

**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 September 30, 2018

☐ **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 000-27115

PCTEL, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

**471 Brighton Drive,
Bloomington, IL**

(Address of Principal Executive Office)

77-0364943

(I.R.S. Employer
Identification Number)

60108

(Zip Code)

(630) 372-6800

(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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ 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 definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☐

Non-accelerated filer ☐

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 Act). Yes ☐ No ☒

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

Title

Outstanding

Common Stock, par value \$.001 per share

18,336,543 as of November 8, 2018

PCTEL, INC.
Form 10-Q
For the Quarterly Period Ended September 30, 2018

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PART I – FINANCIAL INFORMATION

Item 1: Financial Statements (unaudited)

PCTEL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

| | (Unaudited) September 30, 2018 | December 31, 2017 |
|---|--------------------------------------|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 5,377 | \$ 5,559 |
| Short-term investment securities | 31,770 | 32,499 |
| Accounts receivable, net of allowances of \$278 and \$319 at September 30, 2018 and December 31, 2017, respectively | 13,261 | 18,624 |
| Inventories, net | 12,691 | 12,756 |
| Prepaid expenses and other assets | 1,185 | 1,605 |
| Total current assets | 64,284 | 71,043 |
| Property and equipment, net | 12,491 | 12,369 |
| Goodwill | 3,332 | 3,332 |
| Intangible assets, net | 1,280 | 2,113 |
| Deferred tax assets, net | 8,685 | 7,734 |
| Other noncurrent assets | 52 | 72 |
| TOTAL ASSETS | \$ 90,124 | \$ 96,663 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Accounts payable | \$ 5,392 | \$ 5,471 |
| Accrued liabilities | 5,069 | 7,481 |
| Total current liabilities | 10,461 | 12,952 |
| Long-term liabilities | 383 | 392 |
| Total liabilities | 10,844 | 13,344 |
| Stockholders' equity: | | |
| Common stock, \$0.001 par value, 100,000,000 shares authorized, 18,318,141 and 17,806,792 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively | 18 | 18 |
| Additional paid-in capital | 134,455 | 134,505 |
| Accumulated deficit | (54,920) | (51,258) |
| Accumulated other comprehensive (loss) income | (273) | 54 |
| Total stockholders' equity | 79,280 | 83,319 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 90,124 | \$ 96,663 |

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

PCTEL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
(in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUES | \$ 18,426 | \$ 23,665 | \$ 61,739 | \$ 68,136 |
| COST OF REVENUES | 11,705 | 13,515 | 39,355 | 39,570 |
| GROSS PROFIT | 6,721 | 10,150 | 22,384 | 28,566 |
| OPERATING EXPENSES: | | | | |
| Research and development | 3,028 | 2,757 | 9,021 | 8,141 |
| Sales and marketing | 2,957 | 3,230 | 9,059 | 9,394 |
| General and administrative | 3,029 | 3,146 | 9,172 | 10,081 |
| Amortization of intangible assets | 85 | 124 | 333 | 372 |
| Total operating expenses | 9,099 | 9,257 | 27,585 | 27,988 |
| OPERATING (LOSS) INCOME | (2,378) | 893 | (5,201) | 578 |
| Other income, net | 226 | 32 | 486 | 74 |
| (LOSS) INCOME BEFORE INCOME TAXES | (2,152) | 925 | (4,715) | 652 |
| (Benefit) expense for income taxes | (482) | 206 | (961) | (68) |
| (LOSS) INCOME FROM CONTINUING OPERATIONS | (1,670) | 719 | (3,754) | 720 |
| NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX BENEFIT | 0 | 236 | 0 | (148) |
| NET (LOSS) INCOME | \$ (1,670) | \$ 955 | \$ (3,754) | \$ 572 |
| Net (Loss) Income per Share from Continuing Operations: | | | | |
| Basic | \$ (0.10) | \$ 0.04 | \$ (0.22) | \$ 0.04 |
| Diluted | \$ (0.10) | \$ 0.04 | \$ (0.22) | \$ 0.04 |
| Net Income (Loss) per Share from Discontinued Operations: | | | | |
| Basic | \$ 0.00 | \$ 0.01 | \$ 0.00 | \$ (0.01) |
| Diluted | \$ 0.00 | \$ 0.01 | \$ 0.00 | \$ (0.01) |
| Net (Loss) Income per Share: | | | | |
| Basic | \$ (0.10) | \$ 0.06 | \$ (0.22) | \$ 0.03 |
| Diluted | \$ (0.10) | \$ 0.06 | \$ (0.22) | \$ 0.03 |
| Weighted Average Shares: | | | | |
| Basic | 17,234 | 16,757 | 17,145 | 16,526 |
| Diluted | 17,234 | 17,065 | 17,145 | 16,830 |
| Cash dividend per share | \$ 0.055 | \$ 0.055 | \$ 0.155 | \$ 0.155 |

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

PCTEL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (unaudited)
(in thousands)

| | <u>Three Months Ended September 30,</u> | | <u>Nine Months Ended September 30,</u> | |
|---|---|------------------------|--|----------------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| NET (LOSS) INCOME | \$ (1,670) | \$ 955 | \$ (3,754) | \$ 572 |
| OTHER COMPREHENSIVE (LOSS) INCOME: | | | | |
| Foreign currency translation adjustments | (223) | 131 | (327) | 287 |
| COMPREHENSIVE (LOSS) INCOME | <u><u>\$ (1,893)</u></u> | <u><u>\$ 1,086</u></u> | <u><u>\$ (4,081)</u></u> | <u><u>\$ 859</u></u> |

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

PCTEL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(unaudited, in thousands)

| | Common Stock | Additional Paid-In Capital | Retained Deficit | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity of PCTEL, Inc. |
|---|-----------------|----------------------------------|---------------------|--|--|
| BALANCE at DECEMBER 31, 2017 | \$ 18 | \$ 134,505 | \$ (51,258) | \$ 54 | \$ 83,319 |
| Cumulative-effect adjustment resulting from adoption of ASU 2016-16 | 0 | 0 | 92 | 0 | 92 |
| BALANCE at JANUARY 1, 2018 | 18 | 134,505 | (51,166) | 54 | 83,411 |
| Stock-based compensation expense | 0 | 2,572 | 0 | 0 | 2,572 |
| Issuance of shares for stock purchase plans | 0 | 686 | 0 | 0 | 686 |
| Cancellation of shares for payment of withholding tax | 0 | (301) | 0 | 0 | (301) |
| Dividends paid | 0 | (3,007) | 0 | 0 | (3,007) |
| Net loss | 0 | 0 | (3,754) | 0 | (3,754) |
| Change in cumulative translation adjustment, net | 0 | 0 | 0 | (327) | (327) |
| BALANCE at SEPTEMBER 30, 2018 | <u>\$ 18</u> | <u>\$ 134,455</u> | <u>\$ (54,920)</u> | <u>\$ (273)</u> | <u>\$ 79,280</u> |

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

PCTEL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

| | Nine Months Ended September 30, | |
|--|--|------------------------|
| | 2018 | 2017 |
| Operating Activities: | | |
| Net (loss) income from continuing operations | \$ (3,754) | \$ 720 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | |
| Depreciation | 2,088 | 1,913 |
| Intangible asset amortization | 833 | 872 |
| Stock-based compensation | 2,572 | 2,458 |
| Loss on disposal of property and equipment | 11 | 18 |
| Restructuring costs | (28) | (88) |
| Bad debt provision | 248 | 38 |
| Deferred tax provision | (868) | (282) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 4,968 | 672 |
| Inventories | (173) | 1,809 |
| Prepaid expenses and other assets | 425 | 509 |
| Accounts payable | 255 | (1,078) |
| Income taxes payable | (39) | (154) |
| Other accrued liabilities | (2,395) | (426) |
| Deferred revenue | (43) | 95 |
| Net cash provided by operating activities | <u>4,100</u> | <u>7,076</u> |
| Investing Activities: | | |
| Capital expenditures | (2,205) | (2,097) |
| Proceeds from disposal of property and equipment | 14 | 1 |
| Purchases of investments | (33,978) | (37,579) |
| Redemptions/maturities of short-term investments | 34,707 | 26,056 |
| Net cash used in investing activities | <u>(1,462)</u> | <u>(13,619)</u> |
| Financing Activities: | | |
| Proceeds from issuance of common stock | 686 | 1,375 |
| Payment of withholding tax on stock-based compensation | (301) | (1,190) |
| Principle payments on capital leases | (91) | (64) |
| Cash dividends | (3,007) | (2,730) |
| Net cash used in financing activities | <u>(2,713)</u> | <u>(2,609)</u> |
| Cash flows from discontinued operations: | | |
| Net cash used in operating activities | 0 | (697) |
| Net cash provided by investing activities | 0 | 1,434 |
| Net cash flows provided by discontinued operations | <u>0</u> | <u>737</u> |
| Net decrease in cash and cash equivalents | (75) | (8,415) |
| Effect of exchange rate changes on cash | (107) | 87 |
| Cash and cash equivalents, beginning of period | 5,559 | 14,855 |
| Cash and Cash Equivalents, End of Period | <u><u>\$ 5,377</u></u> | <u><u>\$ 6,527</u></u> |

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Nine Months Ended September 30, 2018 (Unaudited)
(in thousands except per share data and as otherwise noted)

1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”).

Nature of Operations

PCTEL, Inc. (“PCTEL”, the “Company”, “we”, “ours”, and “us”) delivers Performance Critical TELEcom technology solutions to the wireless industry. PCTEL is a leading global supplier of wireless network antenna and testing solutions. PCTEL’s Connected Solutions segment designs and manufactures precision antennas. PCTEL antennas are deployed in small cells, enterprise Wi-Fi access points, fleet management and transit systems, and in network equipment and devices for the Industrial Internet of Things (“IIoT”). PCTEL’s RF Solutions segment provides test tools that improve the performance of wireless networks globally. Mobile operators, neutral hosts, and equipment manufacturers rely on PCTEL to analyze, design, and optimize next generation wireless networks.

Segment Reporting

Effective August 2018, the Company consolidated its organizational structure to drive growth and address the convergence in the industrial IoT, public safety, and 4G infrastructure markets and the emergence of new technologies such as 5G. The Company’s operations, engineering, business development, sales and marketing, and operational general and administrative functions were consolidated into single enterprise-wide organizations. As a result of the reorganization that occurred in the third quarter 2018, the Company’s Chief Executive Officer, as the chief operating decision maker (“CODM”) began assessing operating profits and identified assets at the enterprise level for resource allocations, and instead of segment managers, the Chief Operating Officer began reporting to maintaining regular contact with the CODM to discuss operating activities, financial results, forecasts, and plans for the entire business. All operating profit and cash flows are measured and managed at the enterprise level.

Until the reorganization, PCTEL operated in two segments for reporting purposes, Connected Solutions and RF Solutions. The CODM assessed operating profits and identified assets for the Connected Solutions and RF Solutions segments for resource allocations. Each segment had its own segment manager as well as its own engineering, business development, sales and marketing, and operational general and administrative functions. The Company managed its balance sheet and cash flows centrally at the corporate level, with the exception of trade accounts receivable and inventory which were managed at the segment level. Each of the segment managers reported to and maintained regular contact with the CODM to discuss operating activities, financial results, forecasts, and plans for the segment. All of the Company’s accounting and finance, human resources, information technology (“IT”) and legal functions were provided on a centralized basis through the corporate function.

Because the reorganization occurred during the third quarter 2018, this report reflects the segment reporting structure that was in effect for all of 2017 and through August of 2018. Beginning with the Form 10-K for the year ended December 31, 2018, the Company will not report any segment information. The Company will report revenue and gross profit for its two major product lines, Antenna Products and Test and Measurement Products.

Connected Solutions Segment

PCTEL Connected Solutions designs and manufactures precision antennas. PCTEL antennas are deployed primarily in small cells, enterprise Wi-Fi access points, fleet management and transit systems, and in equipment and devices for the IIoT. Revenue growth in these markets is driven by the increased use of wireless communications and increased complexity occurring in these markets. PCTEL antennas are primarily sold to original equipment manufacturer (“OEM”) providers where they are designed into the customer’s solution.

Competition in the antenna markets is fragmented. Competitors include Airgain, Amphenol, Laird, Pulse, and Taoglas. The Company seeks out product applications that command a premium for product performance and customer service, and it avoids commodity markets.

PCTEL maintains expertise in several technology areas in order to be competitive in the antenna market. These include radio frequency engineering, mobile antenna design and manufacturing, mechanical engineering, product quality and testing, and wireless network engineering.

RF Solutions Segment

PCTEL RF Solutions provides test tools that improve the performance of wireless networks globally, with a focus on LTE, public safety, and emerging 5G technologies. Network operators, neutral hosts, and equipment manufacturers rely on PCTEL's scanning receivers and testing solutions to analyze, design, and optimize their networks. Revenue growth is driven by the implementation and roll out of new wireless technology standards (i.e. 3G to 4G, 4G to 5G). PCTEL test equipment is sold directly to wireless carriers or to OEMs who integrate the Company's products into their solutions which are then sold to wireless carriers.

