

Company Registration No. 06879144 (England and Wales)

FLOW HOLDING LIMITED
REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2018

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FLOW HOLDING LIMITED

COMPANY INFORMATION

| | |
|--------------------------|--|
| Directors | D Savage E Torgan B Webb Jr. |
| Secretary | Gravitas Company Secretarial Services Limited |
| Company number | 06879144 |
| Registered office | One New Change London EC4M 9AF |
| Auditor | RSM UK Audit LLP Chartered Accountants St Philips Point Temple Row Birmingham West Midlands B2 5AF |

FLOW HOLDING LIMITED

STRATEGIC REPORT

FOR THE YEAR ENDED 31 DECEMBER 2018

The directors present the strategic report for the year ended 31 December 2018.

Business review and future developments

The company acts solely as a holding company. The company paid and received interest on intercompany loans in both the current year and prior year. The directors expect no change to this position in the foreseeable future

Principal risks and uncertainties

The directors continually review and evaluate the risks that the company is facing. The principal uncertainties facing the company relate primarily to its trading investments in India, Japan and Canada and the wider group.

Financial risk management

Impairment risk

An impairment risk is where the carrying value of an investment cannot be supported, and consequently an impairment provision should be made as the assets are overstated. The company manages this risk by performing impairment reviews of its investments on a regular basis and making suitable provisions as necessary.

Financial liability risk

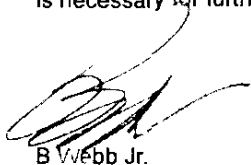
Financial liability risk can arise where the company cannot settle its liabilities as they fall for payment. The company manages this risk by ensuring group balances are agreed under suitable repayment terms.

Credit risk

The principal financial assets are group debtors. The credit risk is influenced by economic factors, however the company manages this risk through group balance repayments.

Key performance indicators

Given the nature of the company, the directors do not believe further analysis using key performance indicators is necessary for further understanding of financial performance.



B Webb Jr.
Director

Date 9-26-19

FLOW HOLDING LIMITED

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2018

The directors present their annual report and financial statements for the year ended 31 December 2018.

Principal activities

The principal activity of the company continued to be that of a holding company

Directors

The directors who held office during the year and up to the date of signature of the financial statements were as follows:

| | |
|------------|-------------------------|
| D Savage | |
| R Carlson | (Resigned 6 June 2019) |
| E Torgan | (Appointed 6 June 2019) |
| B Webb Jr. | (Appointed 6 June 2019) |

Results and dividends

The results for the year are set out on page 6.

No ordinary dividends were paid. The directors do not recommend payment of a final dividend

Qualifying third party indemnity provisions

The company has made qualifying third party indemnity provisions for the benefit of its directors during the year. These provisions remain in force at the reporting date.

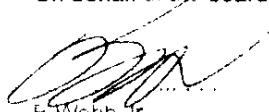
Auditor

RSM UK Audit LLP have indicated their willingness to be reappointed for another term and appropriate arrangements have been put in place for them to be deemed reappointed as auditors in the absence of an Annual General Meeting.

Statement of disclosure to auditor

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information of which the company's auditor is unaware. Additionally, each director has taken all the necessary steps that they ought to have taken as a director in order to make themselves aware of all relevant audit information and to establish that the company's auditor is aware of that information.

On behalf of the board


B Webb Jr.
Director

Date: 9.26.19

FLOW HOLDING LIMITED

DIRECTORS' RESPONSIBILITIES STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2018

The directors are responsible for preparing the Strategic Report and the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FLOW HOLDING LIMITED

Opinion

We have audited the financial statements of Flow Holding Limited (the 'company') for the year ended 31 December 2018 which comprise the statement of comprehensive income, the statement of financial position, the statement of changes in equity and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice,
- have been prepared in accordance with the requirements of the Companies Act 2006

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate, or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements, and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FLOW HOLDING LIMITED (CONTINUED)

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report and the directors' report

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

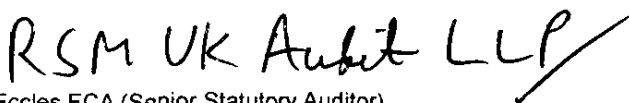
Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: <http://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.



