DUCOMMUN INC /DE/
Form 10-Q
May 10, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-8174

DUCOMMUN INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-0693330 (I.R.S. Employer Identification No.)
200 Sandpointe Avenue, Suite 700, Santa Ana, California (Address of principal executive offices)	92707-5759 (Zip code)

Registrant's telephone number, including area code: (657) 335-3665
N/A
(Former name, former address and former fiscal year, if changed since last report)

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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

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

As of April 27, 2018, the registrant had 11,381,533 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Ducommun Incorporated and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)
(In thousands, except share and per share data)

	March 31, 2018	December 31, 2017
Assets		
Current Assets		
Cash and cash equivalents	$1,797	$ 2,150
Accounts receivable, net of allowance for doubtful accounts of $725 and $868 at March 31, 2018 and December 31, 2017, respectively	64,915	74,064
Contract assets	78,163	—
Inventories	85,932	122,161
Production cost of contracts	11,181	11,204
Other current assets	12,503	11,435
Total Current Assets	254,491	221,014
Property and equipment, net of accumulated depreciation of $147,086 and $143,216 at March 31, 2018 and December 31, 2017, respectively	110,031	110,252
Goodwill	117,435	117,435
Intangibles, net	112,154	114,693
Non-current deferred income taxes	147	261
Other assets	3,311	3,098
Total Assets	$597,569	$ 566,753
Liabilities and Shareholders’ Equity		
Current Liabilities		
Accounts payable	$65,042	$ 51,907
Contract liabilities	15,723	—
Accrued liabilities	22,469	28,329
Total Current Liabilities	103,234	80,236
Long-term debt	209,710	216,055
Non-current deferred income taxes	15,775	15,981
Other long-term liabilities	21,543	18,898
Total Liabilities	350,262	331,170
Commitments and contingencies (Notes 11, 13)		
Shareholders’ Equity		
Common stock - $0.01 par value; 35,000,000 shares authorized; 11,380,982 and 11,332,841 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	114	113
Additional paid-in capital	80,523	80,223
Retained earnings	173,652	161,364
Accumulated other comprehensive loss	(6,982)	(6,117)
Total Shareholders’ Equity	247,307	235,583
Total Liabilities and Shareholders’ Equity	$597,569	$ 566,753

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Net Revenues	$150,455	$136,297
Cost of Sales	123,700	111,292
Gross Profit	26,755	25,005
Selling, General and Administrative Expenses	19,326	20,753
Restructuring Charges	2,173	—
Operating Income	5,256	4,252
Interest Expense	(2,899)	(1,745)
Income Before Taxes	2,357	2,507
Income Tax (Benefit) Expense	(243)	392
Net Income	$2,600	$2,115
Earnings Per Share		
Basic earnings per share	$0.23	$0.19
Diluted earnings per share	$0.22	$0.18
Weighted-Average Number of Common Shares Outstanding		
Basic	11,346	11,208
Diluted	11,613	11,495

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)
(In thousands)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Net Income	$2,600	$2,115
Other Comprehensive Income, Net of Tax:		
Amortization of actuarial losses and prior service costs, net of tax benefit of $45 and $63 for the three months ended March 31, 2018 and April 1, 2017, respectively	141	140
Change in unrealized gains and losses on cash flow hedges, net of tax of $61 and $72 for the three months ended March 31, 2018 and April 1, 2017, respectively	194	(121)
Other Comprehensive Income	335	19
Comprehensive Income	$2,935	$2,134

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Cash Flows from Operating Activities		
Net Income	$2,600	$2,115
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization	5,981	5,782
Property and equipment impairment due to restructuring	1,077	—
Stock-based compensation expense	1,090	1,822
Deferred income taxes	(206)	532
(Recovery of) provision for doubtful accounts	(143)	26
Other	8,810	(1,860)
Changes in Assets and Liabilities:		
Accounts receivable	9,292	4,590
Contract assets	(78,163)	—
Inventories	36,229	(7,305)
Production cost of contracts	(55)	45
Other assets	412	610
Accounts payable	12,213	6,465
Contract liabilities	15,723	—
Accrued and other liabilities	(4,524)	415
Net Cash Provided by Operating Activities	10,336	13,237
Cash Flows from Investing Activities		
Purchases of property and equipment	(3,341)	(6,797)
Proceeds from sale of assets	41	3
Net Cash Used in Investing Activities	(3,300)	(6,794)
Cash Flows from Financing Activities		
Borrowings from senior secured revolving credit facility	76,700	55,600
Repayments of senior secured revolving credit facility	(83,300)	(55,600)
Repayments of term loan	—	(5,000)
Repayments of other debt	—	(3)
Net cash paid upon issuance of common stock under stock plans	(789)	(1,758)
Net Cash Used in Financing Activities	(7,389)	(6,761)
Net Decrease in Cash and Cash Equivalents	(353)	(318)
Cash and Cash Equivalents at Beginning of Period	2,150	7,432
Cash and Cash Equivalents at End of Period	$1,797	$7,114

