GSI TECHNOLOGY INC
Form 10-Q
August 03, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

or

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

For the transition period from to

Commission File Number 001-33387

GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware	77-0398779
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1213 Elko Drive

Sunnyvale, California 94089

(Address of principal executive offices, zip code)

(408) 331-8800

(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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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

The number of shares of the registrant's common stock outstanding as of July 31, 2018: 21,769,194

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GSI TECHNOLOGY, INC.

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PART I — FINANCIAL INFORMATION

Item 1.Financial Statements

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2018	March 31, 2018
	(In thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	$ 36,426	$ 40,241
Short-term investments	16,166	18,124
Accounts receivable, net	6,847	5,279
Inventories	5,141	5,547
Prepaid expenses and other current assets	2,114	2,080
Total current assets	66,694	71,271
Property and equipment, net	9,332	8,172
Long-term investments	11,921	7,923
Goodwill	7,978	7,978
Intangible assets, net	2,911	2,989
Other assets	1,201	1,207
Total assets	$ 100,037	$ 99,540
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 2,267	$ 1,841
Accrued expenses and other liabilities	5,187	5,563
Total current liabilities	7,454	7,404
Income taxes payable	619	619
Other accrued expenses	4,760	4,702

Total liabilities	12,833	12,725
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock: $0.001 par value authorized: 5,000,000 shares; issued and outstanding: none	—	—
Common Stock: $0.001 par value authorized: 150,000,000 shares; issued and outstanding: 21,760,094 and 21,407,247 shares, respectively	22	21
Additional paid-in capital	29,435	27,391
Accumulated other comprehensive loss	(152)	(142)
Retained earnings	57,899	59,545
Total stockholders' equity	87,204	86,815
Total liabilities and stockholders' equity	$ 100,037	$ 99,540

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,	
	2018	2017
	(In thousands, except per share amounts)	
Net revenues	$ 11,266	$ 10,687
Cost of revenues	5,478	5,083
Gross profit	5,788	5,604
Operating expenses:		
Research and development	4,850	4,335
Selling, general and administrative	2,597	2,798
Total operating expenses	7,447	7,133
Loss from operations	(1,659)	(1,529)
Interest income, net	138	97
Other income (expense), net	(115)	1
Loss before income taxes	(1,636)	(1,431)
Provision for income taxes	10	81
Net loss	$ (1,646)	$ (1,512)
Net loss per share:		
Basic	$ (0.08)	$ (0.07)
Diluted	$ (0.08)	$ (0.07)
Weighted average shares used in per share calculations:		
Basic	21,567	20,805
Diluted	21,567	20,805

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	Three Months Ended June 30,	
	2018	2017
	(In thousands)	
Net loss	$ (1,646)	$ (1,512)
Net unrealized loss on available-for-sale investments	(10)	(6)
Total comprehensive loss	$ (1,656)	$ (1,518)

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

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GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended June 30,	
	2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net loss	$ (1,646)	$ (1,512)
Adjustments to reconcile net loss to net cash used in operating activities:		
Allowance for sales returns, doubtful accounts and other	28	(1)
Provision for excess and obsolete inventories	678	448
Depreciation and amortization	329	306
Stock-based compensation	542	478
Amortization of premium on investments	(2)	23
Changes in assets and liabilities:		
Accounts receivable	(1,596)	188
Inventory	(272)	12
Prepaid expenses and other assets	(28)	(394)
Accounts payable	202	350
Accrued expenses and other liabilities	(266)	(1,221)
Net cash used in operating activities	(2,031)	(1,323)
Cash flows from investing activities:		
Purchase of investments	(8,848)	(3,498)
Maturities of short-term investments	6,800	1,250
Decrease in MikaMonu escrow deposit	—	479
Purchases of property and equipment	(1,239)	(105)
Net cash used in investing activities	(3,287)	(1,874)
Cash flows from financing activities:		
Payment of MikaMonu escrow deposit	—	(479)
Proceeds from issuance of common stock under employee stock plans	1,503	1,811
Net cash provided by financing activities	1,503	1,332
Net decrease in cash and cash equivalents	(3,815)	(1,865)
Cash and cash equivalents at beginning of the period	40,241	33,736
Cash and cash equivalents at end of the period	$ 36,426	$ 31,871

Non-cash financing activities:		
Purchases of property and equipment through accounts payable and accruals	277	49
Supplemental cash flow information:		
Net cash received from refunds of income taxes	$ 41	$ —

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

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GSI TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries (“GSI” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

The consolidated results of operations for the three months ended June 30, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year.