Competitors for PCTEL's test tool products include OEMs such as Anritsu, Berkley Varitronics, Digital Receiver Technology, and Rohde and Schwarz.

PCTEL maintains expertise in several technology areas in order to be competitive in the test tool market. These include radio frequency engineering, digital signal process engineering, manufacturing, mechanical engineering, product quality and testing, and wireless network engineering.

During the quarter ended June 30, 2017, the Company approved a plan to sell its Network Engineering Services business ("Engineering Services") and shift its focus to research and development driven radio frequency ("RF") products. On July 31, 2017, the Company sold substantially all of the assets of the Company's Engineering Services business to Gabe's Construction Co., Inc. ("Gabe's") for a purchase price of \$1.45 million. The Engineering Services business provided design, testing, commissioning, optimization, and consulting services for cellular, Wi-Fi and public safety networks and was a reporting unit within the RF Solutions segment. The disposition of Engineering Services qualified as a discontinued operation for reporting purposes due to the material significance of its historical results and because this disposition represented a strategic shift by the Company to focus on products. As such, the Company reported the results of its Engineering Services business as discontinued operations beginning with the quarter ended June 30, 2017. The Company restated the results of Engineering Services as discontinued operations for the three and six months ended June 30, 2017. See Note 5 for more information on discontinued operations.

Basis of Consolidation

The unaudited interim condensed consolidated financial statements of the Company include the condensed consolidated balance sheet and the condensed consolidated statement of stockholders' equity as of September 30, 2018, and the condensed consolidated statements of operations, statements of comprehensive (loss) income, and cash flows for the three and nine months ended September 30, 2018 and 2017, respectively. The interim condensed consolidated financial statements are unaudited and reflect all adjustments of a normal recurring nature that are, in the opinion of management, necessary for a fair presentation of the interim period financial statements. The condensed consolidated balance sheet as of December 31, 2017 is derived from the audited financial statements as of December 31, 2017. Certain amounts in the prior year have been reclassified to conform to the current year presentation.

The unaudited interim condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. The significant accounting policies followed by the Company are set forth within the 2017 Form 10-K. There were no changes in the Company's significant accounting policies during the nine months ended September 30, 2018. See Note 13 related to Revenue from Contracts with Customers for additional disclosures related to revenue policies. In addition, the Company reaffirms the use of estimates in the preparation of the financial statements as set forth in the 2017 Form 10-K. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the 2017 Form 10-K. The results of operations for the period ended September 30, 2018 may not be indicative of the results for the period ending December 31, 2018.

Foreign Operations

The Company is exposed to foreign currency fluctuations due to its foreign operations and because products are sold internationally. The functional currency for the Company's foreign operations is predominantly the applicable local currency. Accounts of foreign operations are translated into U.S. dollars using the exchange rate in effect at the applicable balance sheet date for assets and liabilities and average monthly rates prevailing during the period for revenue and expense accounts. Adjustments resulting from translation are included in accumulated other comprehensive (loss) income, a separate component of stockholders' equity. Gains and losses resulting from other transactions originally in foreign currencies and then translated into U.S. dollars are included in the condensed consolidated statement of operations. Net foreign exchange gains (losses) resulting from foreign currency transactions included in other income,

net were \$37 and \$(45) for the three months ended September 30, 2018 and 2017, respectively. Net foreign exchange gains (losses) resulting from foreign currency transactions included in other income, net were \$28 and \$(98) for the nine months ended September 30, 2018 and 2017, respectively.

Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-13 (“ASU 2016-13”) regarding ASC Topic 326, “Financial Instruments - Credit Losses,” which modifies the measurement of expected credit losses of certain financial instruments. The amendments will be effective for the Company on January 1, 2020. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (“Topic 842”), which amends existing guidance to require lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and to disclose additional quantitative and qualitative information about leasing arrangements. Topic 842 also provides clarifications surrounding the presentation of the effects of leases in the income statement and statement of cash flows. This guidance will be effective for the Company on January 1, 2019. The Company has prepared a complete portfolio of its active leases and has developed a project plan to implement Topic 842. The Company is currently evaluating key policy elections and considerations prompted by the standard. The Company is in process of drafting an internal policy document to address the new standard requirements and is in process of evaluating the impact of the new lease accounting guidance on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of certain cash receipts and cash payments (“Topic 230”). Topic 230 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 (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The Company adopted Topic 230 on January 1, 2018. Adoption of this guidance did not have an impact on the Company’s consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (“Topic 740”): Intra-Entity Transfer of Assets Other than Inventory. Topic 740 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The Company adopted Topic 740 on January 1, 2018 using the modified retrospective approach, and as a result recorded a deferred tax asset with a corresponding adjustment to retained earnings of \$0.1 million associated with an intra-entity transfer of goodwill in 2009. The goodwill was transferred to the U.S. entity from a Canadian entity that was dissolved in 2009.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“Topic 606”) which introduces a new revenue recognition model in which an entity should recognize revenue to depict the transfer of promised 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. Topic 606 defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates may be required in connection with the revenue recognition process than were previously required under prior U.S. GAAP. Topic 606 also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The FASB has also issued the following standards which clarify Topic 606 and have the same effective date as the original standard: ASU 2016-20, Technical Corrections and Improvements to Topic 606, ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, ASU 2016-10, Identifying Performance Obligations and Licensing and ASU 2016-08, Principal versus Agent Considerations. The Company adopted Topic 606 on January 1, 2018 using the modified retrospective approach. The majority of the Company’s revenue is recognized on a “point-in-time” basis and a nominal amount of our revenue is recognized “over time” under the new standard, which is consistent with our revenue recognition policy under the previous guidance. There were no changes to retained earnings from the adoption of Topic 606. The Company made changes to incorporate the impact of the new standard into our policies, processes, and controls. See Note 13 for information on Revenue from Contracts with Customers.

2. Fair Value of Financial Instruments

The Company follows accounting guidance for fair value measurements and disclosures, which establishes a fair value hierarchy that requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is a market-based measurement that should be determined based on assumptions that market participants would use

in pricing an asset or liability. As a basis for considering such assumptions, a three-tier fair value hierarchy has been established, which prioritizes the inputs used in measuring fair value as follows:

Level 1: inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of assets or liabilities.

Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Cash equivalents are measured at fair value and investments are recognized at amortized cost in the Company's financial statements. Accounts receivable and other investments are financial assets with carrying values that approximate fair value due to the short-term nature of these assets. Accounts payable is a financial liability with a carrying value that approximates fair value due to the short-term nature of these liabilities.

3. Earnings per Share

The following table is the computation of basic and diluted earnings per share:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|---------|---------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| Basic Loss Per Share computation: | | | | |
| Numerator: | | | | |
| Net (loss) income from continuing operations | \$ (1,670) | \$ 719 | \$ (3,754) | \$ 720 |
| Net income (loss) from discontinued operations | \$ 0 | \$ 236 | \$ 0 | \$ (148) |
| Net (loss) income | \$ (1,670) | \$ 955 | \$ (3,754) | \$ 572 |
| Denominator: | | | | |
| Common shares outstanding | 17,234 | 16,757 | 17,145 | 16,526 |
| Net Loss per common share - basic | | | | |
| Net (loss) income from continuing operations | \$ (0.10) | \$ 0.04 | \$ (0.22) | \$ 0.04 |
| Net income (loss) from discontinued operations | \$ 0.00 | \$ 0.01 | \$ 0.00 | \$ (0.01) |
| Net (loss) income | \$ (0.10) | \$ 0.06 | \$ (0.22) | \$ 0.03 |
| Diluted Loss Per Share computation: | | | | |
| Denominator: | | | | |
| Common shares outstanding | 17,234 | 16,757 | 17,145 | 16,526 |
| Restricted shares subject to vesting | * | 304 | * | 302 |
| Common stock option grants | * | 4 | * | 2 |
| Total shares | 17,234 | 17,065 | 17,145 | 16,830 |
| Loss per common share - diluted | | | | |
| Net (loss) income from continuing operations | \$ (0.10) | \$ 0.04 | \$ (0.22) | \$ 0.04 |
| Net income (loss) from discontinued operations | \$ 0.00 | \$ 0.01 | \$ 0.00 | \$ (0.01) |
| Net (loss) income | \$ (0.10) | \$ 0.06 | \$ (0.22) | \$ 0.03 |

* As denoted by "*" in the table above, the weighted average common stock option grants and restricted shares of 274 and 566 for the three and nine months ended September 30, 2018, respectively, were excluded from the calculations of diluted net loss per share since their effects are anti-dilutive.

4. Cash, Cash Equivalents and Investments

The Company's cash and investments consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|------------------------|-----------------------|----------------------|
| Cash | \$ 2,237 | \$ 3,785 |
| Cash equivalents | 3,140 | 1,774 |
| Short-term investments | 31,770 | 32,499 |
| Total | <u>\$ 37,147</u> | <u>\$ 38,058</u> |

Cash and Cash Equivalents

At September 30, 2018 and December 31, 2017, cash and cash equivalents included bank balances and investments with original maturities less than 90 days. At September 30, 2018 and December 31, 2017, the Company's cash equivalents were invested in highly liquid AAA rated money market funds that are required to comply with Rule 2a-7 of the Investment Company Act of 1940. Such funds utilize the amortized cost method of accounting, seek to maintain a constant \$1.00 per share price, and are redeemable upon demand. The Company restricts its investments in AAA money market funds to those invested 100% in either short-term U.S. government agency securities or bank repurchase agreements collateralized by these same securities. The fair values of these money market funds are established through quoted prices in active markets for identical assets (Level 1 inputs). The Company's cash in U.S. banks is insured by the Federal Deposit Insurance Corporation up to the insurable limit of \$250.

The Company had \$1.6 million and \$1.2 million of cash and cash equivalents in foreign bank accounts at September 30, 2018 and December 31, 2017, respectively. Included in such amounts are cash of \$1.4 million and \$1.0 million in China bank accounts at September 30, 2018 and December 31, 2017, respectively. As of September 30, 2018, the Company has no intentions of repatriating the cash in its foreign bank accounts in China. If the Company decides to repatriate the cash in the foreign bank accounts, it may experience difficulty in doing so in a timely manner. The Company may also be exposed to foreign currency fluctuations and taxes if it repatriates these funds. The Company is in process of liquidating its Israeli legal entity and will repatriate the cash net of taxes from the foreign bank account in Israel upon liquidation. The Company accounted for the tax impact of the repatriation of the Israel cash in 2017. The Company's cash in its foreign bank accounts is not insured.

Investments

At September 30, 2018, the Company's short-term investments consisted of U.S. government agency bonds, AA or higher rated corporate bonds, and certificates of deposit. At December 31, 2017, the Company's short-term investments consisted of pre-funded municipal bonds, U.S. government agency bonds, AA or higher rated corporate bonds, and certificates of deposit. All of the investments at September 30, 2018 and December 31, 2017 were classified as held-to-maturity. The bonds have original maturities greater than 90 days and mature in less than one year. The Company's bond investments are recorded at the purchase price and carried at amortized cost. The income and principal from the pre-refunded municipal bonds were secured by an irrevocable trust of U.S. Treasury securities. Approximately 8% of the Company's municipal bond investments were protected by bond default insurance at December 31, 2017. All of the municipal bonds matured during the quarter ended June 30, 2018.

Cash equivalents and investments were as follows at September 30, 2018 and December 31, 2017:

| | September 30, 2018 | | | | December 31, 2017 | | | |
|---|--------------------|-----------|---------|-----------|-------------------|-----------|---------|-----------|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Cash equivalents: | | | | | | | | |
| Corporate bonds | \$ 0 | \$ 1,971 | \$ 0 | \$ 1,971 | \$ 0 | \$ 1,350 | \$ 0 | \$ 1,350 |
| US government agency bonds | 0 | 330 | 0 | 330 | 0 | 249 | 0 | 249 |
| Certificates of deposit | 503 | 0 | 0 | 503 | 0 | 0 | 0 | 0 |
| Money market funds | 336 | 0 | 0 | 336 | 175 | 0 | 0 | 175 |
| Total Cash Equivalents | \$ 839 | \$ 2,301 | \$ 0 | \$ 3,140 | \$ 175 | \$ 1,599 | \$ 0 | \$ 1,774 |
| Investments: | | | | | | | | |
| Corporate bonds | 0 | 19,219 | 0 | 19,219 | 0 | 18,463 | 0 | 18,463 |
| Pre-refunded municipal bonds | 0 | 0 | 0 | 0 | 0 | 2,133 | 0 | 2,133 |
| US government agency bonds | 0 | 6,344 | 0 | 6,344 | 0 | 4,457 | 0 | 4,457 |
| Certificates of deposit | 6,207 | 0 | 0 | 6,207 | 7,446 | 0 | 0 | 7,446 |
| Total Investments | \$ 6,207 | \$ 25,563 | \$ 0 | \$ 31,770 | \$ 7,446 | \$ 25,053 | \$ 0 | \$ 32,499 |
| Cash equivalents and Investments - book value | \$ 7,046 | \$ 27,864 | \$ 0 | \$ 34,910 | \$ 7,621 | \$ 26,652 | \$ 0 | \$ 34,273 |
| Cash equivalents and Investments - fair value | \$ 7,045 | \$ 27,842 | \$ 0 | \$ 34,887 | \$ 7,622 | \$ 26,617 | \$ 0 | \$ 34,239 |

The Company categorizes its financial instruments within a fair value hierarchy according to accounting guidance for fair value. The fair value hierarchy is described under the Fair Value of Financial Instruments in Note 2. For the Level 2 investments, the Company uses quoted prices of similar assets in active markets. The fair values in the table above reflect net unrealized losses of \$23 and \$34 at September 30, 2018 and December 31, 2017, respectively.