Richard Eccles FCA (Senior Statutory Auditor)

For and on behalf of RSM UK Audit LLP, Statutory Auditor

Chartered Accountants

St Philips Point

Temple Row

Birmingham

West Midlands, B2 5AF

27/9/19

FLOW HOLDING LIMITED

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018

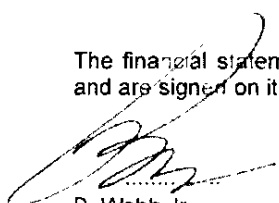
| | | 2018 | 2017 |
|---|--------------|------------------|------------------|
| | Notes | € | € |
| Administrative expenses | | (96,490) | (513,095) |
| Income from shares in group undertakings | 7 | - | 996,204 |
| Interest receivable from group undertakings | 7 | 1,634,202 | 1,133,651 |
| Interest payable to group undertakings | 8 | (174,732) | (107,560) |
| Other interest payable and similar expenses | 8 | (1,332) | - |
| Profit before taxation | | 1,361,648 | 1,509,200 |
| Tax on profit | 9 | 289,092 | (282,291) |
| Profit for the financial year | | 1,650,740 | 1,226,909 |

FLOW HOLDING LIMITED**STATEMENT OF FINANCIAL POSITION****AS AT 31 DECEMBER 2018**

| | Notes | 2018 | | 2017 | |
|--|-------|--------------|-----------|--------------|-----------|
| | | € | € | € | € |
| Fixed assets | | | | | |
| Investments | 10 | | 2,935,631 | | 2,935,631 |
| Current assets | | | | | |
| Debtors falling due after more than one year | 12 | 13,392,461 | | 11,730,330 | |
| Debtors falling due within one year | 12 | 13,878,737 | | 14,348,821 | |
| Cash at bank and in hand | | 5,347,009 | | 1,549,439 | |
| | | 32,618,207 | | 27,628,590 | |
| Creditors: amounts falling due within one year | 13 | (27,923,608) | | (24,299,638) | |
| Net current assets | | | 4,694,599 | | 3,328,952 |
| Total assets less current liabilities | | | 7,630,230 | | 6,264,583 |
| Creditors: amounts falling due after more than one year | 14 | | - | | (285,093) |
| Net assets | | | 7,630,230 | | 5,979,490 |
| Capital and reserves | | | | | |
| Called up share capital | 16 | | 1,149 | | 1,149 |
| Share premium account | 17 | | 3,813,810 | | 3,813,810 |
| Profit and loss reserves | 17 | | 3,815,271 | | 2,164,531 |
| Total equity | | | 7,630,230 | | 5,979,490 |

The financial statements were approved by the board of directors and authorised for issue on
and are signed on its behalf by

9-26-2019


 B Webb Jr.
 Director

FLOW HOLDING LIMITED

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2018

| | Share capital € | Share premium account € | Profit and loss reserves € | Total € |
|--|-----------------------|----------------------------------|-------------------------------------|------------|
| Balance at 1 January 2017 | 1,149 | 3,813,810 | 937,622 | 4,752,581 |
| Year ended 31 December 2017: | | | | |
| Profit and total comprehensive income for the year | - | - | 1,226,909 | 1,226,909 |
| Balance at 31 December 2017 | 1,149 | 3,813,810 | 2,164,531 | 5,979,490 |
| Year ended 31 December 2018: | | | | |
| Profit and total comprehensive income for the year | - | - | 1,650,740 | 1,650,740 |
| Balance at 31 December 2018 | 1,149 | 3,813,810 | 3,815,271 | 7,630,230 |

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1 Accounting policies

Company information

Flow Holding Limited is a private company limited by shares and is registered and incorporated in England and Wales. The registered office is One New Change, London, EC4M 9AF.

The company's principal activities and nature of its operations are disclosed in the Directors' Report.

Accounting convention

These financial statements have been prepared in accordance with FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" ("FRS 102") and the requirements of the Companies Act 2006, including the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The financial statements are presented in Euros, which is the presentational and functional currency of the company. Monetary amounts in these financial statements are rounded to the nearest €. The prior year financial statements were presented in US dollars, and monetary amounts were rounded to the nearest \$. This has been changed to reflect the functional currency as the majority of transactions and balances are denominated in euros. The functional currency of the company has always been euros; disclosure of this fact has been omitted in error in financial statements for earlier years.

The financial statements have been prepared under the historical cost convention. The principal accounting policies adopted are set out below.

Consolidated financial statements

The company has taken advantage of the exemption in section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements. Consequently, these financial statements present the financial position and financial performance of the company as a single entity.

Reduced Disclosure

This company is a qualifying entity for the purposes of FRS 102, being a member of a group where the parent of that group prepares publicly available consolidated financial statements, including this company, which are intended to give a true and fair view of the assets, liabilities, financial position and profit or loss of the group. The company has therefore taken advantage of exemptions from the following disclosure requirements:

- Section 7 'Statement of Cash Flows' – Presentation of a statement of cash flow and related notes and disclosures;
- Section 33 'Related Party Disclosures' – Compensation for key management personnel

The financial statements of Flow Holding Limited are consolidated in the financial statements of Shape Technologies Group, Inc. The consolidated financial statements of Shape Technologies Group, Inc. are available from its registered office, 23500 64TH AVE S KENT, WA 98032, USA.