Significant accounting policies

Except for the accounting policy for revenue recognition, which was updated as a result of adopting a new accounting standard related to revenue recognition, there have been no material changes to our significant accounting policies that were disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

See “Recent accounting pronouncements” below for additional information on the impact of the adoption of the new accounting standard for revenue recognition on the Company’s consolidated financial statements.

Recent accounting pronouncements

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The standard eliminates the second step in the goodwill impairment test which requires an entity to determine the implied fair value of the reporting unit’s goodwill. Instead, an entity should recognize an impairment loss if the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, with the impairment loss not to exceed the amount of goodwill allocated to the reporting unit. The standard is effective for annual and interim goodwill impairment tests conducted in fiscal years beginning after December 15, 2019, with early adoption permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash”. ASU 2016-18 requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The Company adopted ASU 2016-18 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” ASU 2016-13 replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of

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a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted beginning April 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, “Elements of Financial Statements,” and, therefore, recognition of those lease assets and lease liabilities represents a change of previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. This ASU is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Although the Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. The Company adopted ASU 2016-01 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company’s consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)" and has subsequently issued several supplemental and/or clarifying ASUs (collectively, "ASC 606"). The new accounting standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new standard requires a company to recognize revenue as control of goods or services transfers to a customer at an amount that reflects the expected consideration to be received in exchange for those goods or services. It defines a five-step approach for recognizing revenue, which may require a company to use more judgment and make more estimates than under the current standard. The Company adopted ASC 606 on April 1, 2018 using the modified retrospective transition method.

The Company determines revenue recognition through the following steps: (1) identification of the contract with a customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; and (5) recognition of revenue when, or as, we satisfy a performance obligation.

The adoption of ASC 606 was applied to all contracts and did not have a significant impact on the Company’s retained earnings as the timing of Company’s revenue recognition under the new standard coincides with the way the Company previously recognized revenue. There was no impact on the opening retained earnings balance as of April 1, 2018 due to the adoption of ASC 606.

The majority of the Company's customer contracts, which may be in the form of purchase orders, contracts or purchase agreements, contain performance obligations for delivery of agreed upon products. Delivery of all performance obligations contained within a contract with a customer typically occurs at the same time (or within the same accounting period). Transfer of control typically occurs at the time of shipment or at the time the product is pulled from consignment as that is the point at which delivery has occurred, title and the risks and rewards of

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ownership have passed to the customer, and the Company has a right to payment. Thus, the Company will generally recognize revenue upon shipment of the product.

Because all of the Company’s performance obligations relate to contracts with a duration of less than one year, the Company elected to apply the optional exemption practical expedient provided in ASC 606 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

The Company adjusts the transaction price for variable consideration. Variable consideration is not typically significant and primarily results from stock rotation rights and quick pay discounts provided to our distributors. As a practical expedient, the Company is recognizing the incremental costs of obtaining a contract, specifically commission expenses that have a period of benefit of less than twelve months, as an expense when incurred. Additionally, the Company has adopted an accounting policy to recognize shipping costs that occur after control transfers to the customer as a fulfillment activity.

The Company’s contracts with customers do not typically include extended payment terms. Payment terms vary by contract type and type of customer and generally range from 30 to 60 days from shipment. Additionally, the Company has right to payment upon shipment.

The Company records revenue net of sales tax, value added tax, excise tax and other taxes collected concurrent with product sales. The impact of such taxes on products sales is immaterial. The Company has also elected to recognize the cost for freight and shipping when control over the products sold passes to customers and revenue is recognized.