5. Discontinued Operations

During the quarter ended June 30, 2017, the Company approved a plan to sell its Engineering Services business and shift its focus to research and development driven RF products. On July 31, 2017, the Company sold its Engineering Services business to Gabe's. The Company filed a Form 8-K related to the disposition on August 4, 2017.

The disposition met the requirements for classification as held for sale during the quarter ended June 30, 2017 because the disposition met all the criteria outlined in the accounting guidance. Due to the significance of the results during the years ended December 31, 2016, 2015, and 2014, and because this disposition represented a strategic shift by the Company to focus on products, the disposition of Engineering Services also qualified as a discontinued operation for reporting purposes. As such, the Company reported the results of its Engineering Services business as discontinued operations for the three and nine months ended June 30, 2017. There were no activities related to discontinued operations during the nine months ended September 30, 2018 other than transition services related to the billing for one customer. The Company completed the transition for billing as of June 30, 2018.

The Company sold the fixed assets and backlog of the Engineering Services business to Gabe's for \$1.45 million. At closing, the Company received \$1.4 million, consisting of \$1.3 million for the sale of the business and \$0.1 million related to future services. The Company recorded a pre-tax book gain of \$0.5 million in discontinued operations during the quarter ended September 30, 2017. The net pre-tax book gain included proceeds from the sale of assets minus the book value of the assets disposed as well as severance and related payroll benefits for terminated employees. The book value of the assets was \$0.6 million at the date of closing. On August 1, 2017, the Company terminated 25 employees, and Gabe's hired 11 of these employees. The severance and related benefits for the terminated employees who were not subsequently hired by Gabe's was \$0.2 million. The income tax gain was \$0.3 million, which included the tax value of the fixed assets and the remaining tax value for intangible assets no longer being used by the Company as of the sale to Gabe's. The Company retained working capital of approximately \$0.5 million, including accounts receivable, accounts payable, and accrued liabilities. There was no impairment loss recorded on the disposal of the long-lived assets because the fair value of the assets less cost to sell was higher than the carrying value of the assets.

The details of the discontinued operations within the Statement of Operations are as follows:

| | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2017 |
|---------------------------------------|--|---|
| Revenues | \$ 368 | \$ 3,725 |
| Cost of revenues | 415 | 3,974 |
| Gross profit | (47) | (249) |
| Operating expenses: | | |
| Sales and marketing | 51 | 400 |
| General and administrative | 4 | 31 |
| Restructuring expenses | 0 | 8 |
| Total operating expenses | 55 | 439 |
| Operating loss | (102) | (688) |
| Gain on sale | (503) | (503) |
| Net income (loss) before income taxes | 401 | (185) |
| Expense (benefit) for income taxes | 165 | (37) |
| Net income (loss) | \$ 236 | \$ (148) |

All the revenues and cost of revenues in discontinued operations related to services provided by the Company.

The details of the cash flows for discontinued operations are as follows:

| | | Nine Months Ended September 30, 2017 |
|---|-----------|---|
| Cash flows from discontinued operations: | | |
| Operating Activities: | | |
| Net loss | \$ | (148) |
| Gain on sale of assets | | (803) |
| Depreciation | | 197 |
| Deferred tax provision | | (37) |
| Stock compensation | | 49 |
| Prepaid expenses and other assets | | 2 |
| Accrued liabilities | | 43 |
| Net cash used in operating activities | \$ | (697) |
| Investing Activities: | | |
| Capital expenditures | \$ | (16) |
| Proceeds from sale of assets | | 1,450 |
| Net cash provided by investing activities | \$ | 1,434 |
| Net cash flows provided by discontinued operations | \$ | 737 |

6. Goodwill and Intangible Assets

Goodwill

There were no changes to goodwill during the three and nine months ended September 30, 2018. The \$3.3 million of goodwill on the balance sheet relates to the RF Solutions segment. There were no triggering events for the RF Solutions segment during the quarter ended September 30, 2018. The Company will continue to monitor goodwill for impairment going forward.

Due to the Company's reorganization in the third quarter 2018, its operations, engineering, business development, sales and marketing, and operational general and administrative functions were consolidated into a single enterprise-wide organizations. Since there are no longer reportable segments, the Company will not disclose segment information starting with the Form-10K for the year ended December 31, 2018. Beginning with the fourth quarter 2018, the Company will evaluate the goodwill based on the cash flows for the Test and Measurement product line. The revenues and gross margins will be specifically identified, and the operating expenses will be a combination of direct expenses and allocated expenses. The cash flows for Test and Measurement product line will only be prepared for testing goodwill and will not be reviewed by the Company's CODM.

Intangible Assets

The Company amortizes intangible assets with finite lives on a straight-line basis over the estimated useful lives, which range from one to six years. Amortization expense was approximately \$0.3 million for the three months ended September 30, 2018 and 2017, respectively, and \$0.8 million for the nine months ended September 30, 2018 and \$0.9 million for the nine months ended September 30, 2017, respectively. Amortization for technology assets is included in cost of revenues and amortization for all other intangible assets is included in operating expenses. For the three months ended September 30, 2018 and 2017, \$0.1 million of the intangible asset amortization was included in operating expenses and \$0.2 million of the amortization expense was included in cost of revenues. For the nine months ended September 30, 2018 and 2017, \$0.3 million of the intangible asset amortization was included in operating expenses and \$0.5 million of the amortization expense was included in cost of revenues.

The summary of other intangible assets, net is as follows:

| | September 30, 2018 | | | December 31, 2017 | | |
|--------------------------------------|--------------------|--------------------------|-----------------|-------------------|--------------------------|-----------------|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Customer contracts and relationships | \$ 16,880 | \$ 16,880 | \$ 0 | \$ 16,880 | \$ 16,880 | \$ 0 |
| Patents and technology | 10,114 | 9,170 | 944 | 10,114 | 8,670 | 1,444 |
| Trademarks and trade names | 4,834 | 4,559 | 275 | 4,834 | 4,335 | 499 |
| Other | 2,506 | 2,445 | 61 | 2,506 | 2,336 | 170 |
| Total | <u>\$ 34,334</u> | <u>\$ 33,054</u> | <u>\$ 1,280</u> | <u>\$ 34,334</u> | <u>\$ 32,221</u> | <u>\$ 2,113</u> |

The \$0.8 million decrease in the net book value of intangible assets at September 30, 2018 compared to December 31, 2017 relates to amortization expense for the nine months ended September 30, 2018.

The assigned lives and weighted average amortization periods by intangible asset category are summarized below:

| Intangible Assets | Assigned Life | Weighted Average Amortization Period |
|--------------------------------------|---------------|--------------------------------------|
| Customer contracts and relationships | 5 years | 5.0 |
| Patents and technology | 5 to 6 years | 5.1 |
| Trademarks and trade names | 5 to 6 years | 5.6 |
| Other | 1 to 6 years | 3.0 |

The Company's intangible amortization is scheduled through February 2020. The amortization expense for 2018 and the next two years is as follows:

| Fiscal Year | Amount |
|-------------|----------|
| 2018 | \$ 1,084 |
| 2019 | \$ 885 |
| 2020 | \$ 144 |

7. Balance Sheet Information

Accounts Receivable

Accounts receivable are recorded at invoiced amounts with standard net terms that range between 30 and 90 days. The Company extends credit to its customers based on an evaluation of a customer's financial condition and collateral is generally not required. The Company maintains an allowance for estimated uncollectible accounts receivable. The allowance is based on the Company's assessment of known delinquent accounts, historical experience, and other currently available evidence of the collectability and the aging of accounts receivable. The Company's allowance for doubtful accounts was \$0.3 million at September 30, 2018 and at December 31, 2017.

Inventories

Inventories are stated at the lower of cost or market and include material, labor and overhead costs using the first-in, first-out method of costing. Inventories as of September 30, 2018 and December 31, 2017 were composed of raw materials, sub-assemblies, finished goods and work-in-process. The Company had consigned inventory with customers of \$0.7 million and \$0.5 million at September 30, 2018 and December 31, 2017, respectively. The Company records allowances to reduce the value of inventory to the lower of cost or market, including allowances for excess and obsolete inventory. Reserves for excess inventory are calculated based on our estimate of inventory in excess of normal and planned usage. Obsolete reserves are based on our identification of inventory where the carrying value is above net realizable value. The allowance for inventory losses was \$3.1 million at September 30, 2018 and \$3.0 million at December 31, 2017.

Inventories consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|------------------|-----------------------|----------------------|
| Raw materials | \$ 7,179 | \$ 6,849 |
| Work-in-process | 1,111 | 962 |
| Finished goods | 4,401 | 4,945 |
| Inventories, net | <u>\$ 12,691</u> | <u>\$ 12,756</u> |

Prepaid and Other Current Assets

Prepaid assets are stated at cost and are amortized over the useful lives (up to one year) of the assets.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. The Company depreciates computer equipment over three to five years, office equipment, manufacturing and test equipment, and motor vehicles over five years, furniture and fixtures over seven years, and buildings over 30 years. Leasehold improvements are amortized over the shorter of the corresponding lease term or useful life. Depreciation expense and gains and losses on the disposal of property and equipment are included in cost of sales and operating expenses in the condensed consolidated statements of operations. Maintenance and repairs are expensed as incurred.

Property and equipment consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| Building | \$ 6,351 | \$ 6,351 |
| Computers and office equipment | 11,398 | 10,873 |
| Manufacturing and test equipment | 14,100 | 13,012 |
| Furniture and fixtures | 1,338 | 1,288 |
| Leasehold improvements | 1,521 | 1,444 |
| Motor vehicles | 20 | 20 |
| Total property and equipment | <u>34,728</u> | <u>32,988</u> |
| Less: Accumulated depreciation and amortization | (24,007) | (22,389) |
| Land | <u>1,770</u> | <u>1,770</u> |
| Property and equipment, net | <u>\$ 12,491</u> | <u>\$ 12,369</u> |

Depreciation and amortization expense was approximately \$0.7 million for the three months ended September 30, 2018 and 2017, respectively. Depreciation and amortization expense was approximately \$2.1 million and \$1.9 million for the nine months ended September 30, 2018 and 2017, respectively. Amortization for capital leases is included in depreciation and amortization expense. See Note 10 for information related to capital leases.

Liabilities

Accrued liabilities consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| Inventory receipts | \$ 1,261 | \$ 1,730 |
| Payroll, bonuses, and other employee benefits | 1,081 | 2,780 |
| Paid time off | 977 | 1,011 |
| Warranties | 380 | 382 |
| Professional fees and contractors | 172 | 155 |
| Customer refunds for estimated returns | 168 | 197 |
| Deferred revenues | 146 | 189 |
| Employee stock purchase plan | 139 | 314 |
| Income and sales taxes | 123 | 243 |
| Real estate taxes | 111 | 148 |
| Short-term obligations under capital leases | 102 | 97 |
| Other | 409 | 235 |
| Total | <u>\$ 5,069</u> | <u>\$ 7,481</u> |

Long-term liabilities consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|----------------|-----------------------|----------------------|
| Capital leases | \$ 147 | \$ 180 |
| Deferred rent | 109 | 89 |
| Other | 127 | 123 |
| Total | <u>\$ 383</u> | <u>\$ 392</u> |

8. Stock-Based Compensation

The condensed consolidated statements of operations include \$0.8 million and \$0.7 million of stock compensation expense for the three months ended September 30, 2018 and 2017, respectively. The condensed consolidated statements of operations include \$2.6 million and \$2.5 million of stock compensation expense for the nine months ended September 30, 2018 and 2017, respectively. The Company accounts for forfeitures as they occur.

The stock-based compensation expense by type is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|---------------|---------------------------------|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Service-based awards | \$ 730 | \$ 612 | \$ 2,404 | \$ 2,291 |
| Stock option and employee purchase plans | 56 | 49 | 168 | 167 |
| Total continuing operations | 786 | 661 | 2,572 | 2,458 |
| Discontinued operations | 0 | 0 | 0 | 49 |
| Total | <u>\$ 786</u> | <u>\$ 661</u> | <u>\$ 2,572</u> | <u>\$ 2,507</u> |

Total stock-based compensation is reflected in the condensed consolidated statements of operations as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------|----------------------------------|---------------|---------------------------------|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Cost of revenues | \$ (49) | \$ 67 | \$ 131 | \$ 200 |
| Research and development | 165 | 128 | 462 | 394 |
| Sales and marketing | 174 | 117 | 462 | 363 |
| General and administrative | 496 | 349 | 1,517 | 1,501 |
| Total continuing operations | 786 | 661 | 2,572 | 2,458 |
| Discontinued operations | 0 | 0 | 0 | 49 |
| Total | <u>\$ 786</u> | <u>\$ 661</u> | <u>\$ 2,572</u> | <u>\$ 2,507</u> |

Restricted Stock – Service Based

The Company grants restricted shares as employee and director incentives. When service-based restricted stock is granted, the Company records deferred stock compensation within additional paid in capital, representing the fair value of the common stock on the date the restricted shares are granted. The Company records stock compensation expense on a straight-line basis over the vesting period of the applicable service-based restricted shares. These grants vest over various periods. During the first quarter 2018, the Company issued 420,977 service-based restricted stock awards to employees that vest in equal annual increments over three years. During the second quarter 2018, the Company issued 60,998 restricted stock awards to the board of directors that vested upon issuance.

