development, regulatory, sales and marketing and administrative activities. We market and sell our products worldwide primarily through independent distributors, supplemented by our direct sales force. Our sales force is primarily located in the United States. Abaxis Europe GmbH, our wholly-owned subsidiary, markets and distributes diagnostic systems for medical and veterinary uses in the European and Asia Pacific markets.

We manage our business in two operating segments, the medical market and veterinary market, as described below. See "Segment Results" in this section for a detailed discussion of financial results.

**Medical Market.** We serve a worldwide customer group in the medical market consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines.

For our products in the human medical market, we employ primarily independent distributors to market our products. Starting in January 2013, we transitioned the majority of our medical product sales to Abbott as our exclusive distributor in the medical market. Pursuant to our Exclusive Agreement with Abbott, or the Abbott Agreement, Abbott

obtained the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzers and associated consumables in the professionally-attended human healthcare market in the United States and China (including Hong Kong). Effective September 2013, we amended the Abbott Agreement to limit Abbott's territory under such agreement to the United States and effective April 2017, we amended the Abbott Agreement to include clinical research organization in Abbott's customer segment. Effective July 2017, we further amended the Abbott Agreement to outline certain pricing for qualifying customers of Abbott. Under the Abbott Agreement, we have certain responsibilities for providing technical support and warranty services to Abbott in support of its marketing and sales efforts. The initial term of the Abbott Agreement ended on December 31, 2017, and after the initial term, the Abbott Agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date.

We will continue to sell and distribute these medical products outside of the market segments as to which Abbott has exclusive rights. Under our Abbott Agreement, we will continue to sell and distribute to Catapult Health LLC and specified customer segments in the United States, including pharmacy and retail store clinics, shopping malls and cruise ship lines.

## Table of Contents

**Veterinary Market.** Our VetScan products serve a worldwide customer group in the veterinary market consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables, urinalysis instruments and related consumables and VetScan rapid tests. Until March 2015, we provided veterinary reference laboratory diagnostic and consulting services for veterinarians through our Abaxis Veterinary Reference Laboratories, or “AVRL” division. In March 2015, we sold our AVRL business to Antech Diagnostics, Inc., the VCA laboratory division, or “Antech.” As a result, AVRL is presented as discontinued operations in our condensed consolidated financial statements.

We depend on a number of distributors in North America that distribute our VetScan products. In the United States veterinary market segment, we also rely on various independent regional distributors. In September 2012, we entered into a distribution agreement with MWI to purchase, market and sell the full line of Abaxis veterinary products throughout the United States. In October 2014, we entered into distribution agreements with Henry Schein Animal Health (a division of Henry Schein, Inc.) and Patterson Companies, Inc. to sell the full line of Abaxis veterinary products throughout the United States. We depend on our distributors to assist us in promoting our VetScan products, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our revenues until our customers identify another distributor or purchase products directly from us. In addition to selling through distributors, we also directly supply our VetScan products to large group purchasing organizations, hospital networks and other buying groups in the United States, such as Veterinary Centers of America (VCA), a veterinary hospital chain in North America. In May 2014, we entered into a product supply agreement with VCA to supply our VetScan chemistry analyzers and diagnostic reagent discs for placement at VCA’s animal hospitals located in North America that operates more than 800 animal hospitals. In May 2014, we entered into a non-exclusive co-marketing agreement with VCA’s Antech Diagnostic laboratory services to supply our VetScan chemistry analyzers in combination with Antech Diagnostic laboratory services as a diagnostic solution to serve veterinary practices throughout North America. In the third quarter of fiscal 2016, we also entered into a five-year supply agreement with Banfield Pet Hospital, an organization with more than 900 pet hospitals within the United States and Puerto Rico. Under our supply agreement, we will provide our VetScan hematology analyzers and associated consumables to all of Banfield’s pet hospital locations, for which installation and training began in April 2016 and was completed at the end of September 2016.

## Discontinued Operations

In March 2015, we entered into an asset purchase agreement with Antech pursuant to which we sold substantially all of the assets of our AVRL business to Antech. The transaction closed on March 31, 2015. We determined that our AVRL business met the criteria to be classified as a discontinued operation, which required retrospective application to our historical operating results. Accordingly, we report the results of operations of this business in discontinued operations within the financial statements appearing in this report, as applicable. Unless otherwise noted, references to revenues and expenses in this report are to our revenues and expenses excluding those from AVRL operations. See Note 4 of the Notes to Condensed Consolidated Financial Statements contained in this report for additional information.

The total purchase price under the asset purchase agreement was \$21.0 million in cash. We received \$20.1 million in cash proceeds during the fourth quarter of fiscal 2015 and we recognized a pre-tax gain of \$12.3 million (\$7.7 million after-tax) on sale of discontinued operations during fiscal 2015. Additionally, upon meeting certain conditions by the first anniversary of the closing date in March 2016, we recognized a pre-tax gain of \$0.9 million (\$0.6 million after-tax) on sale of discontinued operations during fiscal 2016.



The pre-tax gain on this sale reflects the excess of the sum of the cash proceeds received over the costs incurred in connection with the sale of AVRIL. During the fourth quarter of fiscal 2015, we recorded costs of \$7.8 million related to cash payments for employee-related costs, including severance, contract termination and other associated costs. In connection with the transaction, we recorded disposal and an impairment charge on long-lived assets of \$1.9 million during fiscal 2015. These items partially offset the cash proceeds that we received in accordance with the terms of the asset purchase agreement.

#### Overview of Financial Results

In the third quarter of fiscal 2018, total revenues were \$59.7 million, an increase of 13% from last year's comparable quarter. The net increase in revenues was primarily attributable to an increase in revenues from consumable sales, which were \$45.5 million, an increase of 13% over last year's comparable quarter, primarily attributable to (a) an increase in revenues from medical reagent discs sold in North America and Europe, (b) an increase in revenues from veterinary reagent discs sold in North America and Europe and (c) an increase in revenues from VetScan rapid tests sold in North America, due to an increase in the unit sales of our VetScan Canine Pancreatic Lipase Rapid Test (launched in the first quarter of fiscal 2018), VetScan Canine Parvovirus Rapid Test and VetScan Feline Leukemia Virus Antigen-Feline Immunodeficiency Virus Antibody ("FeLV/FIV") Rapid Test.

## Table of Contents

Gross profit in the third quarter of fiscal 2018 was \$32.2 million, an increase of 9% from last year's comparable quarter, primarily attributable to an increase in revenues from medical and veterinary reagent discs.

Total operating expenses in the third quarter of fiscal 2018 were \$23.6 million, an increase of \$5.0 million, or 27%, compared to the same period last year, primarily attributable to (a) an increase in personnel costs, (b) an increase in research and development expenses related to new product development and (c) an increase in sales and marketing expenses to support our growth in both North America and in the international markets.

Income from continuing operations in the third quarter of fiscal 2018 was \$4.2 million, a decrease of \$2.6 million, or 38%, compared to the same period last year, primarily attributable to an increase in operating expenses, as discussed above and an increase in the income tax provision during the three months ended December 31, 2017, as compared to the same period last year, primarily attributable to a one-time non-cash charge of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. Our diluted net income per share from continuing operations was \$0.18 in the third quarter of fiscal 2018, compared to \$0.30 for the same period last year. Diluted net income per share from continuing operations for the third quarter of fiscal 2018 includes the effect of the non-cash charge of \$2.9 million in our income tax provision.

Cash, cash equivalents and investments increased by \$19.9 million during the nine months ended December 31, 2017 to a total of \$185.0 million as of December 31, 2017. During the nine months ended December 31, 2017, operating cash flows were \$37.2 million, an increase of \$14.9 million, compared to \$22.3 million for the same period last year, primarily attributable to higher accounts payable and accrued liabilities as of December 31, 2017. Key non-operating uses of cash during the nine months ended December 31, 2017 included payments of \$2.5 million made for tax withholdings related to net share settlements of restricted stock units and payment of \$10.0 million in cash dividends to shareholders.

## Factors that May Impact Future Performance

Our industry is impacted by numerous competitive, regulatory and other significant factors. On December 22, 2017, H.R. 1, also known as the "Tax Cuts and Jobs Act" (the "Tax Act"), was signed into law. Following the recent enactment of the Tax Act, we expect our effective income tax rate to decline by 200 to 300 basis points in fiscal 2018 compared to fiscal 2017, excluding a one-time non-cash charge described in Note 17, "Income Taxes." We estimate our effective income tax rate in fiscal 2019 will be lower by 1,000 to 1,200 basis points compared to fiscal 2017. The actual impact of the Tax Act on our effective income tax rates may differ from the estimates due to changes in interpretations and assumptions made by us. We anticipate subsequent regulations associated with the Tax Act will be forthcoming and will continue to analyze the tax legislation to determine the full effects of the new law on our consolidated financial statements.

Our sales for any future periods are not predictable with a significant degree of certainty, and may depend on a number of factors outside of our control. In particular, we are highly dependent upon the efforts and priorities of our distributors in promoting and creating a demand for our products and as such, we do not have full control over the marketing and sale of our products into these markets. Should these efforts be unsuccessful, or should we fail to maintain or effectively manage these relationships, our business, financial condition and results of operations are likely to be adversely affected. We generally operate with a limited order backlog because our products are typically shipped shortly after orders are received. Product sales in any quarter are generally dependent on orders booked and shipped in that quarter. As a result, any shortfall in product sales during a quarter would negatively affect our results of operations and financial condition during that quarter. In addition, our sales may be adversely impacted by pricing pressure from competitors. Our ability to increase our revenues and profitability will depend, in part, on our ability to increase the sales volumes of our products, to increase the sales performance of our independent distributors, and to successfully compete with our competitors.

Abbott controls the marketing and sale of our primary medical products into most of the U.S. medical market and, accordingly, we are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in this market. Should these efforts be unsuccessful, our business, financial condition and results of operations may be adversely affected. For example, during fiscal 2014, we were adversely impacted by the timing of purchases of our medical products sold to Abbott as it integrated our products into its sales process and sold its inventory, and in the third and fourth quarters of fiscal 2017, we were similarly negatively impacted by a reduction of orders from Abbott as a result of excess instrument inventory.

In the United States veterinary market, we rely on our national and independent regional distributors. We are also dependent upon the efforts and priorities of these distributors in promoting and creating a demand for our products and do not have full control over the marketing and sale of our products into these markets. Should these efforts be unsuccessful, or should we fail to maintain or effectively manage these relationships, our business, financial condition and results of operations are likely to be adversely affected. For example, during fiscal 2014, our strategy of increasing demand for our veterinary products through the expansion of our distribution partners, did not lead to the increased demand for our products in the veterinary clinics that we had anticipated resulting in excess channel inventory. The excess channel inventory was the result of our distributors not selling our products to end customers at the same rate as they were purchasing products from us. In response, we took additional steps to more closely monitor and manage channel inventory in an effort to normalize the veterinary product inventories at our distribution partners in the United States. In the third quarter of fiscal 2015, we began selling through our distributors, Henry Schein Animal Health (a division of Henry Schein, Inc.) and Patterson Companies, Inc., and our revenues in future quarters may be impacted by the timing of purchases of our products sold by them as these distributors integrate our products into their sales process. We will continue to closely monitor and manage channel inventory at our distribution partners in the United States.

## Table of Contents

During fiscal 2017, in the North America veterinary market, we experienced a decrease in the unit sales of veterinary reagent discs sold, primarily attributable to a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory, as compared to the same period in fiscal 2016. As a result, this reduced our revenue growth and contributed to lower gross profit margins in the veterinary market. Looking forward, as we believe competition in the veterinary market will remain intense, we have implemented and intend to continue implementing new strategies to improve customer retention and monitor our installed base of customers and distribution inventory more closely. Additionally, we plan to continue to introduce new products that are designed to enhance our veterinary product portfolio. For example, in September 2016, we completed the development of our connectivity product, the VetScan FUSE, a bi-directional connectivity system that provides integration between our point-of-care analyzers and the veterinary practice management systems worldwide. The VetScan FUSE was launched in the second quarter of fiscal 2018 and, we installed VetScan FUSE in approximately two hundred veterinary practices worldwide during the nine months ended December 31, 2017. In June 2017, we launched our VetScan Canine Pancreatic Lipase Rapid Test into the veterinary market and, in September 2017, we launched VetScan UA, a hand held point-of-care urine chemistry analyzer into the veterinary market. We also expect to launch a new point-of-care urine sediment analyzer into the veterinary market in the fourth quarter of fiscal 2018. In addition, the USDA, Center for Veterinary Biologics, recently approved our VetScan FLEX4 Rapid Test, a combination test for heartworm, lyme, ehrlichia and anaplasma, which we plan to start selling during the fourth quarter of fiscal 2018. See “Total Revenues – Continuing Operations within the Results of Operations” section below, for a further discussion regarding the change in total revenues in North America.

## CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and pursuant to the rules and regulations of the Securities and Exchange Commission. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and the sensitivity of these estimates to deviations in the assumptions used in making them. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. However, there can be no assurance that our actual results will not differ from these estimates.

We have identified the policies below as critical because they are not only important to understanding our financial condition and results of operations, but also because application and interpretation of these policies requires both judgment and estimates of matters that are inherently uncertain and unknown. Accordingly, actual results may differ materially from our estimates. The impact and any associated risks related to these policies on our business operations are discussed below. A more detailed discussion on the application of these and other accounting policies are included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

**Revenue Recognition.** Our primary customers are distributors and direct customers in both the medical and veterinary markets. Revenues from product sales, net of estimated sales allowances, discounts and rebates, are recognized when (i) evidence of an arrangement exists, (ii) upon shipment of the products, (iii) the sales price is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. Rights of return are not provided.

Amounts collected in advance of revenue recognition are recorded as a current or non-current deferred revenue liability based on the time from the balance sheet date to the future date of revenue recognition. We recognize revenue associated with extended maintenance agreements ratably over the life of the contract.

**Multiple Element Revenue Arrangements.** Our sales arrangements may contain multiple element revenue arrangements in which a customer may purchase a combination of instruments, consumables or extended maintenance agreements. Additionally, we provide incentives in the form of free goods or extended maintenance agreements to

customers in connection with the sale of our instruments. We participate in selling arrangements in the veterinary market that include multiple deliverables, such as instruments and consumables. Judgments as to the allocation of consideration from an arrangement to the multiple elements of the arrangement, and the appropriate timing of revenue recognition are critical with respect to these arrangements.

A multiple element arrangement includes the sale of one or more tangible product offerings with one or more associated services offerings, each of which are individually considered separate units of accounting. We allocate revenues to each element in a multiple element arrangement based upon the relative selling price of each deliverable. When applying the relative selling price method, we determine the selling price for each deliverable using vendor-specific objective evidence, or “VSOE,” of selling price, if it exists, or third-party evidence, “TPE,” of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our best estimate of selling price for that deliverable. Revenue allocated to each element is then recognized when all revenue recognition criteria are met for each element.

## Table of Contents

Revenues from our multiple element arrangements are allocated separately to the instruments, consumables, extended maintenance agreements and incentives based on the relative selling price method. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product when it is sold separately. Revenues allocated to each element are then recognized when the basic revenue recognition criteria, as described above, are met for each element. Revenues associated with incentives in the form of free goods are deferred until the goods are shipped to the customer. Revenues associated with incentives in the form of extended maintenance agreements are deferred and recognized ratably over the life of the extended maintenance contract, generally one year.

Customer Programs. From time to time, we offer customer marketing and incentive programs. Our most significant customer programs are described as follows:

Instrument Trade-In Programs. We periodically offer trade-in programs to customers for trading in an existing instrument to purchase a new instrument and we will either provide incentives in the form of free goods or reduce the sales price of the instrument. These incentives in the form of free goods are recorded based on the relative selling price method according to the policies described above.

Instrument Rental Programs. We periodically offer programs to customers whereby certain instruments are made available to customers for rent or on an evaluation basis. These programs typically require customers to purchase a minimum quantity of consumables during a specified period for which we recognize revenue on the related consumables according to the policies described above. Depending on the program offered, customers may purchase the instrument during the rental or evaluation period. Proceeds from such sale are recorded as revenue according to the policies described above. Rental income, if any, is also recorded as revenue according to the policies described above.

Lease Programs. Starting in fiscal 2016, we entered into sales contracts as the lessor of instruments under sales-type lease agreements with our customers. In the veterinary market, we may offer arrangements to end users for monthly payments of instruments and consumables purchases over a term of six years. Revenues related to multiple-element arrangements are allocated to lease and non-lease elements based on their relative selling prices as prescribed by our revenue recognition policies described above. Lease elements generally include one or multiple veterinary instruments, while non-lease elements generally include the consumables related to the leased instrument.