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Summary of Significant Accounting Policies
Description of Business
We are a leading global provider of engineering and manufacturing services for high-performance products and high-cost-of failure applications used primarily in the aerospace and defense ("A&D"), industrial, medical and other industries (collectively, "Industrial"). Our operations are organized into two primary businesses: Electronic Systems segment and Structural Systems segment, each of which is a reportable operating segment. Electronic Systems designs, engineers and manufactures high-reliability electronic and electromechanical products used in worldwide technology-driven markets including A&D and Industrial end-use markets. Electronic Systems' product offerings primarily range from prototype development to complex assemblies. Structural Systems designs, engineers and manufactures large, complex contoured aerostructure components and assemblies and supplies composite and metal bonded structures and assemblies. Structural Systems' products are primarily used on commercial aircraft, military fixed-wing aircraft, and military and commercial rotary-wing aircraft. All reportable operating segments follow the same accounting principles.
Basis of Presentation
The unaudited condensed consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries ("Ducommun," the "Company," "we," "us" or "our"), after eliminating intercompany balances and transactions. T
December 31, 2017 condensed consolidated balance sheet data was derived from audited financial statements, but does not contain all disclosures required by accounting principles generally accepted in the United States of America ("GAAP").
Our significant accounting policies were described in Part IV, Item 15(a)(1), "Note 1. Summary of Significant Accounting Policies" in our Annual Report on Form 10-K for the year ended December 31, 2017. We followed the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017.
In the opinion of management, all adjustments, consisting of recurring accruals, have been made that are necessary to fairly state our condensed consolidated financial position, statements of income, comprehensive income and cash flows in accordance with GAAP for the periods covered by this Quarterly Report on Form 10-Q. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year ending December 31, 2018.
Our fiscal quarters typically end on the Saturday closest to the end of March, June and September for the first three fiscal quarters of each year, and ends on December 31 for our fourth fiscal quarter. As a result of using fiscal quarters for the first three quarters combined with leap years, our first and fourth fiscal quarters can range between 12 1/2 weeks to 13 1/2 weeks while the second and third fiscal quarters remain at a constant 13 weeks per fiscal quarter.
Certain reclassifications have been made to prior period amounts to conform to the current year's presentation.
Changes in Accounting Policies
We have adopted ASC 606, "Revenue from Contracts with Customers" ("ASC 606"), with a date of initial adoption of January 1, 2018. As a result, we have changed our accounting policy for revenue recognition as detailed below and in Note 2, as well as other accounting policies as noted below.
We applied ASC 606 using the modified retrospective method (also known as the cumulative effect method) and therefore, recognized the cumulative effect of initially applying ASC 606 as an adjustment to the opening condensed consolidated balance sheet at January 1, 2018. Therefore, the comparative information has not been adjusted and continues to be reported under the previous revenue recognition accounting standard, ASC 605, "Revenue Recognition" ("ASC 605"). The details of the significant changes and quantitative impact of the changes are described below and Note 2.
Use of Estimates
Certain amounts and disclosures included in the unaudited condensed consolidated financial statements require management to make estimates and judgments that affect the amounts of assets, liabilities (including forward loss

reserves), revenues and expenses, and related disclosures of contingent assets and liabilities. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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Supplemental Cash Flow Information

	(In thousands) Three Months Ended	
	March 31, 2018	April 1, 2017
Interest paid	$2,405	$1,535
Taxes paid	$—	$—
Non-cash activities:		
Purchases of property and equipment not paid	$3,026	$3,065

Earnings Per Share

Basic earnings per share are computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding in each period. Diluted earnings per share is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding, plus any potential dilutive shares that could be issued if exercised or converted into common stock in each period.