The following table summarizes service-based restricted stock activity for the nine months ended September 30, 2018:

| | Shares | Weighted Average Fair Value |
|--|------------------|-----------------------------------|
| Unvested Restricted Stock Awards - December 31, 2017 | 828,576 | \$ 5.66 |
| Shares awarded | 481,975 | 6.94 |
| Shares vested | (184,223) | 6.42 |
| Shares cancelled | (55,350) | 5.90 |
| Unvested Restricted Stock Awards - September 30, 2018 | 1,070,978 | \$ 6.10 |

The intrinsic value of service-based restricted shares that vested during the three months ended September 30, 2018 and 2017 was \$36 and \$1.3 million, respectively. The intrinsic value of service-based restricted shares that vested during the nine months ended September 30, 2018, and 2017 was \$0.8 million and \$2.5 million, respectively.

At September 30, 2018, total unrecognized compensation expense related to restricted stock was approximately \$3.4 million to be recognized through 2021 over a weighted average period of 1.4 years.

Restricted Stock Units – Service Based

The Company grants restricted stock units as employee incentives. Restricted stock units are primarily granted to foreign employees for long-term incentive purposes. Employee restricted stock units are service-based awards and are amortized over the vesting period. At the vesting date, these units are converted to shares of common stock. The Company records expense on a straight-line basis for restricted stock units.

The following table summarizes the restricted stock unit activity during the nine months ended September 30, 2018:

| | Shares | Weighted Average Fair Value |
|---|---------------|-----------------------------------|
| Unvested Restricted Stock Units - December 31, 2017 | 31,800 | \$ 5.47 |
| Units awarded | 5,500 | 7.05 |
| Units vested/Shares awarded | (4,087) | 5.79 |
| Units cancelled | (75) | 7.49 |
| Unvested Restricted Stock Units - September 30, 2018 | 33,138 | \$ 5.68 |

The intrinsic value of service-based restricted stock units that vested and were issued as shares during the nine months ended September 30, 2018 and 2017 was \$29 and \$40, respectively. No service-based restricted stock units vested during the three months ended September 30, 2018 or 2017.

As of September 30, 2018, the unrecognized compensation expense related to the unvested portion of the Company's restricted stock units was approximately \$0.1 million, to be recognized through 2021 over a weighted average period of 1.2 years.

Stock Options

The Company grants stock options to purchase common stock as long-term incentives. The exercise price of the stock options is no less than the fair value of the Company's stock on the grant date. The stock options have a seven-year life and generally vest over a period of four years, 25% after one year, and ratably on a monthly basis thereafter. Stock options may be exercised at any time prior

to their expiration date or within ninety days of termination of employment, or such shorter time as may be provided in the related stock option agreement.

A summary of the Company's stock option activity for the nine months ended September 30, 2018 is as follows:

| | Options Outstanding | Weighted Average Exercise Price |
|--|---------------------|--|
| Outstanding at December 31, 2017 | 470,484 | \$ 7.24 |
| Options granted | 2,000 | 6.98 |
| Options forfeited | (84) | 7.31 |
| Options cancelled/expired | (23,416) | 9.11 |
| Outstanding at September 30, 2018 | <u>448,984</u> | <u>\$ 7.15</u> |
| Exercisable at September 30, 2018 | <u>439,356</u> | <u>\$ 7.19</u> |

The range of exercise prices for options outstanding and exercisable at September 30, 2018, was \$5.00 to \$9.68. The following table summarizes information about stock options outstanding under all stock option plans:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | | |
|-----------------------------|-----------------------|--|---|-----------------------|--|--|
| | Number Outstanding | Weighted Average Contractual Life (Years) | Weighted- Average Exercise Price | Number Exercisable | Weighted Average Exercise Price | |
| \$ 5.00 — \$ 6.00 | 13,500 | 4.98 | \$ 5.05 | 6,582 | \$ 5.05 | |
| 6.00 — 7.00 | 9,189 | 2.25 | 6.75 | 7,189 | 6.69 | |
| 7.00 — 8.00 | 420,545 | 1.48 | 7.20 | 420,273 | 7.20 | |
| 8.00 — 9.00 | 5,000 | 3.03 | 8.14 | 4,562 | 8.14 | |
| 9.00 — 9.68 | 750 | 0.08 | 9.68 | 750 | 9.68 | |
| \$ 5.00 — \$ 9.68 | 448,984 | 1.62 | \$ 7.14 | 439,356 | \$ 7.17 | |

The weighted average contractual life and intrinsic value of options outstanding and options exercisable at September 30, 2018, was the following:

| | Weighted Average Contractual Life (years) | Intrinsic Value |
|----------------------------|--|--------------------|
| Options Outstanding | 1.62 | \$ 0 |
| Options Exercisable | 1.54 | \$ 0 |

The intrinsic value is based on the share price of \$4.65 at September 30, 2018.

There were 2,000 stock options granted during the nine months ended September 30, 2018. The Company calculated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model based upon the following assumptions during the nine months ended September 30, 2018:

| | September 30, 2018 |
|--------------------------|-----------------------|
| Dividend yield | 3.2% |
| Risk-free interest rate | 2.4% |
| Expected volatility | 33% |
| Expected life (in years) | 3.7 |

The fair value of each stock option outstanding was estimated on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics significantly different

from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models may not necessarily provide a reliable single measure of the fair value of the employee stock options. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility and expected option life.

The dividend yield rate was calculated by dividing the Company’s annual dividend by the closing price on the grant date. The risk-free interest rate was based on the U.S. Treasury yields with a remaining term that approximates the expected life of the options granted. The expected volatility was based on a five-year historical period of the Company’s stock price. The expected life for options granted was based on historical data of employee exercise performance. The Company records expense based on the graded vesting method.

As of September 30, 2018, the unrecognized compensation expense related to the unvested portion of the Company’s stock options was approximately \$8, to be recognized through 2021 over a weighted average period of 1.3 years.

Performance-based Equity Awards

The Company had 95,500 and 110,500 unvested performance awards at September 30, 2018 and December 31, 2017, respectively. There were 15,000 cancelled performance awards during the nine months ended September 30, 2018 due to employee separations. As of September 30, 2018, the Company does not expect any of the outstanding performance awards to vest.

Short-term incentive plan

Incentive awards earned by certain executives and key managers under the Company’s 2018 short-term incentive plan (“STIP”) will be settled 50% in cash and 50% in shares of the Company’s stock for certain executives. The incentive awards for all other participants under the 2018 STIP will be 100% in cash. All incentive awards earned under the 2017 STIP were paid in cash. The Company has not recorded any expense related to the 2018 STIP because it does not believe that the performance thresholds will be met.

Employee Stock Purchase Plan (“ESPP”)

The ESPP enables eligible employees to purchase common stock at the lower of 85% of the fair market value of the common stock on the first or last day of each offering period. Each offering period is approximately six months. The Company received proceeds of \$0.4 million from the issuance of 68,212 shares under the ESPP in February 2018 and received proceeds of \$0.3 million from the issuance of 72,218 shares under the ESPP in February 2017. The Company received proceeds of \$0.3 million from the issuance of 88,583 shares under the ESPP in August 2018 and received proceeds of \$0.3 million from the issuance of 67,383 shares under the ESPP in August 2017.

Based on the 15% discount and the fair value of the option feature of the ESPP, it is considered compensatory. Compensation expense is calculated using the fair value of the employees’ purchase rights under the Black-Scholes model.

The Company calculated the fair value of each employee stock purchase grant on the date of grant using the Black-Scholes option-pricing model using the following assumptions:

| | Employee Stock Purchase Plan | |
|--------------------------|-------------------------------------|-------------|
| | 2018 | 2017 |
| Dividend yield | 3.2% | 3.8% |
| Risk-free interest rate | 2.1% | 0.8% |
| Expected volatility | 33% | 33% |
| Expected life (in years) | 0.5 | 0.5 |

The dividend yield rate was calculated by dividing the Company’s annual dividend by the closing price on the grant date. The risk-free interest rate was based on the U.S. Treasury yields with a remaining term that approximates the expected life of the options granted. The volatility was based on a five-year historical period of the Company’s stock price. The expected life was based on the offering period.

Board of Director Equity Awards

The Company grants shares of the Company's stock under the PCTEL, Inc. Stock Plan to members of its Board of Directors as an annual retainer for committee service. These awards vest upon issuance. New directors receive a one-time grant that vests over three years. In June, 2018, the Company issued 60,988 shares of the Company's stock with a fair value of \$0.4 million. In June, 2017, the Company issued 52,786 shares of the Company's stock with a fair value of \$0.4 million.

Employee Withholding Taxes on Stock Awards

For ease in administering the issuance of stock awards, the Company holds back shares of vested restricted stock awards and short-term incentive plan stock awards for the value of the statutory withholding taxes. For each individual receiving a share award, the Company redeems the shares it computes as the value for the withholding tax and remits this amount to the appropriate tax authority. For withholding taxes related to stock awards, the Company paid \$0.3 million and \$1.2 million during the nine months ended September 30, 2018 and 2017, respectively.

9. Benefit Plans

Employee Benefit Plans

The Company's 401(k) plan covers all of the U.S. employees beginning the first day of the month following the first month of their employment. Under this plan, employees may elect to contribute up to 15% of their current compensation to the 401(k) plan up to the statutorily prescribed annual limit. The Company matches employee contributions up to 4%, and may also make discretionary contributions to the 401(k) plan. The Company also contributes to various retirement plans for foreign employees.

The Company's contributions to retirement plans were as follows:

| | <u>Three Months Ended September 30,</u> | | <u>Nine Months Ended September 30,</u> | |
|---|---|---------------|--|---------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| PCTEL, Inc. 401(k) profit sharing plan - US employees | \$ 158 | \$ 173 | \$ 523 | \$ 533 |
| Defined contribution plans - foreign employees | 137 | 117 | 400 | 325 |
| Total | <u>\$ 295</u> | <u>\$ 290</u> | <u>\$ 923</u> | <u>\$ 858</u> |

10. Commitments and Contingencies

Restructuring -Discontinued Operations

During the first quarter 2016, the Company exited from its Colorado office in order to consolidate facility space and recorded restructuring expense for the remaining obligations under the lease, net of proceeds for a sublease. The Company signed a sublease for the office space in the second quarter 2017. In July 2017, the Engineering Services business was sold to Gabe's Construction. The activity related to Engineering Services is reported as discontinued operations for the three and nine months ended September 30, 2017. The obligation for the Colorado lease was retained by the Company. See Note 5 for additional information related to discontinued operations.

The following table summarizes the restructuring activity during the nine months ended September 30, 2018 and the status of the reserves at September 30, 2018:

| | <u>Lease Terminations</u> |
|--------------------------------|-------------------------------|
| Balance at December 31, 2017 | \$ 116 |
| Restructuring expense | 0 |
| Payments for lease | (100) |
| Payments received for sublease | 72 |
| Balance at September 30, 2018 | <u>\$ 88</u> |

The restructuring liability is recorded on the balance sheet at September 30, 2018 and December 31, 2017 as follows:

| | September 30, 2018 | December 31, 2017 |
|-----------------------|-----------------------|----------------------|
| Accrued liabilities | \$ 37 | \$ 35 |
| Long-term liabilities | 51 | 81 |
| Total | <u>\$ 88</u> | <u>\$ 116</u> |

Operating Leases

The Company has operating leases for facilities through 2025 and office equipment through 2021. The future minimum rental payments as of September 30, 2018 are as follows:

| Year | Amount |
|-------------------------------|-----------------|
| 2018 | \$ 306 |
| 2019 | 1,130 |
| 2020 | 518 |
| 2021 | 145 |
| 2022 | 146 |
| Thereafter | 268 |
| Future minimum lease payments | <u>\$ 2,513</u> |

The rent expense under leases was \$0.3 million and \$0.2 million for the three months ended September 30, 2018, and 2017, respectively, and was \$0.8 million and \$0.7 million for the nine months ended September 30, 2018 and 2017, respectively.

In August 2017, the Company executed a new seven-year lease for 5,977 square feet of office space in Akron, Ohio for wireless product development. The annual lease obligation pursuant to the lease agreement is approximately \$0.1 million. The Company assumed occupancy of this office in March 2018.