We estimate the fair value of our leased products for the purposes of lease classification. In accordance with Financial Accounting Standards Board Accounting Standards Codification, or ASC, Topic 840, “Leases”, or ASC 840, we define the fair value of a leased product at lease inception as its normal selling price, reflecting any volume or discounts that may apply. We estimate the fair value of our leased products based upon transacted cash sales prices. Estimating the fair value of our leased products can be subjective and thus subject to significant judgment.

The present value of lease receivables, including accrued interest, was \$11.4 million and \$9.1 million, as of December 31, 2017 and March 31, 2017, respectively. Our current and non-current lease receivables are recorded within “Receivables” and “Other assets,” respectively, on our condensed consolidated balance sheets. Revenues from sales-type lease arrangements is recognized upon shipment of the products to the customer, assuming all other revenue recognition criteria have been met. Revenues from sales-type leases are presented as product revenue. Interest income is recognized monthly over the lease term using the effective-interest method.

Sales Incentive Programs. We periodically offer customer sales incentive programs and we record reductions to revenue related to these programs. Incentives may be provided in the form of rebates to distributors for volume-based purchases or upon meeting other specified requirements, end-user rebates and discounts. A summary of our revenue reductions is described below. Other rebate programs offered to distributors or customers vary from period to period in the medical and veterinary markets and were not significant.

Volume-based Incentives. Volume-based incentives, in the form of rebates, are offered from time to time to distributors and group purchasing organizations upon meeting the sales volume requirements during a qualifying period and are recorded as a reduction to gross revenues during a qualifying period. The pricing rebate program is primarily offered to distributors and group purchasing organizations in the North America veterinary market, upon meeting the sales volume requirements of veterinary products during the qualifying period. Factors used in the rebate calculations include the identification of products sold subject to a rebate during the qualifying period and which rebate percentage applies. Based on these factors and using historical trends, adjusted for current changes, we estimate the amount of the rebate and record the rebate as a deduction to gross revenues when we record the sale of the product. The rebate is recorded as a reserve to offset accounts receivable as settlements are made through offsets to outstanding customer invoices. Settlement of the rebate accruals from the date of sale ranges from one to nine months after sale. Changes in the rebate accrual at the end of each period are based upon distributors and group purchasing organizations meeting the purchase requirements during the quarter.

## Table of Contents

**Distributor Rebate Incentives.** From time to time, we offer a customer sales incentive program, whereby distributors are offered a rebate upon meeting certain requirements. We recognize the rebate obligation as a reduction of revenue at the later of the date on which we sell the product or the date the program is offered. These customer sales incentive programs require management to estimate the rebate amounts to distributors who will qualify for the incentive during the promotional period. We record the estimated liability in other current accrued liabilities on our condensed consolidated balance sheets. Management's estimates are based on historical experience and the specific terms and conditions of the incentive programs.

**End-User Rebates and Discounts.** From time to time, cash rebates are offered to end-users who purchase certain products or instruments during a promotional period and are recorded as a reduction to gross revenues. Additionally, we periodically offer sales incentives to end-users, in the form of sales discounts, to purchase consumables for a specified promotional period, typically over five years from the sale of our instrument, and we reimburse resellers for the value of the sales discount provided to the end-user. We estimate the amount of the incentive earned by end-users during a quarter and record a liability to the reseller as a reduction to gross revenues. Factors used in the liability calculation of incentives earned by end-users include the identification of qualified end-users under the sales program during the period and using historical trends. Settlement of the liability to the reseller ranges from one to twelve months from the date an end-user earns the incentive.

**Royalty Revenues.** Our royalty revenue depends on the licensees' use of our technology, and therefore, may vary from period to period and impact our revenues during a quarter. For the three and nine months ended December 31, 2017 and 2016, our royalty revenues have not been significant.

**Allowance for Doubtful Accounts.** We recognize revenue when collection from the customer is reasonably assured. We maintain an allowance for doubtful accounts based on our assessment of the collectibility of the amounts owed to us by our customers. We regularly review the allowance and consider the following factors in determining the level of allowance required: the customer's payment history, the age of the receivable balance, the credit quality of our customers, the general financial condition of our customer base and other factors that may affect the customers' ability to pay. An additional allowance is recorded based on certain percentages of our aged receivables, using historical experience to estimate the potential uncollectible. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered. If our actual collections experience changes, revisions to our allowances may be required, which could adversely affect our operating income.

In the event we determine that a lease receivable may not be paid, we include in our allowance an amount for the outstanding balance related to the lease receivable. We regularly review the adequacy of the allowances for outstanding lease receivables either on an individual or a collective basis. When evaluating the lease receivables, we consider historical experience, credit quality and age of receivable balances, and economic conditions that may affect a customer's ability to pay. Our ongoing consideration of all these factors could result in an increase in our allowance for loss on lease receivables in the future, which could adversely affect our operating results. Lease receivables are charged off at the point when they are considered uncollectible.

**Fair Value Measurements.** We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority



to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities. As of December 31, 2017, our investments in cash equivalents, which we classified as available-for-sale, totaled \$7.1 million, using Level 1 inputs because these investments are traded in an active market. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment because the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument. As of December 31, 2017, our available-for-sale investments in commercial paper, corporate bonds and municipal bonds, totaled \$55.8 million, using Level 2 inputs, based on market pricing and other observable market inputs for similar securities obtained from various third party data providers.

## Table of Contents

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions. As of December 31, 2017, we did not have any Level 3 financial assets or liabilities measured at fair value on a recurring basis.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, our own assumptions are developed to reflect those that market participants would use in pricing the asset or liability at the measurement date. As of December 31, 2017, we also had \$57.2 million in investments classified as held-to-maturity and carried at amortized cost.

Investment in Unconsolidated Affiliates. We use the equity method to account for our investments in entities that we do not control, but have the ability to exercise significant influence over the investee. Equity method investments are recorded at original cost and adjusted periodically to recognize (1) our proportionate share of the investees' net income or losses after the date of investment, (2) additional contributions made and dividends or distributions received and (3) impairment losses resulting from adjustments to net realizable value. We eliminate all intercompany transactions in accounting for our equity method investments. We record our proportionate share of the investees' net income or losses in "Interest and other income (expense), net" on our condensed consolidated statements of income.

We assess the potential impairment of our equity method investments when indicators such as a history of operating losses, a negative earnings and cash flow outlook, and the financial condition and prospects for the investee's business segment might indicate a loss in value. The carrying value of our investments are reviewed quarterly for changes in circumstances or the occurrence of events that suggest our investment may not be recoverable. During the three and nine months ended December 31, 2017 and 2016, we did not record an impairment charge on our investments. As of December 31, 2017 and March 31, 2017, our investments in unconsolidated affiliates totaled \$2.7 million and \$2.9 million, respectively.

In January 2018, we invested an additional \$1.2 million with the privately-held company in which we had invested \$3.0 million in June 2016 and recorded the investment in "Investment in unconsolidated affiliates" on the condensed consolidated balance sheets, resulting in an aggregate equity ownership interest of 32%.

In January 2017, we early adopted ASU No. 2016-07, "Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting," or ASU 2016-07, which eliminates the requirement that an investor retrospectively apply equity method accounting when an investment that it had accounted for by another method initially qualifies for use of the equity method.

Warranty Reserves. We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments. Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service experience. While we engage in product quality programs and processes, including monitoring and evaluating the quality of our suppliers, our estimated accrual for warranty exposure is based on our historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan.

We also provide for the estimated future costs to be incurred under our standard warranty obligation on our reagent discs. A provision for defective reagent discs is recorded and classified as a current liability when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated, at

which time they are included in cost of revenues. The warranty cost includes the replacement costs and freight of a defective reagent disc.

As of December 31, 2017, our current portion of warranty reserves for instruments and reagent discs totaled \$2.1 million and our non current portion of warranty reserves for instruments totaled \$2.9 million, which reflects our estimate of warranty obligations based on the estimated product failure rates, the number of instruments in standard warranty, estimated repair and related costs of instruments, and an estimate of defective reagent discs and replacement and related costs of a defective reagent disc. The change in total accrued warranty reserve from March 31, 2017 to December 31, 2017 was due to an increase in the number of instruments in standard warranty and repair and related costs of instruments.

Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. We review the historical warranty cost trends and analyze the adequacy of the ending accrual balance of warranty reserves each quarter. The determination of warranty reserves requires us to make estimates of the estimated product failure rate, expected costs to repair or replace the instruments and to replace defective reagent discs under warranty. If actual repair or replacement costs of instruments or replacement costs of reagent discs differ significantly from our estimates, adjustments to cost of revenues may be required. Additionally, if factors change and we revise our assumptions on the product failure rate of instruments or reagent discs, then our warranty reserves and cost of revenues could be materially impacted in the quarter of such revision, as well as in following quarters.

## Table of Contents

**Inventories.** We state inventories at the lower of cost or net realizable value, cost being determined using standard costs which approximate actual costs using the first-in, first-out method. Inventories include material, labor and manufacturing overhead. We establish provisions for excess, obsolete and unusable inventories after evaluation of future demand of our products and market conditions. If future demand or actual market conditions are less favorable than those estimated by management or if a significant amount of the material were to become unusable, additional inventory write-downs may be required, which would have a negative effect on our operating income.

**Property and Equipment.** Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization expense is calculated using the straight-line method using the estimated useful lives of the assets. Construction in progress primarily consists of purchased material and internal payroll and related costs used in the development of production lines. Property and equipment includes instruments transferred from inventory and held for loan or evaluation or demonstration purposes to customers. Units held for loan, evaluation or demonstration purposes are carried at cost and depreciated over their estimated useful lives of three to five years. Depreciation expense related to these instruments is recorded in cost of revenues or in the respective operating expense line based on the function and purpose for which it is being used. Proceeds from the sale of evaluation units are recorded as revenue. During the three and nine months ended December 31, 2017 and 2016, purchases of capital equipment primarily related to increasing our manufacturing capacity and to supporting our growth and transfers of equipment from inventory to property and equipment, primarily attributable to our instrument rental program. Transfers of equipment between inventory to property and equipment, net, during the three months ended December 31, 2017 and 2016 were \$1.0 million and \$0.7 million, respectively, and during the nine months ended December 31, 2017 and 2016 were \$1.7 million and \$4.1 million, respectively.

**Intangible Assets.** Intangible assets as of December 31, 2017 and March 31, 2017, which consists of customer relationships acquired in our fiscal 2015 acquisition of QCR, are presented at cost, net of accumulated amortization. The intangible assets are amortized using the straight-line method over their estimated useful lives of 10 years, which approximates the economic benefit. If our underlying assumptions regarding the estimated useful life of an intangible asset change, then the amortization period, amortization expense and the carrying value for such asset would be adjusted accordingly. During the three and nine months ended December 31, 2017 and 2016, our changes in estimated useful life of intangible assets were not significant.

**Valuation of Long-Lived Assets.** We evaluate the carrying value of our long-lived assets, such as property and equipment and amortized intangible assets, whenever events or changes in business circumstances or our planned use of long-lived assets indicate that the carrying amount of an asset may not be fully recoverable or their useful lives are no longer appropriate. We look to current and future profitability, as well as current and future undiscounted cash flows, excluding financing costs, as primary indicators of recoverability. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than the carrying amount. If impairment is determined to exist, any related impairment loss is calculated based on fair value and long-lived assets are written down to their respective fair values. During the three and nine months ended December 31, 2017 and 2016, we did not recognize any impairment charges on long-lived assets.

**Income Taxes.** We account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be recovered.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of evidence indicates that it

is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not to be sustained upon audit, the second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement. Significant judgment is required to evaluate uncertain tax positions. As of December 31, 2017 and March 31, 2017, we had no significant uncertain tax positions. Our policy is to include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. During the three and nine months ended December 31, 2017 and 2016, we did not recognize any interest or penalties related to uncertain tax positions in the condensed consolidated statements of income, and as of December 31, 2017 and March 31, 2017, we had no accrued interest or penalties.

The Company's effective tax rate during the three and nine months ended December 31, 2017 was impacted by the Tax Act. Income tax effects resulting from changes in tax laws are accounted for by the Company in accordance with the authoritative guidance, which requires that these tax effects be recognized in the period in which the law is enacted and the effects are recorded as a component of provision for income taxes from continuing operations. As a result, the Company made an additional provision for income tax resulting from the enactment of the Tax Act during the three and nine months ended December 31, 2017.

## Table of Contents

The Tax Act includes significant changes to the U.S. income tax system. The Tax Act, among other changes, reduces the U.S. federal corporate tax rate from 35% to 21% as of January 1, 2018, eliminates the federal benefit for qualified production activities, expands the deduction limitation for executive compensation, creates a territorial system which will generally allow companies to repatriate future foreign earnings without incurring additional U.S. income tax, subjects foreign earnings on which U.S. income tax is currently deferred to a one time transition tax, creates a “minimum tax” on certain intangible foreign earnings and creates an incentive for U.S. companies to sell goods and services abroad. The decrease in the U.S. federal corporate tax rate from 35% to 21% results in a blended statutory tax rate of 31.5% for the fiscal year ending March 31, 2018.

We are subject to income taxes in the U.S. and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. In the third quarter of fiscal 2017, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015, which was completed in the second quarter of fiscal 2018 and there have not been any proposed assessments as a result of this examination. Our foreign subsidiary income tax returns for fiscal 2013 through 2015 are subject to examination by German tax authorities. The German tax examination commenced in the third quarter of fiscal 2018. As of December 31, 2017, there had been no proposed assessments by such authorities in Germany and we are unable to estimate the range of possible outcomes at this time.

**Share-Based Compensation Expense.** We account for share-based compensation arrangements using the fair value method. We recognize share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award to employees and directors. As required by fair value provisions of share-based compensation, employee share-based compensation expense recognized is calculated over the requisite service period of the awards and reduced for estimated forfeitures. The forfeiture rate is estimated based on historical data of our share-based compensation awards that are granted and cancelled prior to vesting and upon historical experience of employee turnover. Changes in estimated forfeiture rates and differences between estimated forfeiture rates and actual experience may result in significant, unanticipated increases or decreases in share-based compensation expense from period to period. To the extent we revise our estimate of the forfeiture rate in the future, our share-based compensation expense could be materially impacted in the quarter of revision, as well as in following quarters.

### Restricted Stock Unit Awards (Time Vesting)

The fair value of restricted stock unit awards with only time-based vesting terms, which we refer to as RSUs, used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Share-based compensation expense is recognized net of an estimated forfeiture rate, over the requisite service period of the RSU. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. As a result, if factors change and we use different assumptions, our share-based compensation expense could be materially different in the future.

### Restricted Stock Unit Awards (Performance Vesting)

We grant restricted stock unit awards subject to performance vesting criteria, which we refer to as PSUs, to our executive officers and to certain of our other employees. PSUs consist of the right to receive shares of common stock, subject to achievement of time-based criteria and certain corporate performance-related goals over a specified period, as established by the Compensation Committee of our Board of Directors (the “Compensation Committee”). We recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of PSUs used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously

recognized compensation expense is reversed.

Fiscal 2017 Performance RSUs. In April 2016, the Compensation Committee approved the grant of PSUs for 152,000 shares of common stock to our executive officers and to certain of our other employees (the “FY2017 PSUs”). These FY2017 PSUs, as originally granted to our executive officers and other employees other than our Chief Executive Officer, vested only if both of the following criteria are satisfied: (1) our consolidated income from operations during the fiscal year 2017, as certified by the Compensation Committee, was in excess of the applicable target amount described below; and (2) the recipient remains in the continuous service of the Company until the applicable vesting date set forth as follows:

- 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;

- 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;

- 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and

## Table of Contents

25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

The FY2017 PSUs as originally granted to our Chief Executive Officer, Mr. Clinton Severson, vest as follows:

- approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;
- approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;
- approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and
- approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

Of the aggregate shares of common stock issuable upon settlement of the FY2017 PSUs, 84,000 and 68,000 shares of common stock, respectively, were granted with performance conditions subject to vesting in full upon achieving 100% and 90%, respectively, of the financial targets described above. The aggregate estimated grant date fair value of the FY2017 PSUs was \$6.8 million based on the closing market price of our common stock on the date of grant. On January 25, 2017, the Compensation Committee approved an amendment to our FY2017 PSUs so the performance vesting condition refers to the Company's consolidated income from continuing operations before income tax provision, rather than consolidated income from operations. The service vesting condition and all other terms and conditions of our FY2017 PSUs were not changed.

On December 31, 2016, we reviewed each of the underlying performance targets related to the outstanding FY2017 PSUs and determined that it was not probable that the performance targets of the FY2017 PSUs would be met for the 84,000 shares of common stock. Consequently, upon our determination of non-achievement of the performance condition, with respect to achievement of 100% of the financial target in fiscal 2017, we reversed the cumulative share-based compensation expense related to the original awards in the third quarter of fiscal 2017, resulting in no share-based compensation expense recorded for these awards through December 31, 2016. Additional share-based compensation of \$0.6 million would have been recorded during the nine months ended December 31, 2016 had the achievement of performance targets been deemed probable for the 84,000 shares of common stock.