The net income and weighted-average common shares outstanding used to compute earnings per share were as follows:

	(In thousands, except per share data) Three Months Ended	
	March 31, 2018	April 1, 2017
Net income	$2,600	$2,115
Weighted-average number of common shares outstanding		
Basic weighted-average common shares outstanding	11,346	11,208
Dilutive potential common shares	267	287
Diluted weighted-average common shares outstanding	11,613	11,495
Earnings per share		
Basic	$0.23	$0.19
Diluted	$0.22	$0.18

Potentially dilutive stock options and stock units to purchase common stock, as shown below, were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive. However, these shares may be potentially dilutive common shares in the future.

	(In thousands) Three Months Ended	
	March 31, 2018	April 1, 2017
Stock options and stock units	128	58

Fair Value

Assets and liabilities that are measured, recorded or disclosed at fair value on a recurring basis are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value. Level 1, the highest level, refers to the values determined based on quoted prices in active markets for identical assets. Level 2 refers to fair values estimated using significant observable inputs. Level 3, the lowest level, includes fair values estimated using significant unobservable inputs.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less. These assets are valued at cost, which approximates fair value, which we classify as Level 1. See Fair Value above.

Derivative Instruments

We recognize derivative instruments on our condensed consolidated balance sheets at their fair value. On the date that we enter into a derivative contract, we designate the derivative instrument as a fair value hedge, a cash flow hedge, a hedge of a net

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investment in a foreign operation, or a derivative instrument that will not be accounted for using hedge accounting methods. As of March 31, 2018, all of our derivative instruments were designated as cash flow hedges.

We record changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash flow hedge in other comprehensive income (loss), net of tax until our earnings are affected by the variability of cash flows of the underlying hedge. We record any hedge ineffectiveness and amounts excluded from effectiveness testing in current period earnings within interest expense. We report changes in the fair values of derivative instruments that are not designated or do not qualify for hedge accounting in current period earnings. We classify cash flows from derivative instruments in the condensed consolidated statements of cash flows in the same category as the item being hedged or on a basis consistent with the nature of the instrument.

When we determine that a derivative instrument is not highly effective as a hedge, we discontinue hedge accounting prospectively. In all situations in which we discontinue hedge accounting and the derivative instrument remains outstanding, we will carry the derivative instrument at its fair value on our condensed consolidated balance sheets and recognize subsequent changes in its fair value in our current period earnings.

Inventories

Inventories are stated at the lower of cost or net realizable value with cost being determined using a moving average cost basis for raw materials and actual cost for work-in-process and finished goods. The majority of our inventory is charged to cost of sales as raw materials are placed into production and the related revenue is recognized. Inventoried costs include raw materials, outside processing, direct labor and allocated overhead, adjusted for any abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) incurred. We assess the inventory carrying value and reduce it, if necessary, to its net realizable value based on customer orders on hand, and internal demand forecasts using management’s best estimates given information currently available. We maintain a reserve for potentially excess and obsolete inventories and inventories that are carried at costs that are higher than their estimated net realizable values. As a result of adopting ASC 606 as of January 1, 2018, where we utilized the modified retrospective method of adoption and we changed our revenue recognition for the majority of our revenue from point in time to over time, our inventory balance decreased significantly. Our ending inventory consists primarily of raw materials, work-in-process, and finished goods. Raw materials can be used on multiple contracts and as such, until it is issued into production, revenue typically will not be recognized. Revenue is recognized on work-in-process and finished goods inventory when the performance obligations have been met. Work-in-process and finished goods inventory remains when performance obligations have not been met (i.e., additional units built as a result of economies of scale, safety stock, etc.). Finally, there is inventory remaining related to contracts where revenue is recognized using the point in time method shipment or transfer of control to the customer. See Note 2.

Production Cost of Contracts

Production cost of contracts includes non-recurring production costs, such as design and engineering costs, and tooling and other special-purpose machinery necessary to build parts as specified in a contract. Production costs of contracts are recorded to cost of sales using the over time revenue recognition model. We review the value of the production cost of contracts on a quarterly basis to ensure when added to the estimated cost to complete, the value is not greater than the estimated realizable value of the related contracts.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, as reflected on the condensed consolidated balance sheets under the equity section, was comprised of cumulative pension and retirement liability adjustments, net of tax, and change in net unrealized gains and losses on cash flow hedges, net of tax.

Provision for Estimated Losses on Contracts

We record provisions for the total anticipated losses on contracts, considering total estimated costs to complete the contract compared to total anticipated revenues, in the period in which such losses are identified. The provisions for estimated losses on contracts require us to make certain estimates and assumptions, including those with respect to the future revenue under a contract and the future cost to complete the contract. Our estimate of the future cost to complete a contract may include assumptions as to changes in manufacturing efficiency, operating and material costs, and our ability to resolve claims and assertions with our customers. If any of these or other assumptions and estimates do not materialize in the future, we may be required to adjust the provisions for estimated losses on contracts.