In April 2018, the Company extended its lease of its first-floor facility space in Tianjin, China. The total lease obligation pursuant to the lease agreement is approximately \$0.1 million. The lease expires in October 2020 which is consistent with the expiration for the second-floor facility lease.

During the first quarter 2016, the Company vacated its Colorado office lease in order to consolidate facility space related to our Engineering Services reporting unit. In May 2017, the Company signed a sublease with a term through the lease termination date. The lease expires on October 31, 2020. See discussion related to the Colorado office in the restructuring section of this Note 10.

Capital Leases

The Company has capital leases for office equipment. The net book values for assets under capital leases were as follows:

| | September 30, 2018 | December 31, 2017 |
|--------------------------|-----------------------|----------------------|
| Cost | \$ 502 | \$ 453 |
| Accumulated Depreciation | (261) | (195) |
| Net Book Value | <u>\$ 241</u> | <u>\$ 258</u> |

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments due in each year:

| Year | Amount |
|---|---------------|
| 2018 | \$ 29 |
| 2019 | 98 |
| 2020 | 61 |
| 2021 | 48 |
| 2022 | 23 |
| Thereafter | 7 |
| Total minimum payments required | 266 |
| Less: amount representing interest | 17 |
| Present value of net minimum lease payments | <u>\$ 249</u> |

Warranty Reserve and Sales Returns

The Company allows its major distributors and certain other customers to return unused product under specified terms and conditions. The Company accrues for product returns based on historical sales and return trends. The refund liability related to estimated sales returns was \$0.2 million at September 30, 2018 and December 31, 2017, respectively, and is included within accrued liabilities on the accompanying condensed consolidated balance sheets.

The Company offers repair and replacement warranties of up to five years for certain antenna products and scanning receiver products. The Company's warranty reserve is based on historical sales and costs of repair and replacement trends. The warranty reserve was \$0.4 million at September 30, 2018 and at September 30, 2017, and is included in other accrued liabilities in the accompanying condensed consolidated balance sheets.

| | Nine Months Ended September 30, | | | |
|---------------------------|---------------------------------|------------|------|------------|
| | 2018 | | 2017 | |
| Beginning balance | \$ | 382 | \$ | 394 |
| Provisions for warranties | | 74 | | 99 |
| Consumption of reserves | | (76) | | (75) |
| Ending balance | \$ | <u>380</u> | \$ | <u>418</u> |

11. Income Taxes

On December 22, 2017, the United States federal government enacted the Tax Cuts and Jobs Act ("Tax Act"), marking a change from a worldwide tax system to a modified territorial tax system in the United States. As part of this change, the Tax Act provides for a transition tax on the accumulated unremitted foreign earnings and profits of foreign subsidiaries ("Transition Tax"), a reduction of the U.S. federal corporate income tax rate from 34% to 21%, and an indefinite carryforward of net operating losses ("NOLs") incurred in 2018 and future periods.

In response to the enactment of the Tax Act in late 2017, the SEC issued Staff Accounting Bulletin No. 118 ("SAB 118") to address situations where the accounting is incomplete for certain income tax effects of the Tax Act at the time of issuance of an entity's financial statements for the reporting period in which the Tax Act was enacted. Under SAB 118, a company may record provisional amounts during a measurement period for specific income tax effects of the Tax Act for which the accounting is incomplete, but a reasonable estimate can be determined, and when unable to determine a reasonable estimate for any income tax effects, report provisional amounts in the first reporting period in which a reasonable estimate can be determined. The measurement period should not extend beyond one year.

To determine the amount of the Transition Tax, the Company determined, in addition to other factors, the amount of post-1986 earnings and profits of relevant subsidiaries, as well as the amount of non-U.S. income taxes paid on such earnings. At December 31, 2017, the Company recorded provisional income tax expense of \$0.6 million related to the deemed repatriation of the accumulated unremitted earnings and profits of the Company's foreign subsidiaries. This provisional amount was based on information that was available at the time, including estimated tax earnings and profits from foreign subsidiaries. In September 2018, the Company adjusted the accounting for the effects of the Transition Tax, in accordance with the guidance from the I.R.S., states, and other government agencies. The Company recorded an adjustment of \$0.1 million to deferred tax assets related to the Transition Tax for federal income taxes. The Company plans to finalize the Transition Tax at December 31, 2018. Because the Company's 2017 taxable

loss was in excess of \$2.5 million before the inclusion of the Section 965 Income, no cash was paid, and no installment payment plan is required.

The Tax Act also includes a provision designed to tax global intangible low taxed income ("GILTI"). Under the provision, a U.S. shareholder is required to include in gross income the amount of its GILTI, which is generally the net income of its controlled foreign corporations in excess of a 10% return on depreciable tangible assets after identification of other income subject to non-deferral rules. Under U.S. GAAP, the Company is allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the "period cost method") or (2) factoring such amounts into the Company's measurement of its deferred taxes (the "deferred method"). Due to the complexity of the new GILTI tax rules and uncertainty of the application of the foreign tax credit rules in relation to GILTI, the Company is continuing to evaluate this provision of the Tax Act. As of September 30, 2018, the Company does not expect to have a GILTI inclusion for 2018.

The Company recorded an income tax benefit of \$0.5 million and \$1.0 million for the three and nine months ended September 30, 2018, respectively. The benefit recorded for the three and nine months ended September 30, 2018 differed from the statutory rate of 21% because the Company did not record income tax benefits for losses with finite lives such as state net operating losses and due to permanent differences. The Company recorded an income tax expense of \$0.2 million for the three months ended September 30, 2017 and an income tax benefit of \$0.1 million for the nine months ended September 30, 2017. The net tax benefit for the nine months ended September 30, 2017 differed from the statutory rate of 34% due to the combination of U.S. pretax losses and foreign pretax profits taxed at lower rates. The net tax benefit for the nine months ended September 30, 2017 included a \$0.2 million income tax benefit related to state rate and apportionment changes and a \$0.1 million income tax benefit related to previously unrecognized tax benefits for research credits.

The Company had deferred tax assets net of deferred tax liabilities of \$8.7 million and \$7.7 million at September 30, 2018 and at December 31, 2017, respectively, virtually all of which are related to the United States tax jurisdiction. The Company's gross deferred tax assets consist of NOLs and credits as well as timing differences. The Company's NOLs and credits generated as of December 31, 2017 have a finite life primarily based on the 20-year carry forward of federal net operating losses. The timing differences have a ratable reversal pattern over 12 years.

On a regular basis, the Company evaluates the recoverability of deferred tax assets and the need for a valuation allowance. Such evaluations involve the application of significant judgment. The Company considers multiple factors in its evaluation of the need for a valuation allowance. The Company's valuation allowance against its deferred tax assets was \$5.4 million and \$5.2 million at September 30, 2018 and December 31, 2017, respectively. For the deferred tax assets related to federal NOLs generated through 2017 research credits and all state NOLs, the Company believes that it is more likely than not that these deferred tax assets will not be realized based on the negative evidence of a cumulative three-year loss through September 30, 2018 and expiration of these NOLs. The Company does not have a valuation allowance on its deferred tax assets related to timing differences or federal NOLs generated in 2018 because the losses can be carried forward indefinitely. The analysis that the Company prepared to determine the valuation allowance required significant judgment and assumptions regarding future market conditions as well as forecasts for profits, taxable income, and taxable income by jurisdiction. Due to the sensitivity of the analysis, changes to the assumptions in subsequent periods could have a material effect on the valuation allowance.

The Company's gross unrecognized tax benefit was \$0.7 million at September 30, 2018 and at December 31, 2017.

The Company files a consolidated federal income tax return, income tax returns with various states, and foreign income tax returns in various foreign jurisdictions. The Company's U.S. federal tax returns remain subject to examination for 2015 and subsequent periods. The Company's U.S. state tax returns remain subject to examination for 2012 and subsequent periods. The Company's foreign tax returns remain subject to examination for 2010 and subsequent periods.

12. Segment, Customer and Geographic Information

In August 2018, the Company announced a reorganization of its organizational structure to drive growth and address the convergence in the industrial IoT, public safety, and 4G infrastructure markets and the emergence of new technologies such as 5G. The Company's operations, engineering, business development, sales and marketing, and operational general and administrative functions were consolidated into a single enterprise-wide organization. Changes in the organizational structure that were initiated in the third quarter 2018 resulted in the CODM assessing operating profits and identified assets at the enterprise level for resource allocations. All operating profit and cash flows are measured and managed at the total Company level.

Prior to the reorganization, PCTEL operated in two segments for reporting purposes, Connected Solutions and RF Solutions. The Company's CODM assessed operating profits and identified assets for the Connected Solutions and RF Solutions segments for resource allocations. Each segment had its own segment manager as well as its own engineering, business development, sales and marketing, and operational general and administrative functions. All of the Company's accounting and finance, human resources, IT and legal functions are provided on a centralized basis through the corporate function. The Company managed its balance sheet and

cash flows centrally at the corporate level, with the exception of trade accounts receivable and inventory which were managed at the segment level. Each of the segment managers reported to and maintained regular contact with the CODM to discuss operating activities, financial results, forecasts, or plans for the segment.

Because the reorganization occurred during the third quarter 2018, this report has been prepared under the segment reporting structure that was in effect for all of 2017 and through August 2018. Beginning with the Form 10-K for the year ended December 31, 2018, the Company will not report any segment information. The Company will report revenue and gross profit for its two major product lines, Antenna Products and Test and Measurement Products.

The following tables are the segment operating profits and cash flow information for the three and nine months ended September 30, 2018 and 2017, respectively, and the segment balance sheet information as of September 30, 2018 and December 31, 2017:

| | Three Months Ended September 30, 2018 | | | |
|--|---------------------------------------|--------------|------------|------------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| REVENUES | \$ 14,877 | \$ 3,556 | \$ (7) | \$ 18,426 |
| GROSS PROFIT | \$ 4,504 | \$ 2,201 | \$ 16 | \$ 6,721 |
| OPERATING INCOME (LOSS) FOR CONTINUING OPERATIONS | \$ 859 | \$ (1,047) | \$ (2,190) | \$ (2,378) |
| Depreciation | \$ 513 | \$ 136 | \$ 59 | \$ 708 |
| Intangible amortization | \$ 0 | \$ 252 | \$ 0 | \$ 252 |
| Capital expenditures | \$ 560 | \$ 113 | \$ 13 | \$ 686 |

| | Nine Months Ended September 30, 2018 | | | |
|--|--------------------------------------|--------------|------------|------------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| REVENUES | \$ 50,120 | \$ 11,691 | \$ (72) | \$ 61,739 |
| GROSS PROFIT | \$ 14,734 | \$ 7,627 | \$ 23 | \$ 22,384 |
| OPERATING INCOME (LOSS) FOR CONTINUING OPERATIONS | \$ 3,994 | \$ (1,772) | \$ (7,423) | \$ (5,201) |
| Depreciation | \$ 1,504 | \$ 407 | \$ 177 | \$ 2,088 |
| Intangible amortization | \$ 78 | \$ 755 | \$ 0 | \$ 833 |
| Capital expenditures | \$ 1,858 | \$ 275 | \$ 72 | \$ 2,205 |

| | As of September 30, 2018 | | | |
|-----------------------------|--------------------------|--------------|-----------|-----------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| Accounts receivable | \$ 10,537 | \$ 2,724 | \$ 0 | \$ 13,261 |
| Inventories | \$ 11,388 | \$ 1,303 | \$ 0 | \$ 12,691 |
| Long-lived assets: | | | | |
| Property and equipment, net | \$ 10,373 | \$ 1,342 | \$ 776 | \$ 12,491 |
| Goodwill | \$ 0 | \$ 3,332 | \$ 0 | \$ 3,332 |
| Intangible assets, net | \$ 0 | \$ 1,280 | \$ 0 | \$ 1,280 |
| Deferred tax assets, net | \$ 0 | \$ 0 | \$ 8,685 | \$ 8,685 |
| Other noncurrent assets | \$ 0 | \$ 0 | \$ 52 | \$ 52 |

| | Three Months Ended September 30, 2017 | | | |
|---|---------------------------------------|---------------|-------------------|---------------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| REVENUES | \$ 17,988 | \$ 5,739 | \$ (62) | \$ 23,665 |
| GROSS PROFIT | 6,148 | 4,006 | (4) | 10,150 |
| OPERATING INCOME (LOSS) FROM CONTINUING OPERATIONS | <u>\$ 2,684</u> | <u>\$ 883</u> | <u>\$ (2,674)</u> | <u>\$ 893</u> |
| Depreciation | \$ 437 | \$ 140 | \$ 74 | \$ 651 |
| Intangible amortization | \$ 39 | \$ 252 | \$ 0 | \$ 291 |
| Capital expenditures | \$ 437 | \$ 103 | \$ 13 | \$ 553 |

| | Nine Months Ended September 30, 2017 | | | |
|---|--------------------------------------|-----------------|-------------------|---------------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| REVENUES | \$ 52,125 | \$ 16,157 | \$ (146) | \$ 68,136 |
| GROSS PROFIT | 17,283 | 11,275 | 8 | 28,566 |
| OPERATING INCOME (LOSS) FROM CONTINUING OPERATIONS | <u>\$ 6,775</u> | <u>\$ 2,319</u> | <u>\$ (8,516)</u> | <u>\$ 578</u> |
| Depreciation | \$ 1,288 | \$ 419 | \$ 206 | \$ 1,913 |
| Intangible amortization | \$ 117 | \$ 755 | \$ 0 | \$ 872 |
| Capital expenditures | \$ 1,294 | \$ 388 | \$ 415 | \$ 2,097 |

| | As of December 31, 2017 | | | |
|-----------------------------|-------------------------|--------------|-----------|-----------|
| | Connected Solutions | RF Solutions | Corporate | Total |
| Accounts receivable | \$ 13,158 | \$ 5,466 | \$ 0 | \$ 18,624 |
| Inventories | \$ 11,418 | \$ 1,338 | \$ 0 | \$ 12,756 |
| Long-lived assets: | | | | |
| Property and equipment, net | \$ 10,161 | \$ 1,300 | \$ 908 | \$ 12,369 |
| Goodwill | \$ 0 | \$ 3,332 | \$ 0 | \$ 3,332 |
| Intangible assets, net | \$ 78 | \$ 2,035 | \$ 0 | \$ 2,113 |
| Deferred tax assets, net | \$ 0 | \$ 0 | \$ 7,734 | \$ 7,734 |
| Other noncurrent assets | \$ 0 | \$ 0 | \$ 72 | \$ 72 |