Going concern

At the time of approving the financial statements, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus the directors continue to adopt the going concern basis of accounting in preparing the financial statements.

Fixed asset investments

Interests in subsidiaries are initially measured at cost and subsequently measured at cost less any accumulated impairment losses. The investments are assessed for impairment at each reporting date and any impairment losses or reversals of impairment losses are recognised immediately in profit or loss.

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

1 Accounting policies (Continued)

A subsidiary is an entity controlled by the company. Control is the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities.

Cash and cash equivalents

Cash and cash equivalents are basic financial instruments and include cash in hand, deposits held at call with banks, other short-term liquid investments with original maturities of three months or less

Financial instruments

The company has elected to apply the provisions of Section 11 'Basic Financial Instruments' of FRS 102 to all of its financial instruments.

Financial instruments are recognised when the company becomes party to the contractual provisions of the instrument.

Financial assets and liabilities are offset, with the net amounts presented in the financial statements, when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Basic financial assets

Basic financial assets, which include amounts owed by group undertakings and cash and bank balances, are initially measured at transaction price including transaction costs and are subsequently carried at amortised cost using the effective interest method.

Other financial assets

Other financial assets, including trade investments, are initially measured at fair value, which is normally the transaction price. Such assets are subsequently carried at fair value and the changes in fair value are recognised in profit or loss, except that investments in equity instruments that are not publicly traded and whose fair values cannot be measured reliably are measured at cost less impairment.

Impairment of financial assets

Financial assets, other than those held at fair value through profit and loss, are assessed for indicators of impairment at each reporting end date

Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been affected. If an asset is impaired, the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in profit or loss.

Derecognition of financial assets

Financial assets are derecognised only when the contractual rights to the cash flows from the asset expire or are settled, or when the company transfers the financial asset and substantially all the risks and rewards of ownership to another entity, or if some significant risks and rewards of ownership are retained but control of the asset has transferred to another party that is able to sell the asset in its entirety to an unrelated third party

Basic financial liabilities

Basic financial liabilities, including other creditors and amounts due to group undertakings, are initially recognised at transaction price

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2018

1 Accounting policies (Continued)

Derecognition of financial liabilities

Financial liabilities are derecognised when, and only when, the company's contractual obligations are discharged, cancelled, or they expire

Equity instruments

Equity instruments issued by the company are recorded at the fair value of proceeds received, net of transaction costs. Dividends payable on equity instruments are recognised as liabilities once they are no longer at the discretion of the company

Taxation

The tax expense represents the sum of the current tax expense. Current tax assets are recognised when tax paid exceeds the tax payable.

Current tax assets and current tax liabilities are offset, if and only if, there is a legally enforceable right to set off the amounts and the entity intends either to settle on the net basis or to realise the asset and settle the liability simultaneously.

Current tax is based on taxable profit for the year. Current tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted by the reporting date

Foreign exchange

Transactions in currencies other than the functional currency (foreign currency) are initially recorded at the exchange rate prevailing on the date of the transaction

Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the reporting date. Non-monetary assets and liabilities denominated in foreign currencies are translated at the rate ruling at the date of the transaction, or, if the asset or liability is measured at fair value, the rate when that fair value was determined.

All translation differences are taken to profit or loss.

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2018

2 Judgements and key sources of estimation uncertainty

In the application of the company's accounting policies, the directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised where the revision affects only that period, or in the period of the revision and future periods where the revision affects both current and future periods.

Critical judgements

The following judgements (apart from those involving estimates) have had the most significant effect on amounts recognised in the financial statements.

Impairment of investments and debtors

Determining whether the cost of investments and debtors are impaired requires an estimation of the value in use of the asset to which they have been allocated or belong. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction on similar assets. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the asset.

3 Employees

There were no employees during the year (2017: nil).

4 Directors' remuneration

None of the directors received any remuneration, nor were any amounts payable, in respect of their services to Flow Holding Limited during the year (2017: €nil).