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs and the accrued warranty liability were not material as of June 30, 2018.

The majority of the Company’s revenue is derived from sales of SRAM products which represent approximately 97% of total revenues in the three months ended June 30, 2018.

The majority of the Company’s revenue is derived from sales to distributors and contract manufacturers which represented approximately 54% and 44% of net revenue, respectively, for the three months ended June 30, 2018.

Nokia, the Company’s largest customer, purchases products directly from the Company and through contract manufacturers and distributors. Based on information provided to the Company by its contract manufacturers and distributors, purchases by Nokia represented approximately 47% of the Company’s net revenues in the three months ended June 30, 2018.

The Company historically deferred recognition of revenue on shipments to its distributors because it lacked fixed and determinable pricing for contracts in which the distributors had rights to price concessions from the Company upon shipment to the distributors’ customers. During fiscal 2018, the Company revised all of its distribution agreements to eliminate the uncertainty in pricing, allowing the Company to recognize revenue at the time of shipment to the distributors. As a result, the implementation of the guidance did not have a significant impact on the Company’s consolidated financial statements. See “Note 9 - Segment and Geographic Information” for revenue by shipment destination.

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NOTE 2—NET LOSS PER COMMON SHARE

The Company uses the treasury stock method to calculate the weighted average shares used in computing diluted net loss per share. The following table sets forth the computation of basic and diluted net loss per share:

	Three Months Ended June 30,	
	2018	2017
	(In thousands, except per share amounts)	
Net loss	$ (1,646)	$ (1,512)
Denominators:		
Weighted average shares—Basic	21,567	20,805
Dilutive effect of employee stock options	—	—
Dilutive effect of employee stock purchase plan options	—	—
Weighted average shares—Dilutive	21,567	20,805
Net loss per common share—Basic	$ (0.08)	$ (0.07)
Net loss per common share—Diluted	$ (0.08)	$ (0.07)

The following shares of common stock underlying outstanding stock options, determined on a weighted average basis, were excluded from the computation of diluted net loss per share as they had an anti-dilutive effect:

	Three Months Ended June 30,	
	2018	2017
	(In thousands)	
Shares underlying options and ESPP shares	3,044	2,560

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NOTE 3—BALANCE SHEET DETAIL

	June 30, 2018	March 31, 2018
	(In thousands)	
Inventories:		
Work-in-progress	$ 2,321	$ 2,226
Finished goods	2,820	3,321
	$ 5,141	$ 5,547

	June 30, 2018	March 31, 2018
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	$ 6,937	$ 5,342
Less: Allowances for sales returns, doubtful accounts and other	(90)	(63)
	$ 6,847	$ 5,279

	June 30, 2018	March 31, 2018
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid tooling and masks	$ 271	$ 163
Escrow deposit	750	750
Other receivables	514	370
Other prepaid expenses and other current assets	579	797
	$ 2,114	$ 2,080

	June 30, 2018	March 31, 2018
	(In thousands)	
Property and equipment, net:		
Computer and other equipment	$ 18,926	$ 17,845
Software	4,072	4,072
Land	3,900	3,900
Building and building improvements	3,306	2,310
Furniture and fixtures	102	82
Leasehold improvements	815	766
Construction in progress	230	965
	31,351	29,940
Less: Accumulated depreciation	(22,019)	(21,768)
	$ 9,332	$ 8,172

Depreciation expense was $251,000 and $228,000 for the three months ended June 30, 2018 and 2017, respectively. The construction in progress relates to a facility expansion at our Sunnyvale headquarters that will be placed in service in the first half of fiscal 2019.

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	June 30, 2018	March 31, 2018
	(In thousands)	
Other assets:		
Escrow deposit	$ 1,000	$ 1,000
Non-current deferred income taxes	75	75
Deposits	126	132
	$ 1,201	$ 1,207

The escrow deposit at June 30, 2018 and March 31, 2018 includes approximately $1.0 million and $1.0 million, respectively, placed in escrow in connection with the Company's acquisition of MikaMonu Group Ltd. ("MikaMonu") on November 23, 2015.