The Company's revenue to customers by geographic location, as a percent of total revenues, is as follows:

| Region | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------|----------------------------------|------|---------------------------------|------|
| | 2018 | 2017 | 2018 | 2017 |
| Asia Pacific | 17% | 17% | 17% | 19% |
| Europe, Middle East, & Africa | 13% | 9% | 11% | 8% |
| Other Americas | 5% | 8% | 4% | 6% |
| Total Foreign sales | 35% | 34% | 32% | 33% |

The following table represents the customers that accounted for 10% or more of revenues during the three and nine months ended September 30, 2018 and 2017.

| Revenues | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------|----------------------------------|------|---------------------------------|------|
| | 2018 | 2017 | 2018 | 2017 |
| Customer A | 8% | 10% | 9% | 9% |

The following table represents the customer that accounted for 10% or more of total trade accounts receivable at September 30, 2018 and December 31, 2017.

| Trade Accounts Receivable | September 30, 2018 | December 31, 2017 |
|---------------------------|--------------------|-------------------|
| Customer B | 8% | 12% |

13. Revenue from Contracts with Customers

Under Topic 606, a contract with a customer is an agreement which both parties have approved, that creates enforceable rights and obligations, has commercial substance, and has identified payment terms, and for which collectability is probable. Once the Company has entered into a contract, it is evaluated to identify performance obligations. For each performance obligation, revenue is recognized as control of promised goods or services transfers to the customer in an amount that reflects the consideration the Company expects to receive in exchange for those goods or services. The amount of revenue recognized takes into account variable consideration, such as returns and volume rebates. A majority of the Company's revenue is short cycle in nature with shipments within one year from order. The Company's payment terms generally range between 30 to 90 days.

All of the Company's revenue relates to contracts with customers. The Company's accounting contracts are from purchase orders or purchase orders combined with purchase agreements. The majority of the Company's revenue is recognized on a "point-in-time" basis and a nominal amount of revenue is recognized "over time". For the sale of antenna products and test and measurement products, the Company satisfies its performance obligations generally at the time of shipment, or upon delivery based on the contractual terms with its customers. For products shipped on consignment, the Company recognizes revenue upon delivery from the consignment location. For its test and measurement software tools, the Company has a performance obligation to provide software maintenance and support for one year. The Company recognizes revenues for the maintenance and support over this period.

The Company considers shipping and handling performed by the Company as fulfillment activities. Amounts billed for shipping and handling are included in revenues, while costs incurred for shipping and handling are included in cost of revenues. The Company excludes taxes from the transaction price. Cost of contracts include sales commissions. The Company expenses the cost of contracts when incurred because the amortization period is one year or less.

The Company allows its major distributors and certain other customers to return unused product under specified terms and conditions. The Company estimates product returns based on historical sales and return trends and records a corresponding refund liability. The refund liability was \$0.2 million at September 30, 2018 and December 31, 2017, respectively, and is included within accrued liabilities on the accompanying condensed consolidated balance sheets. The December 31, 2017 refund liability was reclassified from accounts receivable to accrued liabilities for consistency with the current year presentation. Additionally, the Company recorded an asset based on historical experience for the amount of product we expect to return to inventory as a result of the return, which is recorded in inventories in the condensed consolidated balance sheets. The product return asset was \$0.1 million at September 30, 2018 and December 31, 2017.

There were no contract assets at September 30, 2018 or December 31, 2017. The Company records contract liabilities for deferred revenue and customer prepayments. Contract liabilities are recorded in accrued liabilities in the condensed consolidated balance sheets. The contract liability was \$0.2 million and \$0.3 million at September 30, 2018 and December 31, 2017, respectively. The Company recognized revenue of \$0.1 million and \$0.2 million during the three and nine months ended September 30, 2018, respectively, related to contract liabilities at the beginning of the period.

14. Subsequent Events

The Company evaluates subsequent events occurring between the most recent balance sheet date and the date that the financial statements are available to be issued in order to determine whether the subsequent events are to be recorded and/or disclosed in the Company's financial statements and footnotes. The financial statements are considered to be available to be issued at the time that they are filed with the SEC. There were no other subsequent events or transactions that required recognition or disclosure in the unaudited interim condensed consolidated financial statements.

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

The following information should be read in conjunction with the unaudited interim condensed consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and in conjunction with the consolidated financial statements for the year ended December 31, 2017 contained in our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"). Except for historical information, the following discussion contains forward looking statements that involve risks and uncertainties, including statements regarding our anticipated revenues, profits, costs and expenses and revenue mix. These forward-looking statements include, among others, those statements including the words "may," "will," "plans," "seeks," "expects," "anticipates," "intends," "believes" and words of similar meaning. Such statements constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. No undue reliance should be placed on these forward-looking statements. Our actual results could differ materially from those projected in these forward-looking statements.

Our third quarter 2018 revenues of \$18.4 million decreased by \$5.2 million or 22.1% compared to revenues of \$23.7 million for the same period in 2017. Revenues decreased for the Connected Solutions segment by \$3.1 million or 17.3% and decreased for the RF Solutions segment by \$2.2 million or 38.0% compared to the third quarter 2017. For the third quarter 2018, we recorded an operating loss of \$2.4 million compared to operating profit of \$0.9 million in the third quarter 2017. Revenues for the nine months ended September 30, 2018 of \$61.7 million declined by \$6.4 million or 9.4% compared to revenues of \$68.1 million for the same period in 2017. Revenues declined in the RF Solutions segment by \$4.5 million or 27.6% and revenues declined in the Connected Solutions segment by \$2.0 million or 3.8%. For the nine months ended September 30, 2018, we recorded an operating loss of \$5.2 million compared to operating profit of \$0.6 million during the same period in 2017. During the three months ended September 30, 2018, we recorded \$0.7 million in restructuring expenses related to the reorganization of the Company. Restructuring expenses included \$0.2 million in cost of revenues and \$0.5 million in operating expenses, primarily related to employee severance and related benefits for U.S. headcount reductions.

The decrease in revenues for the RF Solutions segment for the three and nine months ended September 30, 2018 was primarily due to lower capital spending by U.S. carriers and also lower revenues in the Asia Pacific region because 2017 included some larger projects in China. For the three months ended September 30, 2018, the decrease in revenues for the Connected Solutions segment was due to lower sales in the industrial and public safety vertical markets. For the nine months ended September 30, 2018, the decrease in revenues for the Connected Solutions segment was due to lower sales in the industrial and public safety vertical markets, offset by increased sales in the Enterprise Wi-Fi vertical market. The operating loss for both the three and nine months ended September 30, 2018 was primarily the result of the negative gross margin impact of lower revenues generated by the RF Solutions segment and a lower gross margin percentage for the Connected Solutions segment. Operating expenses were lower for the nine months ended September 30, 2018 compared to the same period in 2017 as lower general and administrative expenses offset higher research and development expenses.

Introduction

PCTEL delivers Performance Critical **TE**lecom technology solutions to the wireless industry. We are a leading global supplier of wireless network antenna and testing solutions. The Connected Solutions segment designs and manufactures precision antennas. PCTEL antennas are deployed in small cells, enterprise Wi-Fi access points, fleet management and transit systems, and in network equipment and devices for the Industrial Internet of Things. The RF Solutions segment provides test tools that improve the performance of wireless networks globally. Mobile operators, neutral hosts, and equipment manufacturers rely on PCTEL to analyze, design, and optimize next generation wireless networks.

Effective August 2018, we consolidated our organizational structure. Our operations, engineering, business development, sales and marketing, and operational general and administrative functions were consolidated into a single enterprise-wide organizations. As a result of the reorganization that occurred in the third quarter 2018, our Chief Executive Officer, as the CODM, began assessing operating profits and identified assets at the enterprise level for resource allocations, and instead of segment managers, the Chief Operating Officer began reporting to and maintaining regular contact with the CODM to discuss operating activities, financial results, forecasts, and plans for the entire business. All operating profit and cash flows are measured and managed at the enterprise level.

Until the reorganization, PCTEL operated in two segments for reporting purposes, Connected Solutions and RF Solutions. Our CODM assessed operating profits and identified assets for the Connected Solutions and RF Solutions segments for resource allocations. Each segment had its own segment manager as well as its own engineering, business development, sales and marketing, and operational general and administrative functions. We managed our balance sheet and cash flows centrally at the corporate level, with the exception of trade accounts receivable and inventory which was managed at the segment level. Each of the segment managers reported to and maintained regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, and plans for the segment. All of our accounting and finance, human resources, information technology ("IT") and legal functions were provided on a centralized basis through the corporate function.

Because the reorganization occurred during the third quarter 2018, this report has been prepared under the segment reporting structure that was in effect for all of 2017 and through August of 2018. Beginning with the Form 10-K for the year ended December 31, 2018, we will not report any segment information. We will report revenue and gross profit for our two major product lines, Antenna Products and Test and Measurement Products.

Generally, revenue growth for the Connected Solutions segment is driven by the increased use of wireless communications and increased complexity trends occurring in these markets. PCTEL antennas are primarily sold to original equipment manufacturers (“OEM”) providers where they are designed into the customer’s solution. PCTEL maintains expertise in several technology areas in order to be competitive in the antenna market. These include radio frequency engineering, mobile antenna design and manufacturing, mechanical engineering, product quality and testing, and wireless network engineering.

Generally, revenue growth for the RF Solutions segment is driven by the implementation and roll out of new wireless technology standards (i.e., 3G to 4G, 4G to 5G, etc.). PCTEL test equipment is sold directly to wireless carriers or to OEMs who integrate our products into their solution, which is then sold to wireless carriers. PCTEL maintains expertise in several technology areas in order to be competitive in the test tool market. These include radio frequency engineering, digital signal processing engineering, manufacturing, mechanical engineering, product quality and testing, and wireless network engineering.

Results of Operations
Three and Nine Months Ended September 30, 2018 and 2017
(in thousands)

Revenues by Segment

| | 2018 | Three Months Ended September 30, 2017 | \$ Change | % Change |
|----------------------------|------------------|--|-------------------|----------------|
| Connected Solutions | \$ 14,877 | \$ 17,988 | \$ (3,111) | -17.3% |
| RF Solutions | 3,556 | 5,739 | (2,183) | -38.0% |
| Corporate | (7) | (62) | 55 | not meaningful |
| Total | <u>\$ 18,426</u> | <u>\$ 23,665</u> | <u>\$ (5,239)</u> | <u>-22.1%</u> |

| | 2018 | Nine Months September 30, 2017 | \$ Change | % Change |
|----------------------------|------------------|-----------------------------------|-------------------|----------------|
| Connected Solutions | \$ 50,120 | \$ 52,125 | \$ (2,005) | -3.8% |
| RF Solutions | 11,691 | 16,157 | (4,466) | -27.6% |
| Corporate | (72) | (146) | 74 | not meaningful |
| Total | <u>\$ 61,739</u> | <u>\$ 68,136</u> | <u>\$ (6,397)</u> | <u>-9.4%</u> |

Revenues decreased 22.1% for the three months ended September 30, 2018 and decreased 9.4% for the nine months ended September 30, 2018 compared to the same periods in 2017. For the three months ended September 30, 2018, the decrease in revenues for the Connected Solutions segment was due to lower sales in the industrial and fleet vertical markets. For the nine months ended September 30, 2018, the decrease in revenues for the Connected Solutions segment was due to lower sales in the industrial and public safety vertical markets, offset by increased sales in the Enterprise Wi-Fi vertical market. Revenues for the RF Solutions segment decreased 38.0% and 27.6% for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017 primarily due to lower capital spending by U.S. carriers for legacy 4G wireless systems in preparation for the capital expenditures required for 5G deployments. RF Solutions revenues were also lower in the Asia Pacific region because 2017 included some large projects in China.