5 Operating loss

| | 2018 | 2017 |
|---|----------|---------|
| | € | € |
| Operating loss for the year is stated after charging/(crediting): | | |
| Exchange (gains)/losses | (22,750) | 395,447 |

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

6 Auditor's remuneration

| | 2018 | 2017 |
|---|--------|--------|
| | € | € |
| Fees payable to the company's auditor and its associates: | | |
| For audit services | | |
| Audit of the financial statements of the company | 11,302 | 11,430 |
| For other services | | |
| Taxation compliance services | 3,391 | 3,429 |
| Other taxation services | 11,302 | - |
| All other non-audit services | 5,086 | 4,000 |
| | 19,779 | 7,429 |

7 Interest receivable and similar income

| | 2018 | 2017 |
|--|-----------|-----------|
| | € | € |
| Interest income | | |
| Interest receivable from group undertakings | 1,634,202 | 1,133,651 |
| Income from fixed asset investments | | |
| Income from shares in group undertakings | - | 996,204 |
| Total income | 1,634,202 | 2,129,855 |
| Disclosed on the statement of comprehensive income as follows: | | |
| Income from shares in group undertakings | - | 996,204 |
| Interest receivable from group undertakings | 1,634,202 | 1,133,651 |
| Investment income includes the following | | |
| Income from group undertakings | 1,634,202 | 1,133,651 |

8 Interest payable and similar expenses

| | 2018 | 2017 |
|--|---------|---------|
| | € | € |
| Interest on financial liabilities measured at amortised cost: | | |
| Interest payable to group undertakings | 174,732 | 107,560 |
| Other interest on financial liabilities | 1,332 | - |
| | 176,064 | 107,560 |
| Disclosed on the statement of comprehensive income as follows | | |
| Interest payable to group undertakings | 174,732 | 107,560 |
| Other interest payable and similar expenses | 1,332 | - |

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

9 Taxation

| | 2018 € | 2017 € |
|--|------------------|----------------|
| Current tax | | |
| UK corporation tax on profits for the current period | 254,298 | 171,640 |
| Adjustments in respect of prior periods | (543,390) | 110,651 |
| Total current tax | (289,092) | 282,291 |

The total tax charge for the year included in the statement of comprehensive income can be reconciled to the profit before tax multiplied by the standard rate of tax as follows:

| | 2018 € | 2017 € |
|--|------------------|----------------|
| Profit before taxation | 1,361,648 | 1,509,200 |
| Expected tax charge based on the standard rate of corporation tax in the UK of 19.00% (2017: 19.25%) | 258,713 | 290,521 |
| Adjustments in respect of prior years | (543,390) | 110,652 |
| Group income | - | (191,735) |
| Current tax asset differences | - | 11,468 |
| Other differences | (4,415) | 61,385 |
| Taxation (credit)/charge for the year | (289,092) | 282,291 |

The main rate of corporation tax reduced from 20% to 19% with effect from 1 April 2017. A further reduction from 19% to 17%, with effect from 1 April 2020, was substantively enacted on 15 September 2017

10 Fixed asset investments

| | Notes | 2018 € | 2017 € |
|-----------------------------|-------|-----------|-----------|
| Investments in subsidiaries | 11 | 2,935,631 | 2,935,631 |

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

10 Fixed asset investments (Continued)

Movements in fixed asset investments

| | Shares in group undertakings € |
|--------------------------------------|---|
| Cost | |
| At 1 January 2018 & 31 December 2018 | 2,935,631 |
| Carrying amount | |
| At 31 December 2018 | 2,935,631 |
| At 31 December 2017 | 2,935,631 |

11 Subsidiaries

Details of the company's subsidiaries at 31 December 2018 are as follows:

| Name of undertaking | Registered office key | Nature of business | Class of shares held | % Held | |
|---|--------------------------|-------------------------|-------------------------|--------|----------|
| | | | | Direct | Indirect |
| Flow Bangalore Waterjet Private Limited | 1 | Water cutting equipment | Ordinary | 99.99 | |
| Flow Japan Corporation | 2 | Water cutting equipment | Ordinary | 100.00 | |
| Tech-Con Automation ULC | 3 | Water cutting equipment | Ordinary | 100.00 | |

Registered Office addresses:

- 1 6/14, Craig Park Layout, Askok Nagar, Bengaluru, Karnataka 560025, India
- 2 Level 18 Yebisu Garden Place Tower, 4-20-3 Ebisu, Shibuya-ku, Tokyo 150-6018, Japan
- 3 1219 Corporate Drive, Burlington, Ontario L7L 5V5, Canada

12 Debtors

| | 2018 € | 2017 € |
|---|------------|------------|
| Amounts falling due within one year: | | |
| Amounts owed by group undertakings | 13,871,016 | 14,337,069 |
| Prepayments and accrued income | 7,721 | 11,752 |
| | 13,878,737 | 14,348,821 |

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

12 Debtors (Continued)

| | 2018 € | 2017 € |
|---|-------------------|-------------------|
| Amounts falling due after more than one year: | | |
| Amounts owed by group undertakings | 13,392,461 | 11,730,330 |
| Total debtors | 27,271,198 | 26,079,151 |