On January 25, 2017, we evaluated the modification of the performance conditions for the FY2017 PSUs and determined that the performance conditions for the 84,000 shares of common stock was a Type III modification or "Improbable to Probable" pursuant to ASC 718 as the awards, on the date of modification, were no longer probable of being achieved in fiscal 2017. Because the 84,000 shares of common stock of the FY2017 PSUs granted were improbable of vesting prior to the modification of the performance conditions, the original grant date fair value is no longer used to measure compensation cost for the awards. In accordance with ASC 718, the fair value of the 84,000 shares of common stock of the modified FY2017 PSUs was re-measured with a measurement date of January 25, 2017, and an aggregate grant date fair value of \$4.0 million. As we determined that the performance conditions of the modified award would be met for the 84,000 shares of common stock as of March 31, 2017, we recorded share-based compensation expense during fiscal 2017, ratably, beginning on January 25, 2017 over the vesting terms of the modified FY2017 PSUs.

For the remaining 68,000 shares of common stock issuable upon settlement of the FY2017 PSUs, we evaluated the modification of the performance conditions for the FY2017 PSUs and determined it was a Type I modification or "Probable to Probable" pursuant to ASC 718. Accordingly, we record share-based compensation expense, ratably, beginning on the original grant date over the vesting terms of the PSUs, as we determined that the performance targets approved by the Compensation Committee in April 2016 would be met.



Fiscal 2018 Performance RSUs. In April 2017, the Compensation Committee approved the grant of PSUs for 137,000 shares of common stock to our executive officers and to certain of our other employees that contained the foregoing time-based and performance-based vesting terms (the “FY2018 PSUs”).

50% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations before income tax provision target described above and continuous service until the third anniversary of the date of grant; and

50% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations before income tax provision target described above and continuous service until the fourth anniversary of the date of grant.

The share-based compensation expense is reduced for an estimate of the PSUs that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. If the service vesting conditions are not met, unvested PSUs will be forfeited. Upon vesting on the third and fourth anniversary date of grant of the PSUs, the equivalent number of common shares are typically issued net of tax withholdings.

Table of Contents

For the PSUs granted in fiscal 2015, 2016 and 2017, we determined that the performance targets (including as adjusted to reflect the modified performance conditions for the FY2017 PSUs discussed above) were met in each respective fiscal year of grant and we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2017. For the FY2018 PSUs, we determined that it was probable that the performance targets would be met and accordingly, we recorded share-based compensation expense ratably over the vesting terms of the FY2018 PSUs during the three and nine months ended December 31, 2017. We will assess the probability of the performance targets at the end of each quarter.

## Results of Operations

Total Revenues – Continuing Operations

Revenues by Product Category. The following table and discussion present our revenues from continuing operations by product category and represent our results for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

Revenues by Product Category	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
Instruments (1)	\$10,468	\$9,349	\$1,119	12 %	\$28,395	\$29,271	\$(876 )	(3 )%
Percentage of total revenues	18 %	18 %			16 %	17 %		
Consumables (2)	45,475	40,353	5,122	13 %	137,884	130,554	7,330	6 %
Percentage of total revenues	76 %	76 %			78 %	77 %		
Other products (3)	3,727	3,070	657	21 %	10,503	9,195	1,308	14 %
Percentage of total revenues	6 %	6 %			6 %	6 %		
Total revenues	\$59,670	\$52,772	\$6,898	13 %	\$176,782	\$169,020	\$7,762	5 %

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- (1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers, i-STAT analyzers and urinalysis instruments.
- (2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i-STAT cartridges, urinalysis tests and rapid tests.
- (3) Other products include products using the Orbos process and extended maintenance agreements.

Revenues by Geographic Region. The following table and discussion present our revenues from continuing operations by geographic region and represent our results for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

Revenues by Geographic Region	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
North America	\$46,442	\$41,538	\$4,904	12 %	\$140,331	\$135,328	\$5,003	4 %
Percentage of total revenues	78 %	79 %			79 %	80 %		
Europe	9,589	7,999	1,590	20 %	26,232	24,390	1,842	8 %
Percentage of total revenues	16 %	15 %			15 %	14 %		
Asia Pacific and rest of the world	3,639	3,235	404	12 %	10,219	9,302	917	10 %
Percentage of total revenues	6 %	6 %			6 %	6 %		
Total revenues	\$59,670	\$52,772	\$6,898	13 %	\$176,782	\$169,020	\$7,762	5 %



Table of Contents

Three Months Ended December 31, 2017 Compared to Three Months Ended December 31, 2016

North America. During the three months ended December 31, 2017, total revenues in North America increased by 12%, or \$4.9 million, as compared to the same period in fiscal 2017. Total revenues in North America were impacted by the following changes:

Total sales of our Piccolo chemistry analyzers and medical reagent discs in North America increased by 24%, or \$1.3 million, primarily attributable to an increase in Piccolo chemistry analyzers sold to Abbott during the quarter and an increase in sales of medical reagent discs to Abbott resulting from an expanded installed base of Piccolo chemistry analyzers.

Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America increased by 4%, or \$0.8 million, primarily attributable to an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer and fluctuation in distribution inventory, partially offset by a decrease in the unit sales of VetScan chemistry analyzers resulting from fewer sales-type lease agreements to new and existing customers compared to higher sales in the prior period due to marketing promotions offered to existing customers during that period.

Total sales of our VetScan hematology instruments and hematology reagent kits in North America increased by 8%, or \$0.6 million, primarily attributable to an increase in the unit sales of VetScan hematology instruments due to marketing promotions offered during the quarter.

Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables, urinalysis instruments and related consumables and VetScan rapid tests in North America increased by 23%, or \$1.6 million, primarily attributable to (a) sales of urinalysis instruments and related consumables (launched in the second quarter of fiscal 2018) and (b) an increase in revenues from VetScan rapid tests, due to an increase in the unit sales of our VetScan Canine Pancreatic Lipase Rapid Test (launched in the first quarter of fiscal 2018), VetScan Canine Parvovirus Rapid Test and VetScan Feline FeLV/FIV Rapid Test.

Revenues from other products in North America increased by 25%, or \$0.6 million, primarily attributable to an increase in revenue from maintenance agreements and an increase in other veterinary products sold, which includes the VetScan FUSE.

Europe. During the three months ended December 31, 2017, total revenues in Europe increased by 20%, or \$1.6 million, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in revenues from medical reagent discs sold due to an expanded installed base of Piccolo chemistry analyzers, (b) an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer and an expanded installed base of VetScan chemistry analyzers and (c) the impact of a higher exchange rate between the Euro and U.S. dollar, as compared to the same period last year.

Asia Pacific and rest of the world. During the three months ended December 31, 2017, total revenues in Asia Pacific and rest of the world increased by 12%, or \$0.4 million, as compared to the same period in fiscal 2017, primarily attributable to an increase in veterinary instruments sold to various distributors, partially offset by a decrease in Piccolo chemistry analyzers sold to various distributors.

Significant concentrations. During the three months ended December 31, 2017, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc. accounted for 21%, 16%, 11% and 10%, respectively, of our total worldwide revenues.

Nine Months Ended December 31, 2017 Compared to Nine Months Ended December 31, 2016

North America. During the nine months ended December 31, 2017, total revenues in North America increased by 4%, or \$5.0 million, as compared to the same period in fiscal 2017. Total revenues in North America were impacted by the following changes:

Total sales of our Piccolo chemistry analyzers and medical reagent discs in North America increased by 4%, or \$0.7 million, primarily attributable to an increase in Piccolo chemistry analyzers sold to Abbott.

Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America decreased by 2%, or \$1.3 million, primarily attributable to a decrease in the unit sales of VetScan chemistry analyzers resulting from fewer sales-type lease agreements to new and existing customers compared to higher sales in the prior period due to marketing promotions offered to existing customers during that period, partially offset by an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer.

Total sales of our VetScan hematology instruments and hematology reagent kits in North America increased by 8%, or \$1.6 million, primarily attributable to (a) an increase in the unit sales of VetScan hematology instruments due to marketing promotions offered and (b) an increase in the unit sales of hematology reagent kits resulting from an expanded installed base of VetScan hematology instruments and due to our supply agreement with Banfield Pet Hospitals.

Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables, urinalysis instruments and related consumables and VetScan rapid tests in North America increased by 10%, or \$2.5 million, primarily attributable to (a) sales of urinalysis instruments and related consumables (launched in the second quarter of fiscal 2018) and (b) an increase in revenues from VetScan rapid tests due to an increase in the unit sales of our VetScan Canine Pancreatic Lipase Rapid Test (launched in the first quarter of fiscal 2018), VetScan Canine Parvovirus Rapid Test and VetScan Feline FeLV/FIV Rapid Test.

Table of Contents

Revenues from other products in North America increased by 20%, or \$1.4 million, primarily attributable to an increase in other veterinary products sold and an increase in products sold using our patented Orbos Discrete Lyophilization Process.

Europe. During the nine months ended December 31, 2017, total revenues in Europe increased by 8%, or \$1.8 million, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in revenues from Piccolo chemistry analyzers and medical reagent discs sold to various distributors and (b) an increase in the unit sales of veterinary reagent discs due to an expanded installed base of VetScan chemistry analyzers.

Asia Pacific and rest of the world. During the nine months ended December 31, 2017, total revenues in Asia Pacific and rest of the world increased by 10%, or \$0.9 million, as compared to the same period in fiscal 2017, primarily attributable to an increase in VetScan hematology instruments and veterinary reagent discs sold to various distributors, partially offset by a decrease in Piccolo chemistry analyzers and VetScan chemistry analyzers sold to various distributors.

Significant concentrations. During the nine months ended December 31, 2017, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc., accounted for 22%, 15%, 11% and 10%, respectively, of our total worldwide revenues.

Segment Results – Continuing Operations

Total Revenues, Cost of Revenues and Gross Profit by Segment. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenues or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold by market and customer group.

Certain reclassifications have been made to prior fiscal period amounts to conform to the current fiscal period presentation in the segment categories. Effective in the fourth quarter of fiscal 2017, we made changes to the presentation of reportable segments to reflect changes in the way our chief operating decision maker, or decision making group, evaluate the performance of our operations and allocate resources. These reclassifications did not result in any change on our consolidated revenues, cost of revenues or gross profit.

## Three Months Ended December 31, 2017 Compared to Three Months Ended December 31, 2016

The following table and the discussion that follows present revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items and represents our results from continuing operations for the three months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,				Change		
	2017	Percent of Revenues (1)	2016	Percent of Revenues (1)	Dollar Change	Percent Change	
Revenues:							
Medical Market	\$10,193	100%	\$8,652	100%	\$1,541	18	%
Percentage of total revenues	17	%	16	%			
Veterinary Market	48,424	100%	43,198	100%	5,226	12	%
Percentage of total revenues	81	%	82	%			
Other (2)	1,053		922		131	14	%
Percentage of total revenues	2	%	2	%			
Total revenues	59,670		52,772		6,898	13	%
Cost of revenues:							

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Medical Market	5,425	53%	4,498	52%	927	21	%
Veterinary Market	21,982	45%	18,845	44%	3,137	17	%
Other (2)	87		25		62	248	%
Total cost of revenues	27,494		23,368		4,126	18	%
Gross profit:							
Medical Market	4,768	47%	4,154	48%	614	15	%
Veterinary Market	26,442	55%	24,353	56%	2,089	9	%
Other (2)	966		897		69	8	%
Gross profit	\$32,176		\$29,404		\$2,772	9	%

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(1) The percentage reported is based on revenues by operating segment.

(2) Represents unallocated items, not specifically identified to any particular business segment.

## Table of Contents

### Medical Market

#### Revenues for Medical Market Segment

During the three months ended December 31, 2017, total revenues in the medical market increased by 18%, or \$1.5 million, as compared to the same period in fiscal 2017. The change in the medical market revenues was primarily attributable to the following:

- Total revenues from Piccolo chemistry analyzers increased by 11%, or \$0.2 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in Piccolo chemistry analyzers sold in North America to Abbott, partially offset by a decrease in Piccolo chemistry analyzers sold to various distributors in Asia Pacific and rest of the world.

Total revenues from medical reagent discs increased by 17%, or \$1.1 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in the unit sales of medical reagent discs in North America to Abbott resulting from an expanded installed base of Piccolo chemistry analyzers and (b) an increase in revenues from medical reagent discs sold due to an expanded installed base of Piccolo chemistry analyzers in Europe.

Total revenues from other products in the medical market increased by 51%, or \$0.3 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in revenue from maintenance agreements.

#### Gross Profit for Medical Market Segment

Gross profit for the medical market segment increased by 15%, or \$0.6 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017. Gross profit percentages for the medical market segment during the three months ended December 31, 2017 and 2016 were 47% and 48%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to an increase in the unit sales of Piccolo chemistry analyzers and medical reagent discs, partially offset by higher manufacturing costs of Piccolo chemistry analyzers. The decrease in gross profit percentage was primarily attributable to an increase in manufacturing costs of Piccolo chemistry analyzers.

### Veterinary Market

#### Revenues for Veterinary Market Segment

During the three months ended December 31, 2017, total revenues in the veterinary market increased by 12%, or \$5.2 million, as compared to the same period in fiscal 2017. The change in the veterinary market revenues was primarily attributable to the following:

Total revenues from veterinary instruments increased by 12%, or \$0.9 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in the unit sales of VetScan hematology instruments due to marketing promotions offered in North America, (b) sales of urinalysis instruments in North America (launched in the second quarter of fiscal 2018) and (c) an increase in the unit sales of veterinary instruments sold to various distributors in Asia Pacific and rest of the world. The net increase was partially offset by a decrease in the unit sales of VetScan chemistry analyzers in North America resulting from fewer sales-type lease agreements to new and existing customers compared to higher sales in the prior period due to marketing promotions offered to existing customers during that period.



Total revenues from consumables in the veterinary market increased by 12%, or \$4.0 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer and fluctuation in distribution inventory in North America, (b) an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer and an expanded installed base of VetScan chemistry analyzers in Europe, (c) sales of urinalysis consumables (launched in the second quarter of fiscal 2018) and (d) an increase in revenues from VetScan rapid tests sold in North America due to an increase in the unit sales of our VetScan Canine Pancreatic Lipase Rapid Test (launched in the first quarter of fiscal 2018), VetScan Canine Parvovirus Rapid Test and VetScan Feline FeLV/FIV Rapid Test.

Total revenues from other products in the veterinary market increased by 16%, or \$0.3 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily due to an increase in other veterinary products sold in North America, which includes the VetScan FUSE.

#### Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 9%, or \$2.1 million, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017. Gross profit percentages for the veterinary market segment during the three months ended December 31, 2017 and 2016 were 55% and 56%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to (a) an increase in the unit sales of hematology instruments and veterinary reagent discs and (b) an increase in revenues from rapid tests due to a shift in the sales mix of higher priced rapid test products, partially offset by (a) a decrease in the unit sales of VetScan chemistry analyzers, (b) higher warranty costs of VetScan chemistry analyzers and (c) higher costs of VetScan hematology instruments due to the Euro exchange rates, as compared to the same period last year. The decrease in gross profit percentage was primarily due to (a) an increase in manufacturing costs of VetScan chemistry analyzers and veterinary reagent discs and (b) an increase in the sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

Table of Contents  
Other

Our other category primarily consists of products sold using our patented Orbos Discrete Lyophilization Process. The change in gross profit in our other category was primarily attributable to an increase in products sold using our patented Orbos Discrete Lyophilization Process during the three months ended December 31, 2017, as compared to the same period in fiscal 2017.

**Nine Months Ended December 31, 2017 Compared to Nine Months Ended December 31, 2016**

The following table and the discussion that follows present revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items and represents our results from continuing operations for the nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Nine Months Ended December 31,				Change	
	2017	Percent of Revenues (1)	2016	Percent of Revenues (1)	Dollar Change	Percent Change
Revenues:						
Medical Market	\$28,337	100%	\$27,130	100%	\$1,207	4%
Percentage of total revenues	16 %		16 %			
Veterinary Market	145,328	100%	139,219	100%	6,109	4%
Percentage of total revenues	82 %		82 %			
Other (2)	3,117		2,671		446	17%
Percentage of total revenues	2 %		2 %			
Total revenues	176,782		169,020		7,762	5%
Cost of revenues:						
Medical Market	15,490	55%	14,485	53%	1,005	7%
Veterinary Market	64,800	45%	60,729	44%	4,071	7%
Other (2)	211		143		68	48%
Total cost of revenues	80,501		75,357		5,144	7%
Gross profit:						
Medical Market	12,847	45%	12,645	47%	202	2%
Veterinary Market	80,528	55%	78,490	56%	2,038	3%
Other (2)	2,906		2,528		378	15%
Gross profit	\$96,281		\$93,663		\$2,618	3%

(1) The percentage reported is based on revenues by operating segment.