Revenue Recognition
Our customers typically engage us to manufacture products based on designs and specifications provided by the end-use

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customer. This will require the building of tooling and manufacturing first article inspection products (prototypes) before volume manufacturing. Contracts with our customers generally include a termination for convenience clause. We have a significant number of contracts that are derived from long-term contracts and programs that can span several years as well as contracts that are started and completed within the same year. We recognize revenue under ASC 606, which utilizes a five-step model, upon our adoption as of January 1, 2018. Further, we utilized the modified retrospective method (also known as the cumulative effect method) of adoption of ASC 606. See Note 2.

The definition of a contract under ASC 606 for us is typically defined as a customer purchase order as this is when we achieve enforceable right to payment. The majority of our contracts are firm fixed-price contracts. The deliverables within a customer purchase order are analyzed to determine the number of performance obligations. In addition, at times, in order to achieve economies of scale and based on our customer's forecasted demand, we may build in advance of receiving a purchase order from our customers.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account under ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from the other promises in the contracts and therefore, not distinct. For contracts with multiple performance obligations, we allocate the contract transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate the standalone selling price is the expected cost plus a margin approach, under which we forecast our expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service.

The majority of our performance obligations are satisfied over time as work progresses. Typically, revenue is recognized over time using an input measure (i.e., costs incurred to date relative to total estimated costs at completion) to measure progress. The majority of our revenues are recognized over time. Contract costs typically include labor, materials, and overhead.

Contract estimates are based on various assumptions to project the outcome of future events that can span multiple months or years. These assumptions include labor productivity and availability; the complexity of the work to be performed; the cost and availability of materials; and the performance of subcontractors.

As a significant change in one or more of these estimates could affect the profitability of our contracts, we review and update our contract-related estimates on a regular basis. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance is recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

The impact of adjustments in contract estimates on our operating earnings can be reflected in either operating costs and expenses or revenue. See Note 2 for the net impact of these adjustments to our unaudited condensed consolidated financial statements for the three-months ended March 31, 2018.

Contract Assets and Contract Liabilities

Contract assets consist of our right to payment for work performed but not yet billed. Contract assets are transferred to accounts receivable when we ship the products to our customers and meet the shipping terms within the revenue contract. Contract liabilities consist of advance or progress payments received from our customers prior to the time transfer of control occurs plus the estimated losses on contracts.

Contract assets and contract liabilities from revenue contracts with customers are as follows:

	(In thousands)	
	March 31, 2018	December 31, 2017
Contract assets	$ 78,163	$ —
Contract liabilities	$ 15,723	$ —

Backlog is defined as customer placed purchase orders ("POs") with firm fixed price and firm delivery dates, and meets the definition of a contract under ASC 606. Our backlog as of March 31, 2018 was $590.8 million. We anticipate recognizing the majority of our remaining performance obligations as revenue during the remainder of 2018 with the remaining performance obligations being recognized in 2019 and beyond.

Revenue by Category

In addition to the revenue categories disclosed above, the following table reflects our revenue disaggregated by major end-use market:

	(In thousands) Three Months Ended	
	March 31 2018	April 1, 2017
Consolidated Ducommun		
Military and space		
Defense electronics	$54,500	$48,923
Defense structures	11,840	14,521
Commercial aerospace	72,470	58,385
Industrial	11,645	14,468
Total	$150,455	$136,297
Structural Systems		
Military and space (defense structures)	$11,840	$14,521
Commercial aerospace	56,206	43,054
Total	$68,046	$57,575
Electronic Systems		
Military and space (defense electronics)	$54,500	$48,923
Commercial aerospace	16,264	15,331
Industrial	11,645	14,468
Total	$82,409	$78,722

Recent Accounting Pronouncements

New Accounting Guidance Adopted in 2018

In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“AOCI”)” (“ASU 2018-02”), which provides financial statement preparers with an option to reclassify stranded income tax effects within AOCI to retained earnings in each period in which the effect of the change in U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The new guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and we have chosen to early adopt ASU 2018-02 beginning January 1, 2018. The adoption of this standard resulted in reclassifying $1.3 million of income tax effects from AOCI to retained earnings during the three months ended March 31, 2018 on our condensed consolidated balance sheets. The income tax effects remaining in AOCI will be released into earnings as the related pre-tax AOCI amounts are reclassified to earnings.