13 Creditors: amounts falling due within one year

| | 2018 € | 2017 € |
|------------------------------------|-------------------|-------------------|
| Amounts owed to group undertakings | 27,691,631 | 23,816,515 |
| Corporation tax | 210,954 | 460,516 |
| Other creditors | 21,023 | 22,607 |
| | 27,923,608 | 24,299,638 |

14 Creditors: amounts falling due after more than one year

| | 2018 € | 2017 € |
|-----------------|-----------|-----------|
| Other creditors | - | 285,093 |

15 Financial instruments

| | 2018 € | 2017 € |
|---|------------|------------|
| Carrying amount of financial assets | | |
| Debt instruments measured at amortised cost | 27,263,477 | 26,067,399 |
| Carrying amount of financial liabilities | | |
| Measured at amortised cost | 27,712,654 | 24,124,215 |

16 Share capital

| | 2018 € | 2017 € |
|-------------------------------------|--------------|--------------|
| Ordinary share capital | | |
| Issued and fully paid | | |
| 1,004 Ordinary shares of €1.14 each | 1,149 | 1,149 |
| | 1,149 | 1,149 |

The company has one class of ordinary shares which have full voting rights, dividend and capital contribution. The class does not confer to any rights of redemption.

FLOW HOLDING LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2018

17 Reserves

Profit and loss reserve

The profit and loss reserve represent cumulative profits and losses net of distribution to owners.

Share premium

Consideration received for shares issued above their nominal value net of transaction costs

18 Ultimate controlling party

The immediate parent company is Flow Foreign Holdings B.V , a company incorporated in the Netherlands.

The largest and smallest group in which the results are consolidated is that of Shape Technologies Group, Inc., a company incorporated in the USA. The consolidated accounts of Flow Holding Limited are available from the companies registered office 23500 64TH AVE S KENT, WA 98032, USA.

The ultimate controlling entity is Shape Funding, LLC, a company incorporated in the USA.

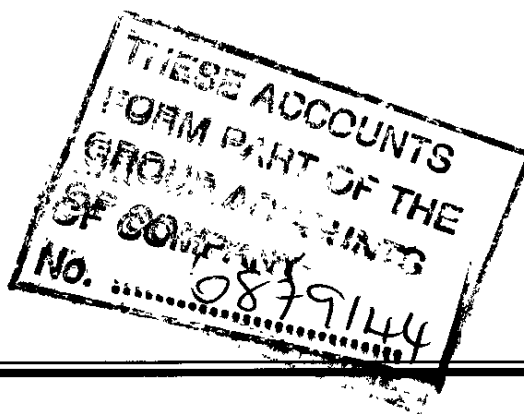
The ultimate controlling party is American Industrial Partners Capital Fund V, L.P

SHAPE

TECHNOLOGIES GROUP

SHAPE TECHNOLOGIES GROUP, INC.

ANNUAL REPORT FOR THE YEAR ENDED
December 31, 2018



FINANCIAL STATEMENTS

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RSM US LLP

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of
Shape Technologies Group, Inc. and Subsidiaries

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Shape Technologies Group, Inc. and Subsidiaries (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for the years ended December 31, 2018 and 2017, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the auditing standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

RSM US LLP

We have served as the Company's auditor since 2013.

Seattle, Washington
April 22, 2019

SHAPE TECHNOLOGIES GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share data)

| | <u>December 31,</u> <u>2018</u> | <u>December 31,</u> <u>2017</u> |
|---|------------------------------------|------------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 14,440 | \$ 7,779 |
| Receivables, net | 83,738 | 80,700 |
| Inventories, net | 109,227 | 101,839 |
| Prepaid expenses and other current assets | 17,996 | 20,823 |
| Total current assets | <u>225,401</u> | <u>211,141</u> |
| Property, plant, and equipment, net | 61,818 | 52,736 |
| Goodwill | 111,913 | 113,463 |
| Other intangible assets, net | 74,772 | 89,747 |
| Deferred financing costs, net | 1,320 | 456 |
| Deferred income taxes | 3,470 | 3,480 |
| Other long-term assets | 4,187 | 2,782 |
| Total assets | <u>\$ 482,881</u> | <u>\$ 473,805</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 44,979 | \$ 35,504 |
| Bank term debt - short-term portion | 3,000 | — |
| Other debt, short-term | 5,860 | 6,712 |
| Accrued payroll and related liabilities | 11,229 | 14,130 |
| Taxes payable and other accrued taxes | 6,490 | 3,647 |
| Accrued expenses | 14,594 | 22,712 |
| Customer deposits and deferred revenue | 18,704 | 24,415 |
| Total current liabilities | <u>104,856</u> | <u>107,120</u> |
| Bank term debt, net - long-term portion | 289,754 | — |
| Revolving loan | — | 25,600 |
| Senior secured notes, net | — | 219,130 |
| Other debt, long-term | 4,669 | 7,487 |
| Deferred income taxes | 8,967 | 9,325 |
| Long-term payables | 15,413 | 14,908 |
| Total liabilities | <u>423,659</u> | <u>383,570</u> |
| Commitments and contingencies (Note 13) | | |
| Stockholders' equity: | | |
| Common stock, \$.001 par value, 100,000 shares authorized; 63,000 shares issued and outstanding | — | — |
| Additional paid-in capital in excess of par | 164,121 | 163,052 |
| Accumulated deficit | (72,919) | (50,609) |
| Accumulated other comprehensive loss: | | |
| Cumulative translation adjustment, net of tax | (31,980) | (22,208) |
| Total stockholders' equity | <u>59,222</u> | <u>90,235</u> |
| Total liabilities and stockholders' equity | <u>\$ 482,881</u> | <u>\$ 473,805</u> |