(2) Represents unallocated items, not specifically identified to any particular business segment.

Medical Market

**Revenues for Medical Market Segment**

During the nine months ended December 31, 2017, total revenues in the medical market increased by 4%, or \$1.2 million, as compared to the same period in fiscal 2017. The change in the medical market revenues was primarily attributable to the following:

• Total revenues from Piccolo chemistry analyzers increased by 13%, or \$0.6 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in Piccolo chemistry analyzers sold in North America to Abbott and to various distributors in Europe, partially offset by a

decrease in sales of Piccolo chemistry analyzers to various distributors in Asia Pacific and rest of the world.

Total revenues from medical reagent discs increased by 2%, or \$0.4 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in the unit sales of medical reagent discs to various distributors in Europe.

Total revenues from other products in the medical market increased by 11%, or \$0.2 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in revenue from maintenance agreements.

## Table of Contents

### Gross Profit for Medical Market Segment

Gross profit for the medical market segment increased by 2%, or \$0.2 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017. Gross profit percentages for the medical market segment during the nine months ended December 31, 2017 and 2016 were 45% and 47%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to an increase in the unit sales of Piccolo chemistry analyzers and medical reagent discs, partially offset by higher manufacturing costs of Piccolo chemistry analyzers. The decrease in gross profit percentage was primarily attributable to an increase in manufacturing costs of Piccolo chemistry analyzers.

### Veterinary Market

#### Revenues for Veterinary Market Segment

During the nine months ended December 31, 2017, total revenues in the veterinary market increased by 4%, or \$6.1 million, as compared to the same period in fiscal 2017. The change in the veterinary market revenues was primarily attributable to the following:

Total revenues from veterinary instruments decreased by 6%, or \$1.5 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) a decrease in the unit sales of VetScan chemistry analyzers in North America resulting from fewer sales-type lease agreements to new and existing customers compared to higher sales in the prior period due to marketing promotions offered to existing customers during that period and (b) a decrease in revenues from VetScan chemistry analyzers sold to various distributors in Asia Pacific and rest of the world. The net decrease was partially offset by (a) an increase in the unit sales of VetScan hematology instruments due to marketing promotions offered in North America, (b) an increase in the unit sales of VetScan hematology instruments to various distributors in Asia Pacific and rest of the world and (c) sales of urinalysis instruments (launched in the second quarter of fiscal 2018) in North America.

Total revenues from consumables in the veterinary market increased by 6%, or \$6.9 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in the unit sales of veterinary reagent discs due to higher average utilization per customer in North America, (b) an increase in the unit sales of veterinary reagent discs due to an expanded installed base of VetScan chemistry analyzers in Europe, (c) an increase in revenues from veterinary reagent discs sold to various distributors in Asia Pacific and rest of the world, (d) an increase in the unit sales of hematology reagent kits in North America resulting from an expanded installed base of VetScan hematology instruments and due to our supply agreement with Banfield Pet Hospitals, (e) sales of urinalysis consumables (launched in the second quarter of fiscal 2018) and (f) an increase in revenues from VetScan rapid tests sold in North America due to an increase in the unit sales of our VetScan Canine Pancreatic Lipase Rapid Test (launched in the first quarter of fiscal 2018), VetScan Canine Parvovirus Rapid Test and VetScan Feline FeLV/FIV Rapid Test.

Total revenues from other products in the veterinary market increased by 14%, or \$0.7 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to an increase in other veterinary products sold in North America, which includes the VetScan FUSE.

#### Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 3%, or \$2.0 million, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017. Gross profit percentages for the veterinary market segment during the nine months ended December 31, 2017 and 2016 were 55% and 56%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to (a) an increase in the unit sales of veterinary

reagent discs, hematology reagent kits and rapid tests and (b) an increase in revenues from rapid tests due to a shift in the sales mix of higher priced rapid test products, partially offset by (a) a decrease in the unit sales of VetScan chemistry analyzers, (b) higher manufacturing costs of VetScan chemistry analyzers and veterinary reagent discs and (c) higher costs of VetScan hematology instruments due to the Euro exchange rates as compared to the same period last year. The decrease in gross profit percentage was primarily due to an increase in the sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

Other

Our other category primarily consists of products sold using our patented Orbos Discrete Lyophilization Process. The change in gross profit in our other category was primarily attributable to an increase in products sold using our patented Orbos Discrete Lyophilization Process during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017.

Table of Contents

Three and Nine Months Ended December 31, 2017 Compared to Three and Nine Months Ended December 31, 2016

Cost of Revenues – Continuing Operations

The following table and discussion present our cost of revenues and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
Cost of revenues	\$27,494	\$23,368	\$4,126	18 %	\$80,501	\$75,357	\$5,144	7 %
Percentage of total revenues	46 %	44 %			46 %	45 %		

Cost of revenues includes the cost of materials, direct labor costs, costs associated with manufacturing, assembly, packaging, warranty repairs, test and quality assurance for our instruments and consumables and manufacturing overhead, including costs of personnel and equipment associated with manufacturing support.

The increase in cost of revenues, in absolute dollars, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, was impacted by (a) an increase in the unit sales of hematology instruments, medical reagent discs and veterinary reagent discs, (b) higher manufacturing costs of chemistry analyzers and reagent discs, (c) higher costs of VetScan hematology instruments due to the Euro exchange rates, (d) higher costs of rapid tests due to sales mix and (e) sales of urinalysis instruments (launched in the second quarter of fiscal 2018), partially offset by a decrease in the unit sales of VetScan chemistry analyzers, as compared to the same period last year. Cost of revenues, as a percentage of total revenues, during the three months ended December 31, 2017, as compared to the same period last year, was impacted by (a) higher manufacturing costs of chemistry analyzers and (b) a shift in the sales mix of higher sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

The increase in cost of revenues, in absolute dollars, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, was impacted by (a) an increase in the unit sales of Piccolo chemistry analyzers, medical reagent discs, veterinary reagent discs, hematology reagent kits and rapid tests, (b) higher manufacturing costs of chemistry analyzers and reagent discs, (c) higher costs of VetScan hematology instruments due to the Euro exchange rates, (d) higher costs of rapid tests due to sales mix and (e) sales of urinalysis instruments (launched in the second quarter of fiscal 2018), partially offset by a decrease in the unit sales of VetScan chemistry analyzers, as compared to the same period last year. Cost of revenues, as a percentage of total revenues, during the nine months ended December 31, 2017, as compared to the same period last year, was impacted by (a) higher manufacturing costs of chemistry analyzers and (b) a shift in the sales mix of higher sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

Gross Profit – Continuing Operations

The following table and discussion present our gross profit and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
Total gross profit	\$32,176	\$29,404	\$2,772	9 %	\$96,281	\$93,663	\$2,618	3 %
Total gross margin	54 %	56 %			54 %	55 %		

The increase in gross profit, in absolute dollars, during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, was primarily attributable to (a) an increase in the unit sales of Piccolo chemistry analyzers and medical reagent discs, (b) an increase in the unit sales of hematology instruments and veterinary reagent discs and (c) an increase in revenues from rapid tests due to a shift in the sales mix of higher priced rapid test products, partially offset by (a) higher manufacturing costs of Piccolo chemistry analyzers, (b) a decrease in the unit sales of VetScan chemistry analyzers, (c) higher warranty costs of VetScan chemistry analyzers and (d) higher costs of VetScan hematology instruments due to the Euro exchange rates, as compared to the same period last year. The decrease in gross profit percentage was primarily due to (a) an increase in manufacturing costs of chemistry analyzers and veterinary reagent discs and (b) an increase in the sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

The increase in gross profit, in absolute dollars, during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, was primarily attributable to (a) an increase in the unit sales of Piccolo chemistry analyzers and medical reagent discs, (b) an increase in the unit sales of veterinary reagent discs, hematology reagent kits and rapid tests and (c) an increase in revenues from rapid tests due to a shift in the sales mix of higher priced rapid test products, partially offset by (a) higher manufacturing costs of chemistry analyzers and veterinary reagent discs, (b) a decrease in the unit sales of VetScan chemistry analyzers and (c) higher costs of VetScan hematology instruments due to the Euro exchange rates, as compared to the same period last year. The decrease in gross profit percentage was primarily due to (a) an increase in manufacturing costs of Piccolo chemistry analyzers and (b) an increase in the sales volume of our original equipment manufacturer supplied products, which have a lower margin contribution.

Table of ContentsResearch and Development – Continuing Operations

The following table and discussion present our research and development expenses and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
Research and development expenses	\$ 5,165	\$ 4,776	\$ 389	8 %	\$ 17,672	\$ 14,915	\$ 2,757	18 %
Percentage of total revenues	9 %	9 %			10 %	9 %		

Research and development expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), consulting expenses and materials and related expenses associated with the development of new tests and test methods, clinical trials, product improvements and optimization and enhancement of existing products and expenses related to regulatory and quality assurance. Research and development expenses are primarily based on the project activities planned and the level of spending depends on budgeted expenditures. Research and development expenses for the periods presented above are related primarily to new product development and enhancement of existing products in both the medical and veterinary markets. Research and development expenses may fluctuate with product development phases and project timing as well as our focused research and development efforts that are aligned with our overall business strategy.

Research and development expenses increased during the three months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to increased costs related to increased personnel expenses related to additional headcount and an increase in bonus expense compared to the third quarter of fiscal 2017 since company performance targets were not met in last year's quarter. Share-based compensation expense included in research and development expenses during the three months ended December 31, 2017 and 2016 was \$0.7 million and \$0.6 million, respectively.

Research and development expenses increased during the nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) expenses related to new product development and enhancement of existing products in both the medical and veterinary markets and (b) increased personnel expenses related to additional headcount and an increase in bonus expense compared to the same period last year since company performance targets were not met in the third quarter of fiscal 2017. Share-based compensation expense included in research and development expenses during the nine months ended December 31, 2017 and 2016 was \$2.2 million and \$1.9 million, respectively.

We anticipate that our research and development expenses, both in absolute dollars and as a percentage of revenues, will increase in fiscal 2018 from fiscal 2017, as we complete new products and enhance existing products for both the medical and veterinary markets.

Sales and Marketing – Continuing Operations

The following table and discussion present our sales and marketing expenses and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

Three Months Ended December 31,				Nine Months Ended December 31,			
2017	2016	Dollar	Percent	2017	2016	Dollar	Percent



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				Change	Change				Change	Change
Sales and marketing expenses	\$ 13,657	\$ 10,629	\$ 3,028	28	%	\$ 38,642	\$ 33,707	\$ 4,935	15	%
Percentage of total revenues	23	%	20	%		22	%	20	%	

Sales and marketing expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), commissions and travel-related expenses for personnel engaged in selling, costs associated with advertising, lead generation, marketing programs, trade shows and services related to customer and technical support.

Sales and marketing expenses increased during the three and nine months ended December 31, 2017, as compared to the same periods in fiscal 2017, primarily attributable to increased costs related to headcount, including share-based compensation expense, to support our growth in both North America and internationally. Share-based compensation expense included in sales and marketing expenses during the three months ended December 31, 2017 and 2016 was \$1.1 million and \$0.8 million, respectively, and during the nine months ended December 31, 2017 and 2016 was \$3.4 million and \$2.2 million, respectively.

Table of ContentsGeneral and Administrative – Continuing Operations

The following table and discussion present our general and administrative expenses and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2017	2016	Dollar Change	Percent Change	2017	2016	Dollar Change	Percent Change
General and administrative expenses	\$4,777	\$3,159	\$1,618	51 %	\$13,494	\$11,714	\$1,780	15 %
Percentage of total revenues	8 %	6 %			8 %	7 %		

General and administrative expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), and expenses for outside professional services related to general corporate functions, including accounting and legal, and other general and administrative expenses.

General and administrative expenses increased during the three and nine months ended December 31, 2017, as compared to the same period in fiscal 2017, primarily attributable to (a) an increase in bonus expense compared to the third quarter of fiscal 2017 since company performance targets were not met in last year's quarter, (b) an increase in share-based compensation expense compared to the same period last year due to adjustments in the third quarter of fiscal 2017 based on our determination that it was not probable that performance targets would be met and (c) increased spending on professional services. Share-based compensation expense included in general and administrative expenses during the three months ended December 31, 2017 and 2016 was \$1.4 million and \$0.7 million, respectively, and during the nine months ended December 31, 2017 and 2016 was \$3.4 million and \$2.9 million, respectively.

Interest and Other Income (Expense), Net – Continuing Operations

The following table and discussion present our interest and other income (expense), net and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,			Nine Months Ended December 31,		
	2017	2016	Dollar Change	2017	2016	Dollar Change
Interest and other income (expense), net	\$ 878	\$ (52 )	\$ 930	\$ 2,962	\$ 6,197	\$ (3,235 )

Interest and other income (expense), net consists primarily of interest earned on cash and cash equivalents and investments, foreign currency exchange gains and losses and our equity in net income (loss) of investments in unconsolidated affiliates.

Interest and other income (expense), net increased during the three months ended December 31, 2017, as compared to the same periods in fiscal 2017, primarily attributable to foreign currency gain resulting from exchange rate fluctuations.

Interest and other income (expense), net decreased during the nine months ended December 31, 2017, as compared to the same periods in fiscal 2017, primarily attributable to a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the three months ended September 30, 2016, partially offset by foreign currency gain resulting from exchange rate fluctuations, primarily during the first quarter of fiscal 2018. See Note 8,

“Investments in Unconsolidated Affiliates” of the Notes to Condensed Consolidated Financial Statements contained in this report for additional information on the sale of our equity method investment.

#### Income Tax Provision – Continuing Operations

The following table and discussion present our income tax provision and represent our results from continuing operations for the three and nine months ended December 31, 2017 and 2016 (in thousands, except percentages):

	Three Months Ended December 31,			Nine Months Ended December 31,		
	2017	2016	Dollar Change	2017	2016	Dollar Change
Income tax provision	\$ 5,229	\$ 3,929	\$ 1,300	\$ 12,278	\$ 14,288	\$ (2,010 )
Effective tax rate	55	% 36	%	42	% 36	%

The Company’s effective tax rate during the three and nine months ended December 31, 2017 was impacted by the Tax Act. Income tax effects resulting from changes in tax laws are accounted for by the Company in accordance with the authoritative guidance, which requires that these tax effects be recognized in the period in which the law is enacted and the effects are recorded as a component of provision for income taxes from continuing operations. As a result, the Company made an additional provision for income tax resulting from the enactment of the Tax Act during the three and nine months ended December 31, 2017.

## Table of Contents

The Tax Act includes significant changes to the U.S. income tax system. The Tax Act, among other changes, reduces the U.S. federal corporate tax rate from 35% to 21% as of January 1, 2018, eliminates the federal benefit for qualified production activities, expands the deduction limitation for executive compensation, creates a territorial system which will generally allow companies to repatriate future foreign earnings without incurring additional U.S. income taxes, subjects foreign earnings on which U.S. income tax is currently deferred to a one time transition tax, creates a “minimum tax” on certain intangible foreign earnings and creates an incentive for U.S. companies to sell goods and services abroad. The decrease in the U.S. federal corporate tax rate from 35% to 21% results in a blended statutory tax rate of 31.5% for the fiscal year ending March 31, 2018.

The dollar increase in the income tax provision during the three months ended December 31, 2017, as compared to the same period last year, was attributable to a one-time non-cash charge of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the federal corporate tax rate from 35% to 21% effective January 1, 2018, partially offset by the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5%.

The dollar decrease in the income tax provision during the nine months ended December 31, 2017, as compared to the same period last year, was attributable to lower pre-tax income and the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5%, partially offset by a one-time non-cash charge of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the federal corporate tax rate from 35% to 21% effective January 1, 2018.

The increase in the effective tax rate during the three and nine months ended December 31, 2017, as compared to the same period last year, was primarily attributable to an additional provision for income tax resulting from the enactment of the Tax Act during the three and nine months ended December 31, 2017, as described above. The increase in the effective tax rate was partially offset by the reduction of the U.S. federal rate from 35% to a blended statutory tax rate of 31.5% and the recognition of excess tax benefits as a discrete item in the three and nine months ended December 31, 2017 pursuant to ASU 2016-09, which we adopted effective the first quarter of fiscal 2018. The adoption of ASU 2016-09 is discussed further in Note 2, “Summary of Significant Accounting Policies.”

As of December 31, 2017, the Company had not fully completed its accounting for the tax effects of the enactment of the Tax Act. The Company’s provision for income taxes during the three and nine months ended December 31, 2017 is based on a reasonable estimate of the effects on its transition tax and existing deferred tax balances. The Company estimates it will incur no transition tax and has recorded a one-time non-cash charge of \$2.9 million due to an estimated reduction in deferred tax assets as a result of the reduction of the federal rate from 35% to 21%. The computation of the transition tax could be impacted by further interpretations from the U.S. and state governments and regulatory organizations. The reduction of the deferred tax assets may be impacted by changes in the timing for the reversal of existing deferred tax assets and liabilities.