Gross Profit by Segment

| | 2018 | % of Revenues | 2017 | % of Revenues | Change Basis Points | % |
|----------------------------|-----------------|----------------|------------------|----------------|------------------------|--------------|
| Connected Solutions | \$ 4,504 | 30.3% | \$ 6,148 | 34.2% | (390) | -3.9% |
| RF Solutions | 2,201 | 61.9% | 4,006 | 69.8% | (790) | -7.9% |
| Corporate | 16 | not meaningful | (4) | not meaningful | | |
| Total | <u>\$ 6,721</u> | <u>36.5%</u> | <u>\$ 10,150</u> | <u>42.9%</u> | <u>(640)</u> | <u>-6.4%</u> |

| | 2018 | % of Revenues | 2017 | % of Revenues | Change Basis Points | % |
|----------------------------|------------------|----------------|------------------|----------------|------------------------|--------------|
| Connected Solutions | \$ 14,734 | 29.4% | \$ 17,283 | 33.2% | (380) | -3.8% |
| RF Solutions | 7,627 | 65.2% | 11,275 | 69.8% | (460) | -4.6% |
| Corporate | 23 | not meaningful | 8 | not meaningful | | |
| Total | <u>\$ 22,384</u> | <u>36.3%</u> | <u>\$ 28,566</u> | <u>41.9%</u> | <u>(560)</u> | <u>-5.6%</u> |

The gross profit decreased by 640 basis points for the three months ended September 30, 2018 compared to the same period in 2017 and decreased by 560 basis points for the nine months ended September 30, 2018, compared to the same period in 2017. The declines in gross profit were due to a higher mix of revenues from the Connected Solutions segment as well as a decline in the gross profit percentage for the Connected Solutions segment. The gross profit for the Connected Solutions segment declined by 390 basis points and 380 basis points for the three and nine months ended September 30, 2018, respectively, due to price pressure in the small cell vertical market and due to product mix. The three months ended September 30, 2018 included \$0.2 million for severance and employee benefits related to manufacturing headcount reductions in the Connected Solutions segment. The gross profit for the RF Solutions segment decreased by 790 and 460 basis points for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017 primarily due to the impact of fixed costs over lower revenues.

Consolidated Operating Expenses

| | Three Months Ended September 30, 2018 | | Change | Three Months Ended September 30, 2017 | | % of Revenues | |
|-----------------------------------|---|-------|----------|---|-------|---------------|-------|
| | | | | | | 2018 | 2017 |
| Research and development | \$ | 3,028 | \$ 271 | \$ | 2,757 | 16.4% | 11.7% |
| Sales and marketing | | 2,957 | (273) | | 3,230 | 16.0% | 13.6% |
| General and administrative | | 3,029 | (117) | | 3,146 | 16.4% | 13.3% |
| Amortization of intangible assets | | 85 | (39) | | 124 | 0.5% | 0.5% |
| Total | \$ | 9,099 | \$ (158) | \$ | 9,257 | 49.3% | 39.1% |

| | Nine Months Ended September 30, 2018 | | Change | Nine Months Ended September 30, 2017 | | % of Revenues | |
|-----------------------------------|---|--------|----------|---|--------|---------------|-------|
| | | | | | | 2018 | 2017 |
| Research and development | \$ | 9,021 | \$ 880 | \$ | 8,141 | 14.6% | 11.9% |
| Sales and marketing | | 9,059 | (335) | | 9,394 | 14.7% | 13.8% |
| General and administrative | | 9,172 | (909) | | 10,081 | 14.9% | 14.8% |
| Amortization of intangible assets | | 333 | (39) | | 372 | 0.5% | 0.5% |
| Total | \$ | 27,585 | \$ (403) | \$ | 27,988 | 44.7% | 41.0% |

Research and Development

Research and development expenses increased approximately \$0.3 million for the three months ended September 30, 2018 and increased \$0.9 million for the nine months ended September 30, 2018 compared to the same periods in 2017. During the three months ended September 30, 2018, expenses for the Connected Solutions segment were higher by \$0.3 million and expenses for the RF Solutions segment were approximately the same compared to the same period in the prior year. The increase during the nine months ended September 30, 2018 consists of higher expenses of \$0.8 million for the Connected Solutions segment and higher expenses of \$0.1 million for the RF Solutions segment compared to the same period in the prior year. Expenses for both segments were higher compared to the prior year periods due to additional headcount and equipment required to support investments in growth areas.

Sales and Marketing

Sales and marketing expenses include costs associated with the sales and marketing employees, sales agents, product line management, and trade show expenses.

Sales and marketing expenses decreased approximately \$0.3 million for the three and nine months ended September 30, 2018 compared to the same periods in 2017. For the three months ended September 30, 2018, sales and marketing expenses were lower by \$0.2 million for the RF Solutions segment and lower by \$0.1 million for the Connected Solutions segment compared to the same period for each of the segments, respectively, in 2017. For the three months ended September 30, 2018, sales commissions were lower by \$0.2 million and product line and marketing expenses for the RF Solutions segment were lower by \$0.1 million compared to the same period in 2017. During the nine months ended September 30, 2018, sales and marketing expenses for the Connected Solutions segment declined \$0.4 million, offsetting higher sales and marketing expenses of \$0.1 million for the RF Solutions segment compared to the same period in 2017. The expense decrease for the Connected Solutions segment is due to headcount reductions in sales and marketing at the end of the first quarter 2017. The expense increase for RF Solutions for the three and nine months ended September 30, 2018 was due to additions to sales and marketing headcount offset by lower sales commission expenses.

General and Administrative

General and administrative expenses include costs associated with the general management, finance, human resources, IT, legal, public company costs, and other operating expenses to the extent not otherwise allocated to business segments.

General and administrative expenses declined by \$0.1 million for the three months ended September 30, 2018 and declined by \$0.9 million for the nine months ended September 30, 2018 compared to the same periods in 2017 because 2017 included incentive compensation expense and corporate expenses related to the CEO transition that were not included in 2018, offsetting expense related to the separation of the Senior Vice President and General Manager of the RF Solutions segment. . Incentive compensation expenses for the three and nine months ended September 30, 2017 were \$0.3 million and \$0.7 million, respectively. Corporate expenses related to the CEO transition were \$0.2 million and \$0.3 million for the three and nine months ended September 30, 2017, respectively. The Company recorded expense of \$0.3 million in the third quarter 2018 related to the severance payment, employee benefits, and the acceleration of shares for this separation.

Amortization of Intangible Assets

Amortization expense within operating expenses was \$0.1 million for the three months ended September 30, 2018 and September 30, 2017. Amortization within operating expenses was \$0.3 million and \$0.4 million during the nine months ended September 30, 2018 and 2017, respectively. The decrease in the expense for three and nine months ended September 30, 2018 compared to the prior year periods due to certain intangible assets for Connected Solutions being fully amortized as of June 30, 2018.

Stock-based compensation expense

Total stock-based compensation is reflected in the condensed consolidated statements of operations as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------|----------------------------------|---------------|---------------------------------|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Cost of revenues | \$ (49) | \$ 67 | \$ 131 | \$ 200 |
| Research and development | 165 | 128 | 462 | 394 |
| Sales and marketing | 174 | 117 | 462 | 363 |
| General and administrative | 496 | 349 | 1,517 | 1,501 |
| Total continuing operations | 786 | 661 | 2,572 | 2,458 |
| Discontinued operations | 0 | 0 | 0 | 49 |
| Total | <u>\$ 786</u> | <u>\$ 661</u> | <u>\$ 2,572</u> | <u>\$ 2,507</u> |

Stock compensation expense was higher for the three and nine months ended September 30, 2018 compared to the same periods in 2017 due to the acceleration of service-based restricted shares pursuant to a separation agreement executed in the third quarter 2018 for the Senior Vice President and General Manager of the RF Solutions segment, as well as an increase in the number of share awards in 2018 compared to 2017 and a higher share price for the awards granted in 2018 compared to 2017. The Company recorded expense of \$0.2 million within general and administrative expenses in the third quarter 2018 related to the acceleration of shares for the separation.

Operating (Loss) Income by Segment

| | 2018 | Three Months Ended September 30, | | 2017 | % of Revenues |
|---------------------|-------------------|----------------------------------|---------------|----------------|---------------|
| | | % of Revenues | | | |
| Connected Solutions | \$ 859 | 5.8% | \$ 2,684 | 14.9% | |
| RF Solutions | (1,047) | -29.4% | 874 | 15.2% | |
| Corporate | (2,190) | not meaningful | (2,665) | not meaningful | |
| Total | <u>\$ (2,378)</u> | <u>-12.9%</u> | <u>\$ 893</u> | <u>3.8%</u> | |

| | 2018 | Nine Months September 30, | | 2017 | % of Revenues |
|---------------------|-------------------|---------------------------|---------------|----------------|---------------|
| | | % of Revenues | | | |
| Connected Solutions | \$ 3,994 | 8.0% | \$ 6,775 | 13.0% | |
| RF Solutions | (1,772) | -15.2% | 2,319 | 14.4% | |
| Corporate | (7,423) | not meaningful | (8,516) | not meaningful | |
| Total | <u>\$ (5,201)</u> | <u>-8.4%</u> | <u>\$ 578</u> | <u>0.8%</u> | |

We reported a total operating loss of \$2.4 million during the three months ended September 30, 2018 and an operating loss of \$5.2 million for the nine months ended September 30, 2018. The operating losses were the result of lower profits for the RF Solutions segment and lower gross profits for the Connected Solutions segment. Due to lower revenues, we recorded operating losses of \$1.0 million and \$1.8 million for RF Solutions segment during the three and nine months ended September 30, 2018, respectively, compared to income for the same periods in 2017. Operating profit for the Connected Solutions segment was lower by approximately \$1.8 million during the three months ended September 30, 2018 and lower by \$2.8 million for the nine months ended September 30, 2018 compared to the prior year primarily due to a lower gross profit percentage. Within the corporate function, expenses were lower by \$0.5 million and \$1.1 million, respectively in the three and nine months ended September 30, 2018 due to lower expenses related to the Short-Term Incentive Plan and because the same periods in 2017 included expenses related to the CEO transition.

Other Income, Net

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|-------------------------------------|--------------|------------------------------------|--------------|
| | 2018 | 2017 | 2018 | 2017 |
| Interest income | \$ 174 | \$ 80 | \$ 438 | \$ 181 |
| Foreign exchange (losses) gains | 37 | (45) | 28 | (98) |
| Other, net | 15 | (3) | 20 | (9) |
| Total | <u>\$ 226</u> | <u>\$ 32</u> | <u>\$ 486</u> | <u>\$ 74</u> |
| Percentage of revenues | 1.2% | 0.1% | 0.8% | 0.1% |

Other income, net consists of interest income, foreign exchange losses and gains, and interest expense. Interest income increased during the three and nine months ended September 30, 2018 compared to the prior year, primarily due to higher average interest rates but also due to higher investment and cash equivalent balances. Our investment and cash equivalent balances declined during the nine months ended September 30, 2018 but the average balance was higher through the first nine months of 2018 compared to the first nine months of 2017.

Benefit for Income Taxes

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------|-------------------------------------|--------|------------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Benefit for income taxes | \$ (482) | \$ 206 | \$ (961) | \$ (68) |
| Effective tax rate | 22.4% | 22.3% | 20.4% | (10.4)% |

We recorded an income tax benefit of \$0.5 million and \$1.0 million for the three and nine months ended September 30, 2018, respectively. The tax benefit recorded for the nine months ended September 30, 2018 differed from the statutory rate of 21% by approximately 1%, because the Company did not record income tax benefits for losses with finite lives and due to permanent differences. The tax benefit recorded for the nine months ended September 30, 2017 differed from the statutory rate of 34% by 44% due to the combination of U.S. pretax losses and foreign pretax profits taxed at lower rates. The net tax benefit for the nine months ended September 30, 2017 included an income tax benefit of \$0.2 million related to state rate and apportionment changes and an \$0.1 million income tax benefit related to previously unrecognized tax benefits for research credits.

We maintain valuation allowances due to uncertainties regarding realization. Our valuation allowance against deferred tax assets was \$5.4 million and \$5.2 million at September 30, 2018 and December 31, 2017, respectively. Most of our deferred tax assets relate to the United States tax jurisdiction. On a regular basis, we evaluate the recoverability of deferred tax assets and the need for a valuation allowance. Such evaluations involve the application of significant judgment. The valuation allowance at September 30, 2018 and December 31, 2017 relates to net operating losses (“NOLs”) and credits. We believe that it is more likely than not that these deferred tax assets will not be realized based on the negative evidence of a cumulative three-year loss through September 30, 2018 and at December 31, 2017 and the finite expiration of state NOLs and credits and federal NOLs generated as of December 31, 2017. See Note 11 to the consolidated financial statements for more information related to income taxes.