See Accompanying Notes to Consolidated Financial Statements

SHAPE TECHNOLOGIES GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands)

| | Years ended | |
|---------------------------------|---------------------|-------------|
| | December 31, | |
| | 2018 | 2017 |
| Sales | \$ 448,717 | \$ 446,833 |
| Cost of sales | 279,600 | 279,904 |
| Gross margin | 169,117 | 166,929 |
| Operating expenses: | | |
| Sales and marketing | 61,995 | 58,775 |
| Research and development | 13,540 | 15,086 |
| General and administrative | 62,073 | 69,609 |
| Restructuring charges | 19,525 | 6,601 |
| Total operating expenses | 157,133 | 150,071 |
| Operating income | 11,984 | 16,858 |
| Interest expense, net | (19,088) | (22,496) |
| Loss on debt retirement | (9,904) | — |
| Foreign exchange gains (losses) | (214) | 3,059 |
| Other, net | 592 | (922) |
| Other expense, net | (28,614) | (20,359) |
| Loss before income taxes | (16,630) | (3,501) |
| Income tax benefit (provision) | (5,680) | 8,197 |
| Net income (loss) | \$ (22,310) | \$ 4,696 |

See Accompanying Notes to Consolidated Financial Statements

SHAPE TECHNOLOGIES GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Amounts in thousands)

| | Years ended | |
|---|---------------------|------------------|
| | December 31, | |
| | 2018 | 2017 |
| Net income (loss) | \$ (22,310) | \$ 4,696 |
| Other comprehensive income (loss): | | |
| Cumulative translation adjustment, net of tax | (9,772) | 6,813 |
| Total comprehensive income (loss) | <u>\$ (32,082)</u> | <u>\$ 11,509</u> |

See Accompanying Notes to Consolidated Financial Statements

SHAPE TECHNOLOGIES GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

| | Years ended December 31, | |
|--|-----------------------------|-----------------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (22,310) | \$ 4,696 |
| Adjustments to reconcile net income (loss) to net cash from operating activities: | | |
| Depreciation | 11,321 | 9,215 |
| Amortization and impairment of intangible assets | 15,826 | 22,573 |
| Amortization of deferred financing costs | 1,826 | 3,239 |
| Loss on disposal of assets | 72 | 70 |
| Loss on retirement of debt | 9,904 | — |
| Stock-based compensation | 1,078 | 993 |
| Warranty expense | 2,190 | 2,194 |
| Inventory obsolescence expense | 491 | 729 |
| Bad debt expense (benefit) | 430 | (607) |
| Deferred income taxes | (961) | (15,580) |
| Reduction in bargain purchase gain on acquisition | — | 742 |
| Changes in operating assets and liabilities, net of the effect of business combinations: | | |
| Receivables, net | (6,753) | (18,971) |
| Inventories, net | (11,327) | (15,278) |
| Other assets | 284 | (3,441) |
| Accounts payable | 10,024 | 1,258 |
| Accrued expenses | (10,584) | 6,224 |
| Other liabilities | (4,632) | 3,348 |
| Net cash from operating activities | <u>(3,121)</u> | <u>1,404</u> |
| Cash flows from investing activities: | | |
| Expenditures for property and equipment, net | (19,493) | (18,962) |
| Expenditures for intangible assets | (869) | (771) |
| Acquisitions, net of cash acquired | (1,344) | (5,123) |
| Net cash from investing activities | <u>(21,706)</u> | <u>(24,856)</u> |
| Cash flows from financing activities: | | |
| Borrowings on bank term debt | 297,000 | — |
| Repayments of bank term debt | (1,500) | — |
| Repayment of senior secured notes | (225,000) | — |
| Net borrowings (repayments) under credit facilities | (25,600) | 20,600 |
| Net repayments of long-term debt | (2,263) | (1,476) |
| Net borrowings of short-term debt | — | 529 |
| Payments on capital leases | (169) | (58) |
| Settlements of stock-based awards | (9) | (167) |
| Earn-out payments for business acquisitions | (840) | (1,500) |
| Payment of debt prepayment and extinguishment costs | (4,558) | — |
| Payment of deferred financing costs | (4,906) | — |
| Net cash from financing activities | <u>32,155</u> | <u>17,928</u> |
| Effects of changes in foreign currency exchange rates on cash and restricted cash | <u>(438)</u> | <u>437</u> |
| Net change in cash and restricted cash | 6,890 | (5,087) |
| Cash and restricted cash, beginning of year | 9,143 | 14,230 |
| Cash and restricted cash, end of year | <u>\$ 16,033</u> | <u>\$ 9,143</u> |