The Tax Act also includes provisions for Global Intangible Low-Taxed Income (“GILTI”) wherein taxes on foreign income are imposed in excess of a deemed return on tangible assets of foreign corporations which applies after the fiscal year ending March 31, 2018. Because of the complexity of the new provisions, we are continuing to evaluate how the provisions will be accounted for under accounting principles generally accepted in the United States of America wherein companies are allowed to make an accounting policy election to either (i) account for GILTI as a component of tax expense in the period in which they are subject to the rules or (ii) account for GILTI in their measurement of deferred taxes. Prior to the reporting period in which the Tax Act was enacted, our policy was to reinvest earnings of our foreign subsidiaries unless such earnings are subject to U.S. taxation. As of March 31, 2017, there were no earnings that have not been subject to U.S. taxation. We do not have sufficient information available to finalize our analysis of the impact of the Tax Act on our repatriation policy, and therefore, the policy has not changed as of December 31, 2017. We expect to finalize our analysis during the fourth quarter ending March 31, 2018, which may include a change in our repatriation policy.

We did not have any unrecognized tax benefits as of December 31, 2017 and March 31, 2017. During the three and nine months ended December 31, 2017 and 2016, we did not recognize any interest or penalties related to unrecognized tax benefits.

We are subject to income taxes in the United States and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. In the third quarter of fiscal 2017, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015, which was completed in the second quarter of fiscal 2018 and there have not been any proposed assessments as a result of this examination. Our foreign subsidiary income tax returns for fiscal 2013 through 2015 is subject to examination by German tax authorities. The German tax examination commenced in the third quarter of fiscal 2018. As of December 31, 2017, there had been no proposed assessments by such authorities in Germany and we are unable to estimate the range of possible outcomes at this time.

#### Discontinued Operations

On March 18, 2015, we entered into an asset purchase agreement, or the APA, with Antech pursuant to which we sold substantially all of the assets of our AVRL business. The sale transaction closed on March 31, 2015. The operating results of our AVRL business are presented as discontinued operations and were not significant during the three and nine months ended December 31, 2017 and 2016.

Table of Contents

## Liquidity and Capital Resources – Continuing and Discontinued Operations

## Cash, Cash Equivalents and Investments

The following table summarizes our cash, cash equivalents and short-term and long-term investments as of December 31, 2017 and March 31, 2017 (in thousands, except percentages):

	December 31, 2017	March 31, 2017
Cash and cash equivalents	\$ 71,902	\$ 91,332
Short-term investments	89,717	51,561
Long-term investments	23,333	22,171
Total cash, cash equivalents and investments	\$ 184,952	\$ 165,064
Percentage of total assets	56	% 54 %

As of December 31, 2017, we had net working capital of \$208.4 million compared to \$199.7 million as of March 31, 2017. The increase in working capital is due to an increase in cash and cash equivalents and short-term investments, partially offset by a reclassification of current net deferred tax assets to non-current net deferred tax assets on the condensed consolidated balance sheets as of December 31, 2017 due to the adoption of ASU 2015-17 in the first quarter of fiscal 2018. ASU 2015-17 is discussed further in Note 2, “Summary of Significant Accounting Policies.”

## Cash Flow Changes

Cash provided by (used in) operating, investing and financing activities during the nine months ended December 31, 2017 and 2016 were as follows (in thousands):

	Nine Months Ended December 31,	
	2017	2016
Net cash provided by operating activities	\$ 37,160	\$ 22,269
Net cash used in investing activities	(45,004 )	(13,816 )
Net cash used in financing activities	(12,501 )	(10,401 )
Effect of exchange rate changes on cash and cash equivalents	915	(722 )
Net decrease in cash and cash equivalents	\$ (19,430 )	\$ (2,670 )

Cash and cash equivalents as of December 31, 2017 were \$71.9 million compared to \$91.3 million as of March 31, 2017. The decrease in cash and cash equivalents during the nine months ended December 31, 2017 was primarily due to purchases of investments of \$102.0 million, purchases of property and equipment of \$4.8 million, payments made for tax withholdings related to net share settlements of restricted stock units of \$2.5 million and payment of cash dividends totaling \$10.0 million. These decreases were partially offset by net cash provided by operating activities of \$37.2 million, proceeds from maturities and redemptions of investments of \$61.8 million and effect of exchange rate changes on cash and cash equivalents of \$0.9 million.

## Cash Flows from Operating Activities

During the nine months ended December 31, 2017, we generated \$37.2 million in cash from operating activities, compared to \$22.3 million during the nine months ended December 31, 2016. The cash provided by operating activities during the nine months ended December 31, 2017 was the result of net income of \$17.2 million, adjusted for the effects of non-cash adjustments including depreciation and amortization of \$5.9 million, share-based compensation expense of \$10.2 million and the following changes in assets and liabilities.

Receivables, net decreased by \$0.2 million, from \$40.6 million as of March 31, 2017 to \$40.4 million as of December 31, 2017, primarily attributable to higher sales in the last month of the quarter ended March 31, 2017.

Inventories increased by \$3.5 million from \$39.0 million as of March 31, 2017 to \$42.5 million as of December 31, 2017, primarily attributable to purchases of original equipment manufacturer supplied products.

Prepaid expenses and other current assets increased by \$1.3 million, from \$5.0 million as of March 31, 2017 to \$6.3 million as of December 31, 2017, primarily attributable to the timing of estimated income taxes and other expenses.

- Current net deferred tax assets decreased by \$5.6 million, from \$5.6 million as of March 31, 2017 to \$0 as of December 31, 2017, and non-current net deferred tax assets increased by \$3.1 million, from \$4.4 million as of March 31, 2017 to \$7.5 million as of December 31, 2017. The changes in current and non-current net deferred tax assets were primarily attributable to (a) the reclassification of current net deferred tax assets to non-current net deferred tax assets on the condensed consolidated balance sheets as of December 31, 2017 due to the adoption of ASU 2015-17 in the first quarter of fiscal 2018 and (b) a reduction in deferred tax assets of \$2.9 million as a result of the reduction of the U.S. federal tax rate from 35% to 21% effective January 1, 2018.

## Table of Contents

Other assets increased by \$1.6 million, from \$7.6 million as of March 31, 2017 to \$9.2 million as of December 31, 2017, primarily attributable to long-term receivables due to sales-type lease agreements with our customers.

Accounts payable increased by \$5.7 million, from \$7.5 million as of March 31, 2017 to \$13.2 million as of December 31, 2017, primarily due to the timing and payment of services and inventory during the quarter and higher inventory purchases in the last month of the quarter ended December 31, 2017.

Accrued payroll and related expenses increased by \$0.7 million, from \$9.6 million as of March 31, 2017 to \$10.3 million as of December 31, 2017, primarily attributable to the timing of payments.

Accrued taxes decreased by \$2.1 million, from \$2.2 million as of March 31, 2017 to \$47,000 as of December 31, 2017, primarily due to the timing of estimated income tax payments.

Other accrued liabilities, current, increased by \$4.6 million, from \$11.0 million as of March 31, 2017 to \$15.6 million as of December 31, 2017 and other liabilities, non-current, increased by \$0.2 million, from \$1.3 million as of March 31, 2017 to \$1.5 million as of December 31, 2017. The net current and non-current other liabilities increased primarily attributable to an increase in liabilities related to the types of customer sales incentive programs offered during a promotional period.

As of December 31, 2017 and March 31, 2017, the current portion of deferred revenue was \$1.1 million and \$1.4 million, respectively, and the non-current portion of deferred revenue was \$1.3 million and \$1.5 million, respectively. Net current and non-current deferred revenue decreased by \$0.5 million from March 31, 2017 to December 31, 2017, primarily attributable to deferred revenue recognized ratably over the life of extended maintenance contracts offered to customers in the form of free services in connection with the sale of our instruments.

As of December 31, 2017 and March 31, 2017, the current portion of warranty reserve was \$2.1 million and \$1.7 million, respectively, and the non-current portion of warranty reserve was \$2.9 million and \$2.7 million, respectively. Net current and non-current warranty reserve increased by \$0.6 million. The change in current and non-current warranty reserve from March 31, 2017 to December 31, 2017 is primarily due to an increase in the number of instruments in standard warranty and our estimated product failure rates and repair and related costs of instruments. Warranty reserve is primarily based on (a) the number of instruments in standard warranty, estimated product failure rates and estimated repair costs and (b) an estimate of defective reagent discs and replacement costs of reagent discs. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, timing of product sales, accounts receivable collections performance, inventory and supply chain management, and the timing and amount of payments. Furthermore, we anticipate that we will incur incremental costs to support our future operations, including research and design costs related to the continuing development of our current and future products; clinical trials for our current and future products, expansion of our international operations and acquisition of capital equipment for our manufacturing facility.

## Cash Flows from Investing Activities

Net cash used in investing activities during the nine months ended December 31, 2017 totaled \$45.0 million, compared to net cash used of \$13.8 million during the nine months ended December 31, 2016. Changes in net cash used in investing activities were attributable to the following:



Cash used in investing activities during the nine months ended December 31, 2017 was primarily due to purchases of investments in certificates of deposit, commercial paper and corporate bonds totaling \$102.0 million during the nine months ended December 31, 2017. The cash used in investing activities was partially offset by proceeds from maturities and redemptions of investments in certificates of deposit, commercial paper and corporate bonds of \$61.8 million during the nine months ended December 31, 2017.

Our capital expenditures totaled \$4.8 million during the nine months ended December 31, 2017. Purchases of capital equipment primarily relate to increasing our manufacturing capacity, support our growth and transfers of equipment from inventory to property and equipment. We expect to continue to make significant capital expenditures as necessary in the normal course of our business.

#### Cash Flows from Financing Activities

Net cash used in financing activities during the nine months ended December 31, 2017 totaled \$12.5 million, compared to net cash used of \$10.4 million during the nine months ended December 31, 2016. Cash used in financing activities during the nine months ended December 31, 2017 was primarily due to cash dividend payments of \$10.0 million and payments made for tax withholdings related to net share settlements of restricted stock units of \$2.5 million. During the nine months ended December 31, 2017, we did not purchase any shares pursuant to our share repurchase program described below.

## Table of Contents

### Dividend Payments

During the three months ended December 31, 2017 and 2016, our total quarterly dividend payout was \$3.6 million and \$3.2 million, respectively. During the nine months ended December 31, 2017 and 2016, our total quarterly dividend payout was \$10.0 million and \$8.6 million, respectively. Our dividend payouts were made from retained earnings.

In January 2018, our Board of Directors declared a cash dividend of \$0.16 per share on our outstanding common stock to be paid on March 15, 2018 to all shareholders of record as of the close of business on March 1, 2018. Future declarations of quarterly dividends, if any, and the establishment of future record and payment dates are subject to the final determination of our Board of Directors.

### Share Repurchase Program

Between August 2011 and July 2016, our Board of Directors authorized the repurchase of up to a total of \$97.3 million of our common stock. In October 2017, our Board of Directors approved a \$21.0 million increase to our existing share repurchase program. As of December 31, 2017, \$75.0 million was available to purchase common stock under our share repurchase program.

Since the share repurchase program began, through December 31, 2017, we have repurchased 1.6 million shares of our common stock at a total cost of \$43.3 million, including commission expense. During the three and nine months ended December 31, 2017 and 2016, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

### Financial Condition

We believe that our cash and cash equivalents, investments and expected cash flows from operations will be sufficient to fund our operations, capital requirements, share repurchase program and anticipated quarterly dividends for at least the next twelve months. Our future capital requirements will largely depend upon the increased customer demand and market acceptance of our point-of-care diagnostic products. However, our sales for any future periods are not predictable with a significant degree of certainty. Regardless, we may seek to raise additional funds to pursue strategic opportunities.

### Contractual Obligations

#### Commitments

We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately \$2.2 million as of December 31, 2017. These purchase order commitments primarily include our purchase obligations to purchase from Diatron of Hungary through fiscal 2018.

In January 2018, we entered into an amendment related to a lease for additional warehousing space consisting of approximately of 26,130 rentable square feet, commencing on the later of March 2018 and the date certain leasehold improvements are substantially complete, and ending in March 2026. Our total commitments under the amended lease are approximately \$2.2 million.

In April 2017, we entered into a joint development agreement with the diagnostics division of a medical products company, whereby we were subject to payments of up to \$10.2 million, in consideration of development efforts, over an estimated period of four years. Our payment obligations were contingent upon the achievement of certain development milestones. In November 2017, prior to the achievement of any such development milestones, both

parties agreed to terminate the joint development agreement and as of December 31, 2017, we had no outstanding obligations under this agreement.

See Note 8, “Investments in Unconsolidated Affiliates” of the Notes to Condensed Consolidated Financial Statements contained in this report for additional information on commitments due in connection with our investment in a privately-held company.

#### Notes Payable

We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City, or the Agency whereby the Agency provides us with an unsecured loan of up to \$1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of December 31, 2017, our short-term and long-term notes payable balances were \$0.1 million and \$0.2 million, respectively, and as of March 31, 2017, our short-term and long-term notes payable balances were \$0.1 million and \$0.3 million, respectively. The short-term balance was recorded in “Other accrued liabilities” on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date we cease operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon an event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of December 31, 2017.

### Table of Contents

In accordance with the terms of the loan agreement, the Agency will provide us with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by us to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in "Interest and other income (expense), net" on the condensed consolidated statements of income.

### Contingencies

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

### Off-Balance Sheet Arrangements

As of December 31, 2017, we did not have any off-balance sheet arrangements, as defined in Item 303 of Regulation S-K promulgated under the Securities Act of 1933. In addition, we identified no variable interests in any variable interest entities.

### RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is included in Note 2 of the Notes to Condensed Consolidated Financial Statements contained in this report.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our financial position is exposed to a variety of risks related to changes in interest rates and foreign currency rates and investment in privately-held companies. As a matter of management policy, we do not currently enter into transactions involving derivative financial instruments.

Interest Rate Risk

Our investment objective is to invest excess cash in cash equivalents and in various types of investments to maximize yields without significantly increased risk. As of December 31, 2017, our short-term and long-term investments totaled \$89.7 million and \$23.3 million, respectively, consisting of investments in certificates of deposit, commercial paper, corporate bonds and municipal bonds. For our securities classified as available-for-sale, we record these investments at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive gain (loss), net of any tax effects, in shareholders' equity. The fair value of our investment portfolio is subject to change as a result of changes in market interest rates and investment risk related to the issuers' credit worthiness. Changes in market interest rates would not be expected to have a material impact on the fair value of these assets as of December 31, 2017, as the assets consisted of highly liquid securities.

We are exposed to the impact of interest rate changes with respect to our short-term and long-term investments. As of December 31, 2017, we had \$57.2 million in investments classified as held-to-maturity and carried at amortized cost. We have the ability to hold the investments classified as held-to-maturity in our investment portfolio as of December 31, 2017 until maturity and therefore, we believe we have no material exposure to interest rate risk. As of December 31, 2017, our investments classified as available-for-sale totaled \$55.8 million, consisting primarily of fixed income securities and thus changes in interest rates would not have a material effect on our business, operating results or financial condition. We have not experienced any significant loss on our investment portfolio during fiscal 2017 or during the three and nine months ended December 31, 2017.

Foreign Currency Rate Fluctuations

We operate primarily in the United States and a majority of our revenues, cost of revenues, operating expenses and capital purchasing activities are transacted in U.S. dollars. However, we are exposed to foreign currency risks that arise from normal business operations. These risks are primarily related to remeasuring local currency balances and results of our foreign subsidiaries, into U.S. dollars and third-party transactions denominated in a currency other than the U.S. dollar. As currency exchange rates change, remeasurement of the accounts of our foreign subsidiaries into U.S. dollars affects year-over-year comparability of operating results.

The functional currency of our wholly-owned subsidiaries is in U.S. dollars. Foreign currency denominated account balances of our subsidiaries are remeasured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for nonmonetary assets. The effects of foreign currency transactions, and of remeasuring the financial condition into the functional currency, resulted in foreign currency gains and losses, which were included in "Interest and other income (expense), net" on our condensed consolidated statements of income. For our sales denominated in foreign currencies, we are exposed to foreign currency exchange rate fluctuations on revenue and collection of receivables. Our revenues were impacted by foreign currency exchange rates during the three and nine months ended December 31, 2017, which increased our revenues by approximately \$0.7 million, during the three months ended December 31, 2017, as compared to the same period last year, and increased our revenues of approximately \$0.5 million, during the nine months ended December 31, 2017, as compared to the same period last year. Continued change in the values of the Euro, the British pound sterling and other foreign currencies against the U.S. Dollar could have an impact on our business, financial condition and results of operations.