In May 2017, the FASB issued ASU 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), which provides clarity on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs” (“ASU 2017-07”), which requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other

components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments also allow only the service cost component to be eligible for capitalization when applicable. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”), which clarifies the definition of a business with the objective of adding guidance to assist entities

with evaluating whether transactions should be accounted for as acquisitions (or disposals) of businesses. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"), which addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies ("COLIs") (including bank-owned life insurance policies ["BOLIs"]); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. It depicts the transfer of promised goods or services to customers in an amount that reflects the consideration an entity expects to receive in exchange for those goods or services. Companies have the option of applying the provisions of ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of initial application. Additional guidance was issued subsequently as follows:

- December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers" ("ASU 2016-20");
- May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12");
- May 2016, the FASB issued ASU 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-06 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting" ("ASU 2016-11");
- April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"); and
- August 2015, the FASB issued ASU 2015-14, "Revenue From Contracts With Customers (Topic 606)" ("ASU 2015-14").

All of this new guidance was effective for us beginning January 1, 2018. The cumulative impact to our retained earnings at January 1, 2018 was a net increase of $8.7 million. See Note 2.

Recently Issued Accounting Standards

In March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118" ("ASU 2018-05"), which amends certain SEC material in Topic 740 for the income tax accounting implications of the recently issued Tax Cuts and Jobs Act ("Tax Cuts and Jobs Act"). The new guidance is effective upon inclusion in the FASB Codification. We are evaluating the impact of this standard.

In January 2018, the FASB issued ASU 2018-01, "Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842" ("ASU 2018-01"), which clarifies the application of the new leases guidance to land easements and eases adoption efforts for some land easements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are evaluating the impact of this standard.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging" ("ASU 2017-12"), which intends to improve and simplify accounting rules around hedge accounting. ASU 2017-12 refines and expands hedge accounting for both financial (i.e., interest rate) and commodity risks. In addition, it creates more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. The new guidance is effective for annual periods beginning after December

15, 2018, including interim periods within those annual periods, which will be our interim period beginning January 1, 2019. Early adoption is permitted, including adoption in any interim period after the issuance of ASU 2017-12. We are evaluating the impact of this standard.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”), which simplifies the subsequent measurement of goodwill, the amendments eliminate Step Two from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by

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comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step Two of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The new guidance is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are evaluating the impact of this standard.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" ("ASU 2016-02"), which requires lessees to present right-of-use assets and lease liabilities on the balance sheet. Lessees are required to apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are currently in the process of performing an assessment and gap identification phases of the implementation project. This includes gathering our leases and identifying differences that would result from applying the requirements under ASU 2016-02. We anticipate the majority of our leases will be recorded onto our condensed consolidated balance sheets. As such, various line items on our condensed consolidated balance sheets, income statements, and cash flows will be impacted.

Note 2. Adoption of Accounting Standards Codification 606

We adopted ASC 606 with an initial application as of January 1, 2018. We utilized the modified retrospective method, under which the cumulative effect of initially applying the new guidance is recognized as an adjustment to certain captions on the condensed consolidated balance sheet, including the opening balance of retained earnings in the three months ended March 31, 2018.

The net impact to the various captions on our January 1, 2018 opening unaudited condensed consolidated balance sheets was as follows:

Unaudited Condensed Consolidated Balance Sheets	(In thousands) December 31, 2017 Balances Without Adoption of ASC 606	Effect of Adoption	January 1, 2018 Balances With Adoption of ASC 606
Assets			
Contract assets	$ —	$ 68,739	$ 68,739
Inventories	122,961	(39,802)	83,159
Non-current deferred income taxes	261	(95)	166
Liabilities			
Contract liabilities	—	24,460	24,460
Accrued liabilities	28,329	(6,091)	22,238
Non-current deferred income taxes	15,781	2,808	18,589
Shareholders' Equity			
Retained earnings	161,664	8,365	170,029

Under ASC 606, we no longer net progress payments from customers related to inventory purchases against inventories but instead, it is included in contract liabilities on the condensed consolidated balance sheets. See Note 6. The net impact to retained earnings as a result of adopting ASC 606 on the January 1, 2018 opening balance sheet was shown as a change in “other” on the condensed consolidated statements of cash flows.