SHAPE TECHNOLOGIES GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

| | Years ended December 31, | |
|--|-------------------------------------|-------------|
| | 2018 | 2017 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Non-cash acquisition consideration | \$ 1,526 | \$ 710 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | \$ 23,427 | \$ 19,170 |
| Income taxes | 1,465 | 2,143 |

See Accompanying Notes to Consolidated Financial Statements

SHAPE TECHNOLOGIES GROUP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Amounts in thousands)

| | <u>Common Stock</u> | | <u>Additional paid-in capital</u> | <u>Accumulated deficit</u> | <u>Accumulated other comprehensive loss</u> | <u>Total</u> |
|---|---------------------|----------------------|---|--------------------------------|---|--------------|
| | <u>Shares</u> | <u>Par value</u> | | | | |
| Balances, December 31, 2016 | 63 | \$ — | \$ 162,226 | \$ (55,305) | \$ (29,021) | \$ 77,900 |
| Net income | | | | 4,696 | | 4,696 |
| Currency translation adjustment, net of tax | | | | | 6,813 | 6,813 |
| Stock-based compensation | | | 993 | | | 993 |
| Settlement of stock-based awards | | | (167) | | | (167) |
| Balances, December 31, 2017 | 63 | \$ — | \$ 163,052 | \$ (50,609) | \$ (22,208) | \$ 90,235 |
| Net loss | | | | (22,310) | | (22,310) |
| Currency translation adjustment, net of tax | | | | | (9,772) | (9,772) |
| Stock-based compensation | | | 1,078 | | | 1,078 |
| Settlement of stock-based awards | | | (9) | | | (9) |
| Balances, December 31, 2018 | 63 | \$ — | \$ 164,121 | \$ (72,919) | \$ (31,980) | \$ 59,222 |

See Accompanying Notes to Consolidated Financial Statements

SHAPE TECHNOLOGIES GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Summary of Significant Accounting Policies

Shape Technologies Group, Inc. and its subsidiaries (the "Company" or "Shape Technologies Group" or "SHAPE") provide solutions based on its Ultra High Pressure ("UHP") technology to manufacturers. The Company provides UHP waterjet pumps, robotic cutting solutions and aftermarket components that are integrated into systems worldwide. SHAPE also designs and manufactures waterjet cutting solutions. SHAPE focuses on solutions for advanced materials processing for prominent customers in fast-growing markets. SHAPE's business strategy focuses on selling UHP equipment and providing aftermarket parts, consumables, and services to an installed base of UHP technology.

Waterjet cutting technology uses ultra-high velocity streams of water (over three times the speed of sound) to cut a broad range of materials, ranging from food, paper products, carpet and plastics, to stone, aluminum, steel and engineered materials including carbon fiber composites. SHAPE's UHP technology is also used in its surface preparation and industrial cleaning systems, in which high-velocity streams of water are used to strip, clean and prepare surfaces for painting and other coatings. SHAPE's offerings include hardware, software, process control, robotic assembly, parts and support, and the technical knowledge to meet customer needs.

The end-markets in which SHAPE's customers deploy its technology include aerospace, automotive, food processing, glass cutting, electronics, paper slitting and trimming, and stone fabricators selling into the residential and commercial construction markets. A significant component of SHAPE's business is aftermarket sales into all of its end-markets, for its systems and pumps as well as those produced by competitors. UHP technology customers are frequent buyers of replacement components, consumables and support services. The Company conducts business on a global basis with manufacturing facilities located in the United States, Canada, France, Sweden, and South Korea.