Our most significant third-party transactions denominated in foreign currency are inventory purchases of hematology products from Diatron MI PLC, which are primarily denominated in Euros. To the extent the U.S. dollar strengthens against the Euro currency, the translation of the foreign currency denominated transactions may result in reduced cost of revenues and operating expenses. Similarly, our cost of revenues and operating expenses will increase if the U.S. dollar weakens against the Euro currency. We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 10% for our foreign currency denominated transactions could be experienced in the near term. If the U.S. dollar weakened or strengthened by 10% against the Euro, the impact of changes in the exchange rate would not have had a material effect on our business, operating results or financial condition for the three and nine months ended December 31, 2017. To date, we have not engaged in any foreign currency hedging transactions. As our international operations grow, we will continue to reassess our approach to managing the risks relating to fluctuations in currency rates.

## Table of Contents

### Investments in Privately-Held Companies

In June 2016, we invested a total of \$3.0 million in a privately-held company. Our investment was initially recorded under the cost method as we did not exercise significant influence over the investee's operating or financial activities. The investment is inherently risky and we could lose our entire investment in this company. To date, we have not recorded an impairment charge on this investment. In January 2017, we entered into a letter agreement with the privately-held company. Under the terms of the letter agreement, the privately-held company will, pending negotiation and execution of a definitive agreement, commence chemistry development activities for us using its intellectual product and technology. As consideration for these development efforts, we agreed to pay a total of up to \$1.5 million to the privately-held company, which includes an upfront payment of \$0.3 million that we paid in January 2017, with the remaining \$1.2 million obligation contingent upon the achievement of certain development milestones. As a result of our ability to exercise significant influence over operating and financial policies in our investment, which we do not control, we accounted for our investment in the privately-held company using the equity method on a prospective basis beginning in January 2017 based on our early adoption of ASU 2016-07. As of December 31, 2017 and March 31, 2017, the carrying value of our equity method investment in this privately-held company was \$2.7 million and \$2.9 million, respectively. In January 2018, we invested an additional \$1.2 million with the privately-held company in which we had invested \$3.0 million in June 2016 and recorded the investment in "Investment in unconsolidated affiliates," on the condensed consolidated balance sheets, resulting in an aggregate equity ownership interest of 32%.

In February 2011, we purchased a 15% equity ownership interest in Scandinavian Micro Biodevices APS ("SMB"), a developer and manufacturer of point-of-care diagnostic products for veterinary use, for \$2.8 million in cash. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. We accounted for our investment in SMB using the equity method due to our significant influence over SMB's operations. In August 2016, we sold our 15% equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB. The total purchase price paid to us for our equity method investment in SMB was approximately \$9.7 million in cash, subject to a holdback for certain adjustments that may occur. The holdback payment is expected to be released 18 months following the closing date. In connection with the sale, we received an initial cash payment of \$8.5 million and recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the period ended September 30, 2016. We have been notified that the holdback will be released in full and expect to receive payment of the holdback amount of approximately \$1.2 million in February 2018.

Other than the foregoing, there have been no material changes in our market risk during the three and nine months ended December 31, 2017 compared to the disclosures in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of December 31, 2017. Based on such evaluation, our principal executive officer and principal financial officer have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act.

### Inherent Limitations on Controls and Procedures

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even an effective system of internal control will provide only reasonable assurance that the objectives of the internal control system are met.



Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

RISK FACTORS THAT MAY AFFECT OUR PERFORMANCE

Our future performance is subject to a number of risks. If any of the following risks actually occur, our business could be harmed and the trading price of our common stock could decline. In evaluating our business, you should carefully consider the following risks in addition to the other information in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017 as filed with the Securities and Exchange Commission on May 30, 2017, as amended. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. It is not possible to predict or identify all such factors and, therefore, you should not consider the following risks to be a complete statement of all the potential risks or uncertainties that we face.

When used in these risk factors, the words “anticipates,” “believes,” “continue,” “could,” “estimates,” “expects,” “future,” “intends,” “may,” “might,” “plans,” “projects,” “will” and similar expressions identify forward-looking statements. Our actual results could differ materially from those that we project in the forward-looking statements as a result of factors that we have set forth throughout this document as well as additional risks not presently known to us or that we currently believe are immaterial that may also significantly impair our business operations.

Our facilities and manufacturing operations are vulnerable to interruption as a result of natural disasters, system failures and other business disruptions. Any such interruption may harm our business.

Our business depends on the efficient and uninterrupted operation of our manufacturing operations, which are co-located with our corporate headquarters in Union City, California. These manufacturing operations are vulnerable to damage or interruption from earthquakes, fire, floods, power loss, telecommunications failures, break-ins and similar events. A failure of manufacturing operations, be it in the development and manufacturing of our Piccolo or VetScan blood chemistry analyzers or the reagent discs used in the blood chemistry analyzers, could result in our inability to supply customer demand. We do not have a backup facility to provide redundant manufacturing capacity in the event of a system failure or other significant loss or problem. Accordingly, if our manufacturing operations in Union City, California were interrupted, we may be required to bring an alternative facility online, a process that could take several weeks to several months or more. The occurrence of a business disruption could harm our revenue and financial condition and increase our costs and expenses. Although we carry property and business interruption insurance to insure against the financial impact of certain events of this nature, our coverage may not be adequate to compensate us for all losses that may occur.

We face significant competition. We may not be able to compete effectively with larger, more established entities or their products, or with future organizations or future products, which could cause our sales to decline.

The diagnostic market is a well-established field in which there are a number of competitors that have substantially greater financial and operational resources and larger, more established marketing, sales and service organizations than we do. We compete primarily with the following organizations: commercial clinical laboratories, hospitals' clinical laboratories, and manufacturers of bench top multi-test blood analyzers and other testing systems that health care providers can use at the point of care.

Historically, hospitals and commercial laboratories perform most of the human diagnostic testing, and veterinary specialized commercial laboratories perform most of the veterinary medical testing. We have identified five principal factors that we believe customers typically use to evaluate our products and those of our competitors. These factors include the following: range of tests offered, immediacy of results, cost effectiveness, ease of use and reliability of results. We believe that we compete effectively on each of these factors except for the range of tests offered. Clinical laboratories are effective at processing large panels of tests using skilled technicians and complex equipment. Currently, while our offering of instruments and reagent discs does not provide the same broad range of tests as hospitals and commercial laboratories, we believe that in certain markets, our products provide a sufficient breadth of test menus to compete successfully with clinical laboratories given the advantages of our products with respect to the other four factors. In addition, we cannot assure you that we will continue to be able to compete effectively on cost effectiveness, ease of use, immediacy of results or reliability of results. We also cannot assure you that we will ever be able to compete effectively on the basis of range of tests offered.

### Table of Contents

Our principal competitors in the point-of-care human medical diagnostic market are Alere, Alfa Wassermann S.P.A., Ortho Clinical Diagnostics, Inc. and F. Hoffmann-La Roche Ltd. Additionally, in certain segments of the human medical diagnostic market, we compete with Abbott's i-STAT division. Many of our competitors in the human medical diagnostic market have significantly larger product lines to offer and greater financial and other resources than we do. In particular, many of these competitors have large sales forces and well-established distribution channels and brand names.

Our principal competitors in the veterinary diagnostic market are Idexx Laboratories, Inc. and Heska Corporation. Idexx has a larger veterinary product and service offering than we do and a large sales infrastructure network and well-established brand name. Consequently, we must develop our distribution channels and significantly expand our direct sales force in order to compete more effectively in these markets. If we are unable to effectively manage our distribution channels in our highly competitive industry, we may fail to retain customers or obtain new customers and our business will suffer.

We would fail to achieve anticipated revenues if the market does not accept our products.

We believe that our core compact blood chemistry analyzer product differs substantially from current blood chemistry analyzers on the market. We compete with centralized laboratories that offer a greater number of tests than our products, at a lower cost, but require more time. We also compete with other point-of-care analyzers that often require more maintenance and offer a narrower range of tests. However, these point-of-care analyzers are generally marketed by larger companies which have greater resources for sales and marketing, in addition to a recognized brand name and established distribution relationships.

In the human medical market, we believe that our blood chemistry analyzers offer customers many advantages, including substantial improvements in clinical efficiencies. However, the implementation of point-of-care diagnostics in the current healthcare environment involves changes to current standard practices, such as using large clinical laboratories, and adopting our technology requires a shift in both the procedures and mindset of care providers. The human medical market in particular is highly regulated, structured and subject to government and managed care influences; accordingly, the market can be difficult to penetrate and slower to adapt to new technologies. If we or our distribution partner, Abbott, are unable to convince large numbers of medical clinics, hospitals and other point-of-care environments of the benefits of our Piccolo blood chemistry analyzers and our other products, we could fail to achieve anticipated revenue.

Historically, in the veterinary market, we marketed our VetScan products through both direct sales and distribution channels to veterinarians. We continue to develop new animal blood tests to expand our product offerings; however, we cannot be assured that these products will be accepted by the veterinary market. Any failure to achieve market acceptance with our current or future products would harm our business and financial condition. Moreover, we may identify new areas for serving our veterinary market customers and our offerings in these areas may not be accepted by the market or achieve our financial goals to increase revenues and profitability at acceptable levels. For example, we sold our AVRL business in March 2015, as it failed to perform to our expectations.

We need to successfully market additional products in the veterinary diagnostic market if we are to compete in that market.

We continue to develop products, such as VetScan FUSE, a web-based integration system that provides connectivity between our point-of-care diagnostic instruments and the veterinary practice management systems; a new point-of-care urine sediment and chemistry analyzers and new animal blood tests to expand our product offerings; however, we cannot be assured that these products will be accepted by the veterinary market. Any failure to achieve market acceptance with our current or future products would harm our business and financial condition.

We are not able to predict sales in future quarters and a number of factors affect our periodic results, which may result in significant variance in our quarterly results of operations and may negatively impact our stock price.

We are not able to accurately predict our sales in future quarters. Our revenues in the medical and veterinary markets are derived primarily by selling to distributors that resell our products to the ultimate user. While we are better able to predict sales of our reagent discs and other consumable products, as we sell these discs primarily for use with our instruments that we sold in prior periods, we generally are unable to predict with much certainty sales of our instruments, as we typically sell our instruments to new users or as an upgrade for to our existing customers, which can fluctuate on a quarterly basis. We generally operate with a limited order backlog, because we ship our products shortly after we receive the orders from our customers. As a result, our product sales in any quarter are generally dependent on orders that we receive and ship in that quarter. Accordingly, our sales in any one quarter or period are not indicative of our sales in any future period.

The sales cycle for our products can fluctuate, which may cause revenue and results of operations to vary significantly from period to period. We believe this fluctuation is primarily due (i) to seasonal patterns in the decision making processes by our independent distributors and direct customers, (ii) to inventory or timing considerations by our distributors and (iii) on the purchasing requirements of the U.S. government to acquire our products. Accordingly, we believe that period to period comparisons of our results of operations are not necessarily meaningful. In the future, our periodic results of operations may vary significantly depending on, but not limited to, a number of factors, including:

Table of Contents

- new product or service announcements made by us or our competitors;
- changes in our pricing structures or the pricing structures of our competitors;
- the sales performance of our independent distributors;
- excess inventory levels and inventory imbalances at our independent distributors;
- our ability to develop, introduce and market new products or services on a timely basis, or at all;
- our manufacturing capacities and our ability to increase the scale of these capacities;
- the mix of sales among our instruments and consumable products;
- the amount of our research and development, sales and marketing and general and administrative expenses; and
- changes in our strategies.

As a result, it is likely that in some periods our operating results will not meet investor expectations or those of public market analysts. Any unanticipated change in revenues or operating results is likely to cause our stock price to fluctuate because such changes reflect new information available to investors and analysts. Any fluctuations in our quarterly results may not accurately reflect the underlying performance of our business and could cause a decline in the trading price of our common stock.

A failure to manage the inventory levels of our distributors effectively could adversely affect our revenues, gross margins and results of operations.

We must manage the inventory of our products held by our distributors effectively. Any excess or shortage of inventory held by our distributors could affect our results of operations. Our distributors may increase orders during periods of product shortages and cancel or delay orders if their inventory is too high. They also may adjust their orders in response to the supply of our products, the products of our competitors that are available to them, and in response to seasonal fluctuations in customer demand. Revenues from sales to our distributors generally are recognized based upon shipment of our products to the distributors, net of estimated sales allowances, discounts and rebates. Inventory management remains an area of focus as we balance inventory levels of our instruments and consumables, especially in our United States veterinary market distribution channel, consisting of both national and regional distributors. We must also balance the need to maintain sufficient inventory levels in the distribution channel against the risk of inventory obsolescence because of the shelf life of our consumable products and customer demand. If we ultimately determine that we have excess inventory at our distributors or inventory imbalances in the distribution channel, we may have to reduce our selling prices, which could result in lower gross margins. For example, during the second half of fiscal 2014, as compared to the same period in fiscal 2013, our revenues were adversely impacted in the United States veterinary market by excess channel inventory and inventory imbalances and resulted to a decrease of sales orders from our largest distributors in the veterinary market. The excess channel inventory was the result of our distributors not selling our products to end customers at the same rate as they were purchasing products from us. In addition, we only began selling through our distributors Henry Schein Animal Health (a division of Henry Schein, Inc.) and Patterson Companies, Inc. in the third quarter of fiscal 2015 and our revenues in future quarters may be impacted by the timing of purchases of our products sold by them as these new distributors integrate our products into their sales process. Should our efforts to monitor and manage channel inventory be unsuccessful, our business, financial condition and results of operations are likely to be adversely affected.

We rely primarily on distributors to sell our products and we rely on sole distributor arrangements in a number of countries. Our failure to successfully develop, manage and maintain these relationships could adversely affect our business, financial condition and results of operations.

We sell our medical and veterinary products primarily through a limited number of distributors. As a result, we are dependent upon these distributors to sell our products and to assist us in promoting and creating a demand for our products. We operate on a purchase order basis with the distributors and the distributors are under no contractual obligation to continue carrying our products. Further, many of our distributors may carry our competitors' products, and may promote our competitors' products over our own products.

We depend on a number of distributors in North America who distribute our VetScan products. In the United States veterinary market segment, we rely on our distribution network, consisting of both national distributors and independent regional distributors, and our ability to effectively manage this network. We depend on our distributors to assist us in promoting our products in the veterinary market, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our sales revenues until our customers identify another distributor or purchase products directly from us.

## Table of Contents

Internationally, we rely on only a few distributors for our products in both the medical and veterinary diagnostic markets. We currently rely on distributors that carry either our medical or veterinary products in the following countries: Australia, Austria, Belgium, Canada, China, Czech Republic, Denmark, France, Germany, Hong Kong, India, Indonesia, Israel, Italy, Japan, Korea, Mexico, the Netherlands, New Zealand, the Philippines, Portugal, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, the United Kingdom and the United States. Our distributors in each of these countries are responsible for obtaining the necessary approvals to sell our new and existing products. These distributors may not be successful in obtaining proper approvals for our new and existing products in their respective countries, and they may not be successful in marketing our products. Furthermore, an inability of, or any delays by, our distributor in receiving the necessary approvals for our new or other products can adversely impact our revenues in a country. We plan to continue to enter into additional distributor relationships to expand our international distribution base and presence. However, we may not be successful in entering into additional distributor relationships on favorable terms, or at all. In addition, our distributors may terminate their relationship with us at any time. Historically, we have experienced a high degree of turnover among our international distributors. This turnover makes it difficult for us to establish a steady distribution network overseas. Consequently, we may not be successful in marketing our Piccolo and VetScan products internationally, and our business and financial condition may be harmed as a result.

In the United States, we rely on Abbott as our exclusive distributor in certain medical markets to sell our products. Our dependency on Abbott means that any failure to successfully develop products and maintain this relationship could adversely affect our business, financial condition and results of operations.

Abbott has the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzer and associated consumables in the United States professionally-attended human healthcare market, excluding sales and distribution to Catapult Health LLC and specified customer segments, which includes pharmacy and retail store clinics, shopping malls and cruise ship lines. As a result of the Abbott Agreement, we no longer have control over the marketing and sale of our primary medical products into most of the U.S. medical market and are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in such market. We do not have any control over pricing, inventory levels, distribution efforts and other factors that may impact the level of sales achieved, timing of revenue recognized and other adjustments that may impact our reported sales. Moreover, we are dependent upon Abbott's forecasts and sales efforts and maintenance of pre-existing sub-distributor agreements that were assigned to Abbott. As a result, if Abbott's efforts are unsuccessful, our business, financial condition and results of operations are likely to be adversely affected. For example, the transition of this U.S. medical business had an adverse effect on our revenues during fiscal 2014, with respect to lower average selling prices of Piccolo products sold to Abbott and the timing of purchases of our products now sold by Abbott as it integrated our products into its sales process.