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The following tables summarize the impact of adopting ASC 606 on our unaudited condensed consolidated financial statements for the three months ended March 31, 2018 (in thousands, except per share data):

	March 31, 2018		
Unaudited Condensed Consolidated Balance Sheets	As Reported	Effect of Adoption	Balances Without Adoption of ASC 606
Assets			
Current Assets			
Cash and cash equivalents	$1,797	$—	$1,797
Accounts receivable, net of allowance for doubtful accounts of $725 and $868 at March 31, 2018 and December 31, 2017, respectively	64,915	—	64,915
Contract assets	78,163	(78,163)	—
Inventories	85,932	51,918	137,850
Production cost of contracts	11,181	—	11,181
Other current assets	12,503	(472)	12,031
Total Current Assets	254,491	(26,717)	227,774
Property and equipment, net of accumulated depreciation of $147,086 and $143,216 at March 31, 2018 and December 31, 2017, respectively	110,031	—	110,031
Goodwill	117,435	—	117,435
Intangibles, net	112,154	—	112,154
Non-current deferred income taxes	147	114	261
Other assets	3,311	—	3,311
Total Assets	$597,569	$(26,603)	$570,966
Liabilities and Shareholders’ Equity			
Current Liabilities			
Accounts payable	$65,042	$—	$65,042
Contract liabilities	15,723	(15,723)	—
Accrued liabilities	22,469	2,507	24,976
Total Current Liabilities	103,234	(13,216)	90,018
Long-term debt	209,710	—	209,710
Non-current deferred income taxes	15,775	(3,116)	12,659
Other long-term liabilities	21,543	—	21,543
Total Liabilities	350,262	(16,332)	333,930
Commitments and contingencies (Notes 11, 13)			
Shareholders’ Equity			
Common stock - $0.01 par value; 35,000,000 shares authorized; 11,380,982 and 11,332,841 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	114	—	114
Additional paid-in capital	80,523	—	80,523
Retained earnings	173,652	(10,271)	163,381
Accumulated other comprehensive loss	(6,982)	—	(6,982)
Total Shareholders’ Equity	247,307	(10,271)	237,036
Total Liabilities and Shareholders’ Equity	$597,569	$(26,603)	$570,966

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Unaudited Condensed Consolidated Statements of Operations	Three Months Ended March 31, 2018		
	As Reported	Effect of Adoption	Balances Without Adoption of ASC 606
Net Revenues	$150,455	$(11,997)	$138,458
Cost of Sales	123,700	(10,203)	113,497
Gross Profit	26,755	(1,794)	24,961
Selling, General and Administrative Expenses	19,326	—	19,326
Restructuring Charges	2,173	—	2,173
Operating Income	5,256	(1,794)	3,462
Interest Expense	(2,899)	—	(2,899)
Income Before Taxes	2,357	(1,794)	563
Income Tax Benefit	(243)	(76)	(319)
Net Income	$2,600	$(1,718)	$882
Earnings Per Share			
Basic earnings per share	$0.23		
Diluted earnings per share	$0.22		
Weighted-Average Number of Common Shares Outstanding			
Basic	11,346		
Diluted	11,613		

Unaudited Condensed Consolidated Statements of Comprehensive Income	Three Months Ended March 31, 2018		
	As Reported	Effect of Adoption	Balances Without Adoption of ASC 606
Net Income	$2,600	$(1,718)	$ 882
Other Comprehensive Income, Net of Tax:			
Amortization of actuarial losses and prior service costs, net of tax benefit of $45 and $63 for the three months ended March 31, 2018 and April 1, 2017, respectively	141	—	141
Change in unrealized gains and losses on cash flow hedges, net of tax of $61 and $72 for the three months ended March 31, 2018 and April 1, 2017, respectively	194	—	194
Other Comprehensive Income	335	—	335
Comprehensive Income	$2,935	$(1,718)	$ 1,217

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	Three Months Ended March 31, 2018		
Unaudited Condensed Consolidated Statements of Cash Flows	As Reported	Effect of Adoption	Balances Without Adoption of ASC 606
Cash Flows from Operating Activities			
Net Income	$2,600	$(1,718)	$ 882
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation and amortization	5,981	—	5,981
Property and equipment impairment due to restructuring	1,077	—	1,077
Stock-based compensation expense	1,090	—	1,090
Deferred income taxes	(206)	(3,116)	(3,322)
Recovery of doubtful accounts	(143)	—	(143)
Other	8,810	(8,975)	(165)
Changes in Assets and Liabilities:			
Accounts receivable	9,292	—	9,292
Contract assets	(78,163)		