Net (Loss) Income from Discontinued Operations, Net of Income Tax (Benefit) Expense

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Net (loss) income from discontinued operations, net of income tax | \$ 0 | \$ 236 | \$ 0 | \$ (148) |

During the quarter ended June 30, 2017, we approved a plan to sell our Network Engineering Services business (“Engineering Services”) and shift our focus toward research and development driven radio frequency (“RF”) products. We sold the business to Gabe’s Construction on July 31, 2017. See Note 5 to the consolidated financial statements for information related to discontinued operations. The results for Engineering Services are reported as discontinued operations for the three and nine months ended September 30, 2017. The net income for the three months ended September 30, 2017 reflects a gain on the sale of the business of \$0.5

million, offsetting a net operating loss of \$0.1 million and income tax expense of \$0.2 million. The net loss for the nine months ended September 30, 2017 reflects a net operating loss of \$0.7 million, offsetting a gain on the sale of the business of \$0.5 million.

Liquidity and Capital Resources

| | Nine Months Ended September 30, | |
|--|---------------------------------|-------------|
| | 2018 | 2017 |
| Net (loss) income from continuing operations | \$ (3,754) | \$ 720 |
| Charges for depreciation, amortization, stock-based compensation, and other non-cash items | 4,854 | 4,929 |
| Changes in operating assets and liabilities | 3,000 | 1,427 |
| Net cash provided by operating activities | \$ 4,100 | \$ 7,076 |
| Net cash used in investing activities | \$ (1,462) | \$ (13,619) |
| Net cash used in financing activities | \$ (2,713) | \$ (2,609) |
| Net cash flows provided by discontinued operations | \$ 0 | \$ 737 |
| Net decrease in cash | \$ (75) | \$ (8,415) |

| | September 30, | December 31, |
|--|---------------|--------------|
| | 2018 | 2017 |
| Cash and cash equivalents at the end of period | \$ 5,377 | \$ 5,559 |
| Short-term investments at the end of period | \$ 31,770 | \$ 32,499 |
| Working capital at the end of period | \$ 53,823 | \$ 58,091 |

Liquidity and Capital Resources Overview

Our primary source of liquidity is cash provided by operations, with short-term swings in liquidity supported by a significant balance of cash and short-term investments. The balance has fluctuated with cash from operations, acquisitions and divestitures, payment of dividends and the repurchase of our common shares.

Within operating activities, we are historically a net generator of operating funds from our income statement activities. During the years ended December 31, 2017 and 2016, our balance sheet provided operating funds. In periods of expansion, we expect to use cash from our balance sheet.

Within investing activities, capital spending historically ranges between 2.0% and 4.0% of our revenues and the primary use of capital is for manufacturing and engineering development. Our capital expenditures during the nine months ended September 30, 2018 were approximately 3.6% of revenues. We historically have significant transfers between investments and cash as we rotate our large cash balances and short-term investment balances between money market funds, which are accounted for as cash equivalents, and other investment vehicles. We have a history of supplementing our organic revenue with acquisitions of product lines or companies, resulting in significant uses of our cash and short-term investment balances from time to time. We expect the historical trend for capital spending and the variability caused by moving money between cash and investments and periodic merger and acquisition activity to continue in the future.

Within financing activities, we have historically generated funds from the exercise of stock options and proceeds from the issuance of common stock through the Employee Stock Purchase Plan and have historically used funds to repurchase shares of our common stock through our share repurchase programs and through quarterly dividends. Whether this activity results in our being a net user of funds versus a net generator of funds is largely dependent on our stock price during any given year.

At September 30, 2018, our cash, cash equivalents, and investments were approximately \$37.1 million, and we had working capital of \$53.8 million. Management believes that our cash and investments and no debt, combined with our historic ability to generate free cash flow (cash flow from operations less capital spending) provide adequate liquidity and working capital to support our operations.

Operating Activities:

Operating activities generated \$4.1 million of cash during the nine months ended September 30, 2018. We generated \$1.1 million of cash from our income statement activities and generated \$3.0 million of cash from the balance sheet. Within the balance sheet, we generated cash primarily due to net collections of accounts receivable of \$5.0 million, offsetting use of cash for net payments of accrued liabilities of \$2.5 million. The reduction in accounts receivable during the nine months ended September 30, 2018 is because revenues for the most recent quarter were \$4.8 million lower compared to the fourth quarter of 2017. Accrued liabilities were lower at

September 30, 2018 compared to December 31, 2017, primarily due to the payout of \$1.7 million for the 2017 short-term incentive plan.

Operating activities from continuing operations provided \$7.0 million of cash during the nine months ended September 30, 2017. We generated \$5.6 million of cash from our income statement activities and \$1.5 million of cash from our balance sheet activities. From the balance sheet activities, we generated cash of \$0.7 million from decreases in accounts receivable and \$1.8 million from reductions in inventories and used cash of \$0.4 million from reductions in accrued liabilities and \$1.1 million from reductions in accounts payable. Inventories declined during the nine months ended September 30, 2017 for both Connected Solutions and RF Solutions due to process improvements related to purchasing and forecasting, as well as a decrease in revenues for the three months ended September 30, 2017 compared to the three months ended December 31, 2016. Accounts receivables declined during the nine months ended September 30, 2017 due to the decrease in revenues for the three months ended September 30, 2017 compared to the three months ended December 31, 2016. In total, accrued liabilities and accounts payable were lower by \$1.1 million due to the reduction in amounts due for inventory purchases.

Investing Activities:

Our investing activities used \$1.5 million of cash during the nine months ended September 30, 2018. During the nine months ended September 30, 2018, redemptions and maturities of our short-term investments provided \$34.7 million in funds and we rotated \$34.0 million of cash into new short-term investments. We used \$2.2 million for capital expenditures during the nine months ended September 30, 2018. Capital expenditures included equipment for our new development office in Akron, Ohio.

Our investing activities used \$13.6 million of cash during the nine months ended September 30, 2017. During the nine months ended September 30, 2017, redemptions and maturities of our short-term investments provided \$26.1 million in funds and we rotated \$37.6 million of cash into new short-term investments. We used \$2.1 million for capital expenditures during the nine months ended September 30, 2017. Capital expenditures included \$0.6 million for a new IP phone and communications system.

Financing Activities:

We used \$2.7 million in cash for financing activities during the nine months ended September 30, 2018. We used \$3.0 million for cash dividends paid in February 2018, May 2018 and August 2018. We received \$0.7 million in proceeds from the purchase of shares through our ESPP and we used \$0.3 million for payroll taxes related to stock-based compensation and \$0.1 million on payments for capital leases. The tax payments related to our stock issued for restricted stock awards.

We used \$2.6 million in cash for financing activities during the nine months ended September 30, 2017. We used \$2.7 million for cash dividends and we received \$1.4 million in proceeds from the purchase of shares through our ESPP and stock option exercises. We used \$1.2 million for payroll taxes related to stock-based compensation. The tax payments related to our stock issued for restricted stock awards.

Contractual Obligations and Commercial Commitments

We had purchase obligations of \$6.1 million and \$5.7 million at September 30, 2018 and December 31, 2017, respectively. These obligations are for the purchase of inventory, as well as for other goods and services in the ordinary course of business and exclude the balances for purchases currently recognized as liabilities on the balance sheet.

As of September 30, 2018, we had operating lease obligations of approximately \$2.5 million through 2025, primarily for facility leases. We had capital lease obligations of \$0.2 million and \$0.3 million at September 30, 2018 and at December 31, 2017, respectively.

We had a liability of \$0.7 million related to income tax uncertainties at September 30, 2018 and December 31, 2017. We do not know the timing of the settlement of this liability.

U.S. Tariffs

During the third quarter 2018, the Office of the United States Trade Representative (“USTR”) imposed duties on certain Chinese imports containing industrially significant technologies, including certain PCTEL antenna and antenna components. Duties of 25% became effective on July 6, 2018 and on August 23, 2018 and duties of 10% on additional products became effective on September 24, 2018. The tariffs that became effective on September 24 will increase to 25% on January 1, 2019. These Tariffs increased the cost of the Company’s products, adversely impacting the gross margin that the Company earns on sales of its products and making our products more expensive for customers. During the trailing twelve months ended September 30, 2018, \$7.5 million of our customer

revenues were based on products subject to the new tariffs. To recover the additional costs incurred because of these tariffs, we initiated a 20% upcharge to end customers of the products subject to the 25% tariffs. The Company will continue to monitor and adjust prices as necessary and as market conditions permit. However, the Company does not know the price elasticity of the unit volume based on the price increase.

Critical Accounting Policies and Estimates

We use certain critical accounting policies as described in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates” of the 2017 Form 10-K. There have been no material changes in any of our critical accounting policies since December 31, 2017. See Note 1 to the Condensed Consolidated Financial Statements for discussion on recent accounting pronouncements and see Note 13 to the Condensed Consolidated Financial Statements for information related to revenue recognition policies.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

See our 2017 Form 10-K (Item 7A). As of November 9, 2018, there have been no material changes in this information.

Item 4: Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act, as amended (the “Exchange Act”) were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported within time periods specified in the Securities and Exchange Commission rules and forms.

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 1: Legal Proceedings

We are the subject of various pending or threatened legal actions in the ordinary course of our business. All such matters are subject to many uncertainties and outcomes that are not predictable with assurance. In our opinion, as of September 30, 2018, there were no claims or litigation pending that would be reasonably likely to have a material adverse effect on our consolidated financial position, results of operations or liquidity.

Item 1A: Risk Factors

See our 2017 Form 10-K (Item 7A). As of November 9, 2018, there have been no material changes in this information except for an update based on US tariffs imposed on PCTEL antenna and antenna components manufactured in China:

Conducting business in foreign countries involves additional financial, operating, and regulatory risks.

A substantial portion of our manufacturing activities is conducted in China. There are a number of risks inherent in doing business in foreign countries, including: (i) fluctuations in the value of the U.S. dollar relative to other currencies, and in particular the impact of a re-valuation of the Chinese Yuan; (ii) impact of tariffs or trade wars among the countries in which we do business; (iii) difficulties in repatriation of earnings; (iv) disruption to our supply chain, including our ability to import materials and export products; (v) nationalist sentiment creating advantages for our competitors in their home countries; (vi) impact of labor unrest; (vii) unexpected legal or regulatory changes, particularly changes to environmental, labor or manufacturing regulations; (viii) lack of sufficient protection for intellectual property rights; (ix) difficulties in recruiting and retaining personnel and managing international operations; (x) less developed infrastructure; and (xi) other unfavorable political or economic factors which could include nationalization of the wireless communications or related industries. If we are unable to manage successfully these and other risks pertaining to our international activities, our operating results, cash flows and financial position could be materially and adversely affected.

In the third quarter 2018, the Office of the United States Trade Representative (“USTR”) imposed duties on certain Chinese imports containing industrially significant technologies, including certain PCTEL antenna and antenna components, and there are additional tariffs under review. Tariffs impact the gross margin that the Company earns on sales of its products and have necessitated price increases. Furthermore, political uncertainty surrounding international trade disputes and protectionist measures may have a negative effect on customer confidence and spending. The Company will continue to monitor and adjust prices as necessary and as market conditions permit. The impact of the tariffs on the Company’s future revenue and profitability is uncertain.

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

None.

Item 3: Defaults Upon Senior Securities

None.

Item 4: Mine Safety Disclosures

Not applicable.

Item 5: Other Information

None.

Item 6: Exhibits

| Exhibit No. | Description |
|-------------|--|
| 10.1*** | <u>Separation agreement dated August 27, 2018 between the Company and Jeffery A. Miller, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 29, 2018</u> |
| 31.1* | <u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2* | <u>Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1** | <u>Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101* | The following materials from PCTEL, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in XBRL (eXtensible Business Reporting Language): (i) the Unaudited Condensed Consolidated Statement of Operations, (ii) the Unaudited Condensed Consolidated Balance Sheet, (iii) the Unaudited Condensed Consolidated Statement of Stockholders' Equity, (iv) the Unaudited Condensed Consolidated Statement of Cash Flows, and (v) Notes to the Unaudited Condensed Consolidated Financial Statements |

* filed herewith

** furnished herewith

*** incorporated by reference

SIGNATURE

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:

PCTEL, Inc.,
a Delaware corporation

/s/ David A. Neumann

David A. Neumann
Chief Executive Officer

Date: November 9, 2018

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO EXCHANGE ACT RULES 13A-14(A) and 15(D)-14(A), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David A. Neumann, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of PCTEL, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2018

/s/ David A. Neumann
 David A. Neumann
 Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO ACT RULES 13A-14(A) and 15(D)-14(A), AS
ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, John Schoen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of PCTEL, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2018

/s/ John W. Schoen

John W. Schoen
Chief Financial Officer

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, David A. Neumann, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of PCTEL, Inc. for the quarterly period ended September 30, 2018 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of PCTEL, Inc. A signed original of this written statement required by Section 906 has been provided to PCTEL, Inc. and will be retained by PCTEL, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

DATE: November 9, 2018

By: /s/ David A. Neumann

NAME: DAVID A. NEUMANN

Title: Chief Executive Officer

I, John Schoen, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of PCTEL, Inc. for the quarterly period ended September 30, 2018 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of PCTEL, Inc. A signed original of this written statement required by Section 906 has been provided to PCTEL, Inc. and will be retained by PCTEL, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

DATE: November 9, 2018

By: /s/ John W. Schoen

NAME: JOHN W. SCHOEN

Title: Chief Financial Officer