In addition, as a result of the Abbott Agreement, we substantially reduced the size of our United States medical sales force. The initial term of the Abbott Agreement ended on December 31, 2017, and after the initial term, the agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date. In the event the agreement is terminated, we would be required to invest and re-establish presence and sales capabilities in markets that were served by Abbott and/or identify one or more suitable replacement distribution partner(s), which would require significant time and effort. We could not be assured of replacing the capabilities of Abbott in those markets. New sales personnel and distribution partners take time to train and gain full productivity with customers, and if we are unable to accomplish this successfully, our business, financial condition and results of operations could be adversely affected.

We depend on limited or sole suppliers, many of whom we do not have long-term contracts with, and failure of our suppliers to provide the components or products to us could harm our business

We use several key components that are currently available from limited or sole sources as discussed below.

**Blood Chemistry Analyzer Components:** Our blood analyzer products use several technologically-advanced components that we currently purchase from a limited number of suppliers, including certain components from our single source supplier, Hamamatsu Corporation. Our analyzers also use a printer that is primarily made by Advanced Printing Systems. The loss of the supply of any of these components could force us to redesign our blood chemistry analyzers.

**Reagent Discs:** Two injection-molding manufacturers, Balda C. Brewer and Nypro, Inc., a subsidiary of Jabil Circuit, currently make the molded plastic discs that, when loaded with reagents and welded together, form our reagent disc products. We believe that only a few manufacturers are capable of producing these discs to the narrow tolerances that we require. To date, we have only qualified these two manufacturers to manufacture the molded plastic discs.

**Reagent Chemicals:** We currently depend on the following single source vendors for some of the chemicals that we use to produce the reagents and dry reagent chemistry beads that are either inserted in our reagent discs, lateral flow rapid tests or sold as stand-alone products: Amano Enzyme USA Co., Ltd., Kikkoman Corporation Biochemical Division, Microgenics Corporation, a division of Thermo Fisher Scientific, Roche Molecular Biochemicals of Roche Diagnostics Corporation, a division of F. Hoffmann-La Roche, Ltd., SA Scientific Co., Sekisui Diagnostics, Sigma Aldrich Inc. and Toyobo Specialties.



Table of Contents

We market original equipment manufacturer supplied products that are currently available from limited sources as discussed below.

**Hematology Instruments and Reagent Kits:** Our VetScan hematology instruments are manufactured by Diatron in Hungary and are purchased by us as a completed instrument. In addition, we currently have qualified two suppliers to produce the reagent kits for our hematology instruments: Clinical Diagnostic Solutions, Inc. and Diatron.

**VSpro Specialty Analyzers and Cartridges:** Our VetScan VSpro specialty analyzers and cartridges are manufactured by SMB in Denmark, which was acquired by Zoetis Inc. in August 2016, and are purchased by us as completed products.

**i-STAT Analyzers and Cartridges:** Our VetScan i-STAT analyzers and cartridges are manufactured by Abbott and are purchased by us as completed products.

**Rapid Tests:** Substantially all of our VetScan Rapid Tests are manufactured by a single source supplier, SA Scientific Co., located in the United States.

We currently have purchase obligations with Diatron to purchase Diatron hematology products. However, with our other suppliers, we primarily operate on a purchase order basis and, therefore, these suppliers are under no contractual obligation to supply us with their products or to do so at specified prices. Although we believe that there may be potential alternate suppliers available for these critical components, to date we have not qualified additional vendors beyond those referenced above and cannot assure you we would be able to enter into arrangements with additional vendors on favorable terms, or at all. For the suppliers of original equipment manufactured products with which we have long-term contracts, there can be no assurance that these suppliers will always fulfill their obligations under these contracts, or that any suppliers will not experience disruptions in their ability to supply our requirements for products. In addition, under some contracts with suppliers we have minimum purchase obligations and our failure to satisfy those obligations may result in a loss of some or all of our rights under these contracts.

Because we are dependent on a limited number of suppliers and manufacturers for our products, we are particularly susceptible to any interruption in the supply of these products or the viability of our assembly arrangements. The loss of any one of these suppliers or a disruption in our manufacturing arrangements could adversely affect our business, financial condition and results of operations.

We must increase sales of our Piccolo and VetScan products or we may not be able to increase or sustain profitability.

Our ability to continue to be profitable and to increase profitability will depend, in part, on our ability to increase our sales volumes of our Piccolo and VetScan products. Increasing the sales volume of our products will depend upon, among other things:

- the sales performance of our independent distributors;
- our ability to improve our existing products and develop new and innovative products;
- our ability to increase our sales and marketing activities;
- our ability to effectively manage our manufacturing activities; and
- our ability to effectively compete against current and future competitors.

We cannot assure you that we will be able to successfully increase the sales volumes of our products to increase or sustain profitability.

We must continue to increase our sales, marketing and distribution efforts in the human diagnostic market or our business will not grow.

The human diagnostic market is fragmented, heavily regulated and constantly changing. Our limited sales, marketing and distribution capabilities are continually challenged to translate these changes into compelling value propositions for our prospective customers. Accordingly, we cannot assure you that:

- we will be able to maintain consistent growth through Abbott and our other independent distributors;
- the costs associated with sales, marketing and distributing our products will not be excessive; or
- government regulations or private insurer policies will not adversely affect our ability to be successful.

## Table of Contents

We depend on key members of our management and scientific staff and, if we fail to retain and recruit qualified individuals, our ability to execute our business strategy and generate sales would be harmed.

Our future success depends, to a great degree, on the principal members of our management and scientific staff. The loss of any of these key personnel, including in particular Clinton H. Severson, our Chief Executive Officer and Chairman of our Board of Directors, might impede the achievement of our business objectives. We may not be able to continue to attract and retain skilled and experienced marketing, sales and manufacturing personnel on acceptable terms in the future because numerous medical products and other high technology companies compete for the services of these qualified individuals. If we are unable to hire and train qualified personnel, we may not be able to maintain or expand our business. Additionally, if we are unable to retain key personnel, we may not be able to replace them readily or on terms that are reasonable, which also could hurt our business. We currently do not maintain key man life insurance on any of our employees.

We may experience manufacturing problems related to our instruments, which could adversely affect our business, financial condition or results of operations.

We manufacture our point-of-care chemistry analyzers at our manufacturing facility in Union City, California. Should we experience problems related to the manufacture of our blood chemistry analyzer, we could fail to achieve anticipated revenues or we may incur an additional increase in our cost of revenues. These problems may include manufacturing defects and product failures, defects in raw materials acquired from our suppliers, delays in receipt of raw materials from our suppliers, obsolescence, increases in raw materials costs and labor disturbances. There can be no assurance that our efforts to resolve manufacturing difficulties will be successful or that similar problems will not arise in the future. If we are unable to prevent such problems from occurring in the future, we may not be able to manufacture sufficient quantities to meet anticipated demand and, therefore, will not be able to effectively market and sell our blood chemistry analyzers or other instruments that we market and sell; accordingly, our business, financial condition and results of operations could be adversely affected.

We need to successfully manufacture and market additional reagent discs for the human diagnostic market if we are to compete in that market.

We believe that we must develop and obtain regulatory clearance and third-party payor reimbursement for additional series of reagent discs with various tests for use with our Piccolo chemistry analyzers if we are to successfully compete in the human medical market. Our failure to meet these challenges will materially adversely affect our operating results and financial condition.

We rely on patents and other proprietary information, the loss of which would negatively affect our business.

As of December 31, 2017, 93 patent applications have been filed on our behalf with the United States Patent and Trademark Office, or the USPTO, of which 54 patents have been issued and 26 patents are currently active. Additionally, we have filed several international patent applications covering the same subject matter as our domestic applications. The patent position of any medical device manufacturer, including us, is uncertain and may involve complex legal and factual issues. Consequently, we may not be issued any additional patents, either domestically or internationally. Furthermore, our patents may not provide significant proprietary protection because there is a chance that they will be circumvented or invalidated. We cannot be certain that we were the first creator of the inventions covered by our issued patents or pending patent applications, or that we were the first to file patent applications for these inventions, because (1) the USPTO maintains all patent applications that are not filed in any foreign jurisdictions in secrecy until it issues the patents (when a patent application owner files a request for nonpublication) and (2) publications of discoveries in the scientific or patent literature tend to lag behind actual discoveries by several months. We may have to participate in interference proceedings, which are proceedings in front of the USPTO, to determine who will be issued a patent. These proceedings could be costly and could be decided against us.

We also rely upon copyrights, trademarks and unpatented trade secrets. Others may independently develop substantially equivalent proprietary information and techniques that would undermine our proprietary technologies. Further, others may gain access to our trade secrets or disclose such technology. Although we require our employees, consultants and advisors to execute agreements that require that our corporate information be kept confidential and that any inventions by these individuals are property of Abaxis, there can be no assurance that these agreements will provide meaningful protection or adequate remedies for our trade secrets in the event of unauthorized use or disclosure of such information. The unauthorized dissemination of our confidential information would negatively impact our business.

Changes in health care regulations and third-party payor reimbursement can negatively affect our business.

By regulating the availability of, or the maximum amount of reimbursement provided for blood testing services, third-party payors, such as managed care organizations, pay-per-service insurance plans, and the Centers for Medicare and Medicaid Services, or the CMS, can indirectly affect the pricing or the relative attractiveness of our human testing products. For example, in the United States, the CMS set the national level of reimbursement of fees for blood testing services for Medicare beneficiaries. If third-party payors decrease the reimbursement amounts for blood testing services, it may decrease the likelihood that physicians and hospitals will adopt point-of-care diagnostics as a viable means of care delivery. Consequently, we would need to charge less for our products. If the government and third-party payors do not provide for adequate coverage and reimbursement levels to allow health care providers to use our products, the demand for our products will decrease and our business and financial condition would be harmed.

## Table of Contents

In the United States, there have been and continue to be a number of legislative initiatives to contain healthcare costs. For example, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, collectively, the ACA, enacted in March 2010, made changes that significantly impact the medical device industries and clinical laboratories. There have been judicial and congressional challenges to the ACA, as well as efforts by the Trump Administration to repeal or replace certain aspects of the ACA. President Trump has signed two Executive Orders designed to delay the implementation of certain provisions of the ACA or otherwise circumvent some of the requirements for health insurance mandated by the ACA. While Congress has not passed comprehensive repeal legislation, two bills affecting the implementation of certain taxes under the ACA have been signed into law, including a bill that, among other things, extends the suspension of the ACA's medical device excise tax until January 1, 2020. Congress may continue to consider subsequent legislation to replace or repeal elements of the ACA. Thus, the full future impact of the ACA on our business remains unclear.

On April 1, 2014, the Protecting Access to Medicare Act of 2014, or PAMA, was signed into law, which, among other things, significantly altered the payment methodology under the Medicare Clinical Laboratory Fee Schedule, or CLFS. Some commercial payors are guided by the CLFS in establishing their reimbursement rates. Clinicians may decide not to order clinical diagnostic tests if third party payments are inadequate, and we cannot predict whether third-party payors will offer adequate reimbursement for tests utilizing our products to make them commercially attractive. Changes in healthcare policy, such as the creation of test utilization limits for diagnostic products in general or requirements that Medicare patients pay for portions of clinical laboratory tests or services received, could substantially impact the sales of our tests, increase costs and divert management's attention from our business. We expect that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand or additional pricing pressures. In addition, sales of our tests outside of the United States will subject us to foreign regulatory requirements, which may also change over time.

We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws and other federal and state laws applicable to our sales and marketing practices. If we are unable to comply, or have not complied, with such laws, we could face substantial penalties.

Our operations are directly, or indirectly through our customers, subject to various federal and state fraud and abuse laws, including, without limitation, the federal and state anti-kickback statutes, physician payment transparency laws and false claims laws. These laws may impact, among other things, our sales and marketing and education programs and require us to implement additional internal systems for tracking certain marketing expenditures and reporting them to government authorities. In addition, we may be subject to patient privacy regulation by both the federal government and the states in which we conduct our business. If our operations are found to be in violation of any of these laws or any other governmental regulations that apply to us, we may be subject to penalties, without limitation, including civil and criminal penalties, damages, fines, disgorgement, the curtailment or restructuring of our operations, exclusion from participation in federal and state healthcare programs and imprisonment, any of which could adversely affect our ability to operate our business and our results of operations.

Approval and/or clearance by the FDA, USDA and foreign regulatory authorities for our products requires significant time and expenditures.

Before we may commercialize our human medical diagnostic products in the United States, we are required to obtain either 510(k) clearance or pre-marketing approval, or PMA, from the U.S. Food and Drug Administration, or FDA, unless an exemption from pre-market review applies. In our veterinary market, certain products that we sell are subject to regulations pertaining to veterinary biologics, for which we must obtain approval from the U.S. Department of Agriculture, or USDA, Center for Veterinary Biologics. The process of obtaining regulatory clearances or approvals to market a medical device can be costly and time consuming, and we may not be able to successfully obtain 510(k) clearance from the FDA or may be subject to the more costly and time-consuming PMA process.

In addition, governmental agencies may change their clearance or approval policies, adopt additional regulations or revise existing regulations, or take other actions that may prevent or delay approval or clearance of our products under development or impact our ability to modify our currently approved or cleared products on a timely basis. Any delay in, or failure to receive or maintain, clearance or approval for our products could prevent us from generating revenue from these products and adversely affect our business operations and financial results.

## Table of Contents

The FDA and other regulatory authorities have broad enforcement powers. For example, the manufacture of medical devices must comply with the FDA's Quality System Regulation, or the QSR. In addition, manufacturers must register their manufacturing facilities, list the products with the FDA, and comply with requirements relating to labeling, marketing, complaint handling, adverse event and medical device reporting, reporting of corrections and removals, and import and export. The FDA monitors compliance with the QSR and these other requirements through periodic inspections. If our facilities or those of our manufacturers or suppliers are found to be in violation of applicable laws and regulations, or if we or our manufacturers or suppliers fail to take satisfactory corrective action in response to an adverse inspection, the regulatory authority could take enforcement actions that could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands, and could have a material adverse effect on our reputation, business, results of operations and financial condition. We may also be required to bear other costs or take other actions that may have a negative impact on our future sales and our ability to generate profits.

Sales of our products outside the United States are subject to foreign regulatory requirements governing vigilance reporting, marketing approval, manufacturing, product licensing, pricing and reimbursement. These regulatory requirements vary greatly from country to country. As a result, the time required to obtain approvals outside the United States may differ from that required to obtain FDA clearance or USDA approval, and we may not be able to obtain foreign regulatory approvals on a timely basis or at all. Clearance or approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure clearance or approval by regulatory authorities in other countries or by the FDA.

A recall of our products, or the discovery of serious safety issues with our products that leads to corrective actions, could have a significant adverse impact on our business, financial condition or results of operations.

The FDA, USDA and similar foreign governmental authorities have the authority to require the recall of commercialized products in the event of material deficiencies or defects in design or manufacture of a product or in the event that a product poses an unacceptable risk to health. Manufacturers may, under their own initiative, recall a product if any material deficiency in a device is found. A government-mandated or voluntary recall by us or one of our distributors could occur as a result of component failures, manufacturing errors, design or labeling defects or other deficiencies and issues. We are required to report to the FDA any incident in which our product may have caused or contributed to a death or serious injury or in which our product malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury. Repeated product malfunctions may result in a voluntary or involuntary product recall. Recalls of any of our products would divert managerial and financial resources and could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands, any of which could have an adverse effect on our business, financial condition and results of operations. Moreover, if we do not adequately address problems associated with our devices, we may face additional regulatory enforcement action, including FDA warning letters, product seizure, injunctions, administrative penalties, or civil or criminal fines. We may also be required to bear other costs or take other actions that may have a negative impact on our sales as well as face significant adverse publicity or regulatory consequences, which could harm our business, financial condition or results of operations.

We may inadvertently design or produce defective products, which may subject us to significant warranty liabilities or product liability claims. We may have insufficient product liability insurance to pay uninsured claims.

Our business exposes us to potential warranty and product liability risks that are inherent in the design, testing, manufacturing and marketing of human and veterinary medical products. Although we have established procedures for quality control on both the raw materials that we receive from suppliers as well as the design and manufacturing of our products, these procedures may prove inadequate to detect a design or manufacturing defect. In addition, our Piccolo and VetScan chemistry analyzers may be unable to detect all errors that could result in the misdiagnosis of human or veterinary patients.

We may be subject to substantial claims for defective products under our warranty policy or product liability laws. In addition, our policy is to credit medical providers for any defective product that we produce, including those reagent discs that are rejected by our Piccolo and VetScan chemistry analyzers. Therefore, even if a mass defect within a lot or lots of reagent discs were detected by our Piccolo and VetScan chemistry analyzers, the replacement of such reagent discs free of charge would be costly and could adversely affect our business, financial condition and results of operations. Further, in the event that a product defect is not detected in our Piccolo chemistry analyzer, our expansion into the human medical market greatly increases the risk that the amount of damages involved with just one product defect would adversely impact our business, financial condition and results of operations. Our product liability insurance and cash may be insufficient to cover potential liabilities. In addition, in the future the coverage that we require may be unavailable on commercially reasonable terms, if at all. Even with our current insurance coverage, a mass product defect, product liability claim or recall could subject us to claims above the amount of our coverage and could adversely affect our business, our financial condition or results of operations.