The following tables summarize the components of intangible assets and related accumulated amortization balances at June 30, 2018 and March 31, 2018 (in thousands):

	As of June 30, 2018		
	Gross Carrying Amount	Accumulated amortization	Net Carrying Amount
Intangible assets:			
Product designs	$ 590	$ (590)	$ —
Patents	4,220	(1,309)	2,911
Software	80	(80)	—
Total	$ 4,890	$ (1,979)	$ 2,911

	As of March 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:			
Product designs	$ 590	$ (590)	$ —
Patents	4,220	(1,231)	2,989

Software	80	(80)	—
Total	$ 4,890	$ (1,901)	$ 2,989

Amortization of intangible assets included in cost of revenues was $78,000 and $78,000 for the three months ended June 30, 2018 and 2017, respectively.

As of June 30, 2018, the estimated future amortization expense of intangible assets in the table above is as follows (in thousands):

Fiscal year ending March 31,	
2019 (remaining nine months)	$ 189
2020	233
2021	233
2022	233
2023	233
Thereafter	1,790
Total	$ 2,911

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	June 30, 2018	March 31, 2018
	(In thousands)	
Accrued expenses and other liabilities:		
Accrued compensation	$ 2,547	$ 2,786
Accrued professional fees	42	31
Accrued commissions	323	299
Contingent consideration	1,112	1,102
Accrued retention payment	322	291
Miscellaneous accrued expenses	841	1,054
	$ 5,187	$ 5,563

	June 30, 2018	March 31, 2018
	(In thousands)	
Other accrued expenses:		
Contingent consideration	$ 4,438	$ 4,411
Other long-term accrued liabilities	322	291
	$ 4,760	$ 4,702

NOTE 4—GOODWILL

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed in a business combination. The Company tests for goodwill impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. The Company has one reporting unit. The Company assesses goodwill for impairment on an annual basis on the last day of February in the fourth quarter of its fiscal year.

The Company had a goodwill balance of $8.0 million as of both March 31, 2018 and June 30, 2018. The goodwill resulted from the acquisition of MikaMonu Group Ltd. in fiscal 2016.

The Company utilized a two-step quantitative analysis to complete its annual impairment test during the fourth quarter of fiscal 2018 and concluded that there was no impairment, as the fair value of its sole reporting unit exceeded its carrying value. The Company determined that the second step of the impairment test was not necessary. No triggering event took place subsequent to the fiscal 2018 annual assessment that necessitated a quantitative impairment analysis for the Company’s one reporting unit.

NOTE 5—INCOME TAXES

The current portion of the Company’s unrecognized tax benefits was $0 at both June 30, 2018 and March 31, 2018. The long-term portion at June 30, 2018 and March 31, 2018 was $619,000 and $619,000, respectively, of which the timing of the resolution is uncertain. As of June 30, 2018, $2.2 million of unrecognized tax benefits had been recorded as a reduction to net deferred tax assets. As of June 30, 2018, the Company’s net deferred tax assets of $6.6 million were subject to a valuation allowance of $6.5 million. As of March 31, 2018, the Company’s net deferred tax assets of $6.0 million were subject to a valuation allowance of $5.9 million.

On December 22, 2017, the “Tax Cuts and Jobs Act” ("H.R. 1") was signed into law, significantly impacting several sections of the Internal Revenue Code. Following the enactment of H.R. 1, the SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of the law. SAB 118 provides a measurement period that should not extend beyond one year from the enactment date of H.R. 1 for companies to complete the accounting under ASC 740. In accordance with SAB 118, the Company must reflect the income tax effects of those aspects of H.R. 1 for which the accounting under ASC 740 is complete. To the extent that the Company’s accounting for certain income tax effects of H.R. 1 is incomplete but the Company is able to determine a reasonable estimate, the Company must record a provisional estimate in the financial statements. If the Company cannot determine a

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provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax law that were in effect immediately before the enactment of H.R 1.