## Table of Contents

Acquisitions, strategic investments, partnerships, or alliances could be difficult to identify and integrate, divert the attention of management, disrupt our business, dilute shareholder value, and adversely affect our business, financial condition or results of operations.

We have in the past and may in the future seek to acquire or invest in businesses, products, or technologies that we believe could complement or expand our products, enhance our capabilities, or otherwise offer growth opportunities. For example, we acquired Quality Clinical Reagents Limited, or QCR, and Trio Diagnostics (Ireland) Ltd, or Trio, in November 2014. Any acquisition may divert the attention of management and cause us to incur various expenses in identifying, investigating, and pursuing suitable acquisitions, whether or not the acquisitions are completed, and may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel, or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their products are not easily adapted to work with ours, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management, or otherwise. Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for development of our existing business. Any acquisitions we are able to complete may not result in any synergies or other benefits we had expected to achieve, which could result in impairment charges that could be substantial. In addition, we may not be able to find and identify desirable acquisition targets or be successful in entering into an agreement with any particular target. Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our financial condition or results of operations. In addition, if an acquired business, including QCR or Trio, fails to meet our expectations, our business, financial condition or results of operations may suffer or we may be exposed to risks or liabilities that were unknown to us at the time of the acquisition.

Divestitures or other dispositions could negatively impact our business.

On an ongoing basis, we assess opportunities for improved operational effectiveness and efficiency and may divest, spin-off, split-off, or otherwise dispose of businesses that are deemed not to fit with our strategic plan or are not achieving the desired return on investment. For example, we sold our AVRL business to Antech in March 2015, and we sold our equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB in August 2016. These transactions pose risks and challenges that could negatively impact our business. For example, when we decide to sell or otherwise dispose of a business or assets, the sale is typically subject to satisfaction of pre-closing conditions that may not become satisfied. In addition, divestitures or other dispositions may dilute our earnings per share, have other adverse financial and accounting impacts, distract management, disrupt our business, negatively impact market perception of our prospects and involve the loss of key employees, and disputes may arise with buyers. In addition, we may retain responsibility for or agree to indemnify buyers against contingent liabilities, which could have a material effect on our financial statements. Divestitures may also result in significant asset impairment charges, including those related to goodwill and other intangible assets, which could have a material adverse effect on our financial condition and results of operations. We cannot assure you that divestiture or other disposition efforts will be successful in generating improved operating efficiencies. In addition, past disposition activities may not be a good indication of future disposition opportunities, and any divestiture or other disposition of any business may leave us with reduced financial and marketing resources to develop products and services to compete against our competitors.

A change in our effective tax rate can have a significant adverse impact on our business.

Recent changes to U.S. tax laws will significantly impact how U.S. multinational corporations are taxed on foreign earnings. We earn profits in, and are therefore potentially subject to taxes in, the U.S. and numerous foreign jurisdictions, including Germany, Hong Kong and the United Kingdom, the countries in which we earn the majority of our non-U.S. profits. Due to economic, political or other conditions, tax rates in those jurisdictions may be subject to significant change. A number of factors may adversely impact our future effective tax rates, such as the jurisdictions in which our profits are determined to be earned and taxed; changes in the tax rates imposed by those jurisdictions;

expiration and non-renewal of tax holidays in certain jurisdictions; the resolution of issues arising from tax audits with various tax authorities; changes in the valuation of our deferred tax assets and liabilities; adjustments to estimated taxes upon finalization of various tax returns; increases in expenses not deductible for tax purposes, including changes in available tax credits; changes in share-based compensation expense; changes in tax laws or the interpretation of such tax laws; changes in generally accepted accounting principles; and the repatriation of earnings from outside the U.S. for which we have not previously provided for U.S. taxes. A change in our effective tax rate can materially and adversely impact our results from operations.

On December 22, 2017, H.R. 1, also known as the “Tax Cuts and Jobs Act” (the “Tax Act”), was signed into law. As a result of the Tax Act, we recorded a provisional amount of \$2.9 million due to a reduction in deferred tax assets as a result of the reduction of the federal tax rate from 35% to 21% effective January 1, 2018. In addition, as a general matter, the Tax Act contains other significant changes to corporate taxation, apart from the tax on deemed repatriated foreign earnings and reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%. The Tax Act also introduces a limitation of the tax deduction for interest expense to 30% of adjusted earnings (except for certain small businesses), a limitation of the deduction for net operating losses incurred in taxable years beginning after December 31, 2017 to 80% of current year taxable income and the elimination of net operating loss carrybacks with respect to such losses, the elimination of U.S. tax on foreign earnings (subject to certain important exceptions), immediate deductions for certain new investments instead of deductions for depreciation expense over time, and the modification of, or repeal of, many business deductions and credits. Notwithstanding the reduction in the corporate income tax rate, the overall impact of the new federal tax law is uncertain and our business and financial condition could be adversely affected. In addition, it is uncertain if and to what extent various U.S. states will conform to the newly enacted federal tax law. The impact of this tax reform on holders of our common stock is also uncertain and could be adverse.

## Table of Contents

We are still evaluating the tax provisions related to Global Intangible Low-Taxed Income (“GILTI”) and we expect to finalize our analysis during the fourth quarter ending March 31, 2018, which may include a change in our repatriation policy. Because of the complexity of the new provisions, we are continuing to evaluate how the provisions will be accounted for under U.S. generally accepted accounting principles wherein companies are allowed to make an accounting policy election to either (i) account for GILTI as a component of tax expense in the period in which they are subject to the rules or (ii) account for GILTI in their measurement of deferred taxes.

We continue to assess and analyze the impact of the Tax Act on our business and our company and the possibility that the final impact of the Tax Act on our consolidated financial results may be materially different from our current estimates based on our actual results for future periods, our further assessment and analysis of the Tax Act, any additional Congressional administrative and FASB actions, or other guidance related to the Tax Act and any actions that we may take as a result of the Tax Act.

We may be subject to litigation for a variety of claims, which could adversely affect our business, financial condition or results of operations.

In addition to product liability claims, we and our directors and officers may be subject to claims arising from our normal business activities. These may include claims, suits, and proceedings involving shareholder and fiduciary matters, intellectual property, labor and employment, wage and hour, commercial and other matters. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation or settlement or other resolution of a legal matter could adversely affect our business, financial condition or results of operations, harm our reputation or otherwise negatively impact our business.

Our stock price is highly volatile and investing in our stock involves a high degree of risk, which could result in substantial losses for investors.

The market price of our common stock, like the securities of many other medical products companies, fluctuates over a wide range, and will continue to be highly volatile in the future. During the quarter ended December 31, 2017, the closing sale prices of our common stock on the NASDAQ Global Select Market ranged from \$45.58 to \$51.61 per share and the closing sale price on December 29, 2017, the last day of trading for the quarter ended December 31, 2017 was \$49.52 per share. During the last eight fiscal quarters ended December 31, 2017, our stock price closed at a high of \$55.02 per share most recently on January 9, 2017 and a low of \$38.65 per share on February 11, 2016. Many factors may affect the market price of our common stock, including:

- fluctuation in our operating results;
- announcements of technological innovations or new commercial products by us or our competitors;
- changes in governmental regulation in the United States and internationally;
- prospects and proposals for health care reform;
- governmental or third-party payors’ controls on prices that our customers may pay for our products;
- product liability claims and public concern as to the safety of our devices or similar devices developed by our competitors;
- developments or disputes concerning our patents or our other proprietary rights; and

· general market conditions.

In the past, stockholders have filed securities class action litigation following periods of market volatility. If we were to become involved in such securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business, and adversely affect our business, financial condition or results of operations. Because our stock price is so volatile, investing in our common stock is highly risky. A potential investor must be able to withstand the loss of his entire investment in our common stock.

Table of Contents

Fluctuations in foreign exchange rates could adversely affect our business, financial condition or results of operations.

For our international sales denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. For our sales denominated in foreign currencies, we are subject to fluctuations in exchange rates between the U.S. dollar and the particular foreign currency and changes in such exchange rates could adversely affect our reported results of operations and distort period to period comparisons. Our business, financial condition or results of operations could also be adversely affected by the seasonality of international sales and the economic conditions of our overseas markets.

Our subsidiaries in Europe and the United Kingdom increase our exposure to foreign currency fluctuation risks. These risks include uncertainty regarding the Euro and the British pound sterling, that could adversely impact our results of operations based on the movements of the applicable foreign currency exchange rates in relation to the U.S. dollar. Fluctuating exchange rates cause the value of items on both the assets and liabilities side of the balance sheet to change, which could also negatively impact our results of operations. Our financial results will therefore be sensitive to movements in foreign exchange rates. A depreciation of non-U.S. dollar currencies relative to the U.S. dollar could have a material adverse impact on our results of operations and could cause our results of operations to differ from our expectations and the expectations of our investors. For example, in June 2016, the United Kingdom held a referendum in which voters approved an exit from the European Union, which caused significant volatility in global stock markets and currency exchange rate fluctuations that resulted in the strengthening of the U.S. dollar against foreign currencies in which we conduct business. Additionally, such foreign currency exchange rate fluctuations could make it more difficult to detect underlying trends in our business and results of operations. We do not currently engage in hedging transactions to mitigate foreign currency exchange risks.

Our international operations subject us to unique risks different than those faced by us in the United States and we may not be able to effectively manage our international business.

We have operations outside of the United States. We expect that we will continue to expand our international operations in the future. International operations inherently subject us to a number of risks and uncertainties, including:

- the increased complexity and costs inherent in managing international operations;
- diverse regulatory and compliance requirements, and changes in those requirements that could restrict our or our distributors' ability to manufacture, market or sell our products;
- our limited knowledge of and relationships with distributors, contractors, suppliers or other parties in these areas;
- political and economic instability;
- diminished protection of intellectual property in some countries outside of the United States;
- trade protection measures and import or export licensing requirements;
- complexity and costs associated with staffing and managing international development and operations;
- differing labor regulations and business practices;
- potentially negative consequences from changes in or interpretations of tax laws;
- changes in international medical reimbursement policies and programs;

financial risks such as longer payment cycles, difficulty collecting accounts receivable and exposure to fluctuations in foreign currency exchange rates;

regulatory and compliance risks that relate to maintaining accurate information and control over sales and distributors' and service providers' activities that may fall within the purview of the Foreign Corrupt Practices Act (the "FCPA"); and

regulations relating to data security and the unauthorized use of, or access to, commercial and personal information.

Any of these factors may, individually or as a group, have a material adverse effect on our business and results of operations. As our international operations grow, we may encounter new risks. For example, to build our international sales and distribution networks in new geographic regions, we must continue to develop relationships with qualified local distributors. If we are not successful in developing and maintaining these relationships, we may not be able to grow sales in these geographic regions. These or other similar risks could adversely affect our revenue and profitability.

Table of Contents

We are dependent on information technology systems, infrastructure and data.

We are dependent upon information technology systems, infrastructure and data. We operate and manage our business by relying on several information systems to maintain financial records, process customer orders, manage inventory, process shipments to customers and operate other critical functions. Information technology system failures, network disruptions and breaches of data security could disrupt our operations. If we were to experience a system disruption in the information technology systems that enable us to interact with customers and suppliers, it could result in the loss of sales and customers, delays or cancellation of orders, impeding the manufacture or shipment of products, processing transactions and reporting financial results and significant incremental costs.

The multitude and complexity of our computer systems make them inherently vulnerable to service interruption or destruction, malicious intrusion and random attack. Likewise, data privacy or security breaches by employees or others may pose a risk that sensitive data, including our intellectual property, trade secrets or personal information of our employees, customers or other business partners and any patient information may be exposed to unauthorized persons or to the public. Cyberattacks are increasing in their frequency, sophistication and intensity. Cyberattacks could include the deployment of harmful malware, denial-of-service, social engineering and other means to affect service reliability and threaten data confidentiality, integrity and availability. Our business partners face similar risks and any security breach of their systems could adversely affect our security posture.

Management has taken steps to address these concerns by implementing network security and internal control measures. While we have invested, and continue to invest, in the protection of our data and information technology infrastructure, there can be no assurance that our efforts will prevent service interruptions, or identify breaches in our systems, that could adversely affect our business and operations and/or result in the loss of critical or sensitive information, which could result in financial, legal, business or reputational harm to us. In addition, our liability insurance may not be sufficient in type or amount to cover us against claims related to security breaches, cyberattacks and other related breaches.

We are subject to complex requirements from legislation requiring companies to evaluate internal control over financial reporting.

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of internal control over financial reporting by our management and an attestation of the effectiveness of our internal control over financial reporting by an independent registered public accounting firm. We have an ongoing program to perform the assessment, testing and evaluation to comply with these requirements and we expect to continue to incur significant expenses for Section 404 compliance on an ongoing basis.

We cannot predict the outcome of our testing in future periods. In the event that our internal control over financial reporting is not effective as defined under Section 404, or any failure to implement required new or improved controls, or difficulties encountered in implementation could harm results of operations or prevent us from accurately reporting financial results or cause a failure to meet our reporting obligations in the future. If management cannot assess internal control over financial reporting is effective, or our independent registered public accounting firm is unable to provide an unqualified attestation report on such assessment, investor confidence and our share value may be negatively impacted.

We must comply with strict and potentially costly environmental regulations or we could pay significant fines.

We are subject to stringent federal, state and local laws, rules, regulations and policies that govern the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials and wastes. In particular, we are subject to laws, rules and regulations governing the handling and disposal of biohazardous materials used in the development and testing of our products. Our costs to comply with applicable environmental regulations

consist primarily of handling and disposing of human and veterinary blood samples for testing (whole blood, plasma and serum). Although we believe that we have complied with applicable laws and regulations in all material respects and have not been required to take any action to correct any noncompliance, we may have to incur significant costs to comply with environmental regulations if our manufacturing to commercial levels continues to increase. In addition, if a government agency determines that we have not complied with these laws, rules and regulations, we may have to pay significant fines and/or take remedial action that would be expensive and we do not carry environmental-related insurance coverage.



Table of Contents

We are subject to taxation in multiple jurisdictions. Our financial condition and results of operations could be adversely affected by unanticipated changes in our tax provisions or exposure to additional income tax liabilities.

We are subject to taxation in, and to the tax laws and regulations of, multiple jurisdictions as a result of the international scope of our operations and our corporate and financing structure. We are also subject to transfer pricing laws with respect to our intercompany transactions, including those relating to the flow of funds among our companies. Adverse developments in these laws or regulations, or any change in position regarding the application, administration or interpretation thereof, in any applicable jurisdiction, could have a material adverse effect on our business, consolidated financial condition or results of our operations. Our determination of our tax liability is subject to review by tax authorities in any applicable jurisdiction, including the United States or Germany, who may disagree with the positions we have taken or intend to take regarding the tax treatment or characterization of any of our transactions. Any adverse outcome of such a review could have an adverse effect on our results of operations and financial condition. In addition, the determination of our provision for income taxes and other tax liabilities requires significant judgment including our determination of whether a valuation allowance against deferred tax assets is required. Our ultimate tax liability may differ from the amounts recorded in our consolidated financial statements and may adversely affect our financial condition and results of operations.

Our ability to issue preferred stock may delay or prevent a change of control of Abaxis.

Our board of directors has the authority to issue up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the shareholders, except to the extent required by NASDAQ rules. The issuance of preferred stock, while providing flexibility in connection with possible financings or acquisitions or other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock and, consequently, negatively affect our stock price.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

Exhibit No.	Description of Document
<u>3.1</u>	Amended and Restated Articles of Incorporation, as amended (filed with the Securities and Exchange Commission on May 30, 2014 as Exhibit 3.1 to our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 and incorporated herein by reference).
<u>3.2</u>	Amended and Restated Bylaws (filed with the Securities and Exchange Commission on July 10, 2015 as Exhibit 3.2 to our Current Report on Form 8-K and incorporated herein by reference).
<u>31.1</u>	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>32.1#</u>	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<u>32.2#</u>	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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These exhibits are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Abaxis, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q and irrespective of any general incorporation language contained in any such filing.

Table of Contents

SIGNATURES

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

ABAXIS, INC.  
(Registrant)

Date: February 9, 2018 BY: /s/ Clinton H. Severson  
Clinton H. Severson  
Chief Executive Officer  
and Director  
(Principal Executive  
Officer)

Date: February 9, 2018 BY: /s/ Ross Taylor  
Ross Taylor  
Chief Financial Officer  
and Vice President of  
Finance  
(Principal Financial and  
Accounting Officer)