H.R. 1 includes significant changes to the U.S. corporate income tax system, including a permanent reduction in the corporate income tax rate from 35% to 21%, limitations on the deductibility of interest expense and executive compensation and the transition of U.S. international taxation from a worldwide tax system to a territorial tax system. We re-measured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. The re-measurement of our deferred tax balance of $1.1 million was offset by application of our valuation allowance. We calculated our best estimate of the impact of H.R. 1 in the fiscal 2018 year end income tax provision, including the impact of the one-time transition tax, in accordance with our understanding of H.R. 1 and guidance available as of the date of this filing and recorded a tax expense of $367,000 in the year ended March 31, 2018 related to the transition tax associated with deemed repatriation of foreign earnings. As the Company completes the analysis of H.R. 1, collects and prepares necessary data, and interprets any additional guidance, the Company may make adjustments to its initial assessment. Pursuant to Staff Accounting Bulletin No. 118, adjustments to the provisional amounts recorded by the Company that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined.

The Company’s original estimate may be materially impacted by a number of additional considerations, including but not limited to the issuance of the final regulations and the Company’s ongoing analysis of the new law.

H.R. 1 subjects a U.S. shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred.

At June 30, 2018, the Company has estimated the impact of the GILTI income inclusion as part of the Company’s estimate of its fiscal 2019 income taxes. Due to the Company’s valuation allowance in the United States, it is projected that there will be no net income tax effect related to GILTI in the Company’s fiscal year ending March 31, 2019.

Management believes that within the next twelve months the Company will have no reduction in uncertain tax benefits, including interest and penalties, related to positions taken with respect to credits and loss carryforwards on previously filed tax returns.

The Company’s policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the Condensed Consolidated Statements of Operations.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Fiscal years 2013 through 2018 remain open to examination by federal tax authorities, and fiscal years 2011 through 2018 remain open to examination by California tax authorities.

The Company’s estimated annual effective income tax rate was approximately (4.8%) and (9.9%) as of June 30, 2018 and 2017, respectively. The annual effective tax rates as of June 30, 2018 and 2017 vary from the United States statutory income tax rate primarily due to valuation allowances in the United States, whereby pre-tax losses do not result in the recognition of corresponding income tax benefits and expenses, the foreign tax differential, and the impact of new tax reform.

NOTE 6—FINANCIAL INSTRUMENTS

Fair value measurements

Authoritative accounting guidance for fair value measurements provides a framework for measuring fair value and related disclosures. The guidance applies to all financial assets and financial liabilities that are measured

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on a recurring basis. The guidance requires fair value measurement to be classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. As of June 30, 2018, the Level 1 category included money market funds of $6.1 million, which were included in cash and cash equivalents on the Condensed Consolidated Balance Sheets.

Level 2: Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers. As of June 30, 2018, the Level 2 category included short-term investments $16.1 million and long-term investments of $11.9 million, which were comprised of certificates of deposit, corporate debt securities and government and agency securities.

Level 3: Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing. As of June 30, 2018, the Company's Level 3 financial instruments measured at fair value on the Condensed Consolidated Balance Sheets consisted of the contingent consideration liability related to the acquisition of MikaMonu. The fair value of the contingent consideration liability was initially determined as of the acquisition date using unobservable inputs. These inputs include the estimated amount and timing of future cash flows, the probability of success (achievement of the various contingent events) and a risk-adjusted discount rate of approximately 14.8% used to adjust the probability-weighted cash flows to their present value. Subsequent to the acquisition date, at each reporting period, the contingent consideration liability is re-measured to fair value with changes recorded in selling, general and administrative expenses in the Consolidated Statements of Operations. The change in fair value for the three month period ended June 30, 2018 was $36,000.

The fair value of financial assets measured on a recurring basis is as follows (in thousands):

Fair Value Measurements at Reporting Date Using		
Quoted Prices in Active Markets for Identical Assets and Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs

June
30,
2018