Basis of Presentation

The consolidated financial statements include the accounts of Shape Technologies Group and all of its wholly owned subsidiaries. The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company acquired additional companies (see "Note 2: Business Combinations") in years ended December 31, 2018 and 2017. The results of the acquisitions are included in the accompanying Shape Technologies Group consolidated statements of operations from the respective acquisition dates forward.

Foreign Currency

The local currency is the functional currency for substantially all operations outside of the United States. Assets and liabilities are translated at the exchange rate in effect as of the Company's balance sheet date. Revenues and expenses are translated at the average monthly exchange rates throughout the year. The effects of exchange rate fluctuations in translating assets and liabilities of international operations into U.S. dollars are accumulated and reflected as a cumulative translation adjustment in the accompanying consolidated statements of comprehensive income (loss). A net foreign currency transaction loss of \$214,000 and a gain of \$3,059,000 for the years ended December 31, 2018 and 2017, respectively, are recorded in other expense, net in the consolidated statements of operations.

Use of Estimates

The preparation of these consolidated financial statements requires management to make certain assumptions and estimates about future events, and apply judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the consolidated financial statements. The Company bases its assumptions, estimates, and judgment on historical experience, current trends and other factors which management believes to be relevant and appropriate at the time the consolidated financial statements are prepared. Estimates include those used for useful lives of other intangible assets and property, plant, and equipment, acquisition accounting, valuation of long-term debt and investments, revenue recognition, the estimated allowances for doubtful accounts, obsolete, slow moving and nonsalable inventory, and warranty claims, accrued contingencies, valuation of insurance reserves, stock option valuation, and valuation allowance for deferred tax assets. Actual results could differ from management's estimates and assumptions.

Cash

The Company's cash consists of demand deposits in large financial institutions. At times, balances may exceed federally insured limits. At December 31, 2018, the Company had cash of \$11.4 million held in foreign financial institutions which are not federally insured.

Receivables

Receivables consist of amounts billed and currently due from customers and amounts not yet billed but earned. The Company extends credit to customers in the normal course of business and maintains an allowance for doubtful accounts resulting from the inability or unwillingness of customers to make required payments. Management determines the allowance for doubtful accounts by evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. The Company prepares an analysis of its ability to collect outstanding receivables that provides a basis for an allowance estimate for doubtful accounts.

Based on this evaluation, the Company establishes a reserve for specific accounts receivable that are believed to be uncollectible, as well as an estimate of uncollectible receivables not specifically known. Historical trends and the Company's current knowledge of potential collection problems provide the Company with sufficient information to establish a reasonable estimate for an allowance for doubtful accounts.

Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received. Bad debt expense, net of recoveries, is recorded in Sales and marketing expense in the consolidated statements of operations.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of receivables and foreign forward exchange contracts.

The Company maintains cash with various major financial institutions. The Company performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any institution.

Credit risks are mitigated by the diversity of customers in the Company's customer base across many different geographic regions and performing credit worthiness analyses on such customers.

Concentration of credit risk with respect to accounts receivable is limited due to the large number of customers and their dispersion across many geographic areas. The Company continuously monitors credit risk associated with its receivables. For the years ended December 31, 2018 and 2017, the Company did not have any customer that made up more than 10% of its consolidated sales and accounts receivable.

Inventories

Inventories are stated at the lower of cost or net realizable value. Costs included in inventories consist of materials, labor and manufacturing overhead, which are related to the purchase or production of inventories. The Company uses the first-in, first-out method to determine its cost of inventories. If inventory costs exceed expected market value due to obsolescence, or quantities in excess of expected demand, the Company records reserves for the difference between the cost and the market value in Cost of sales in the consolidated statements of operations. These reserves are recorded based on recent sales history.

Business Combinations and Intangible Assets Including Goodwill

The Company accounts for business combinations using the acquisition method, and, accordingly, the identifiable assets acquired and liabilities assumed are recorded at their acquisition date fair values. Goodwill is calculated as the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. Identifiable intangible assets with finite lives are amortized over their useful lives on a straight-line basis, except for definite-lived trade names, technology and customer relationship assets, which are amortized proportional to expected revenue. Acquisition-related costs, including advisory, legal, accounting, valuation, and other similar costs, are expensed in the periods in which the costs are incurred. The results of operations of acquired businesses are included in the consolidated financial statements from the acquisition date.

Intangible assets consist of acquired identifiable intangible assets as well as internally developed patents and trademarks. Acquired identifiable intangible assets include customer relationships, order backlog, existing technology, patents and trade names acquired as part of our acquisitions of KMT Group AB and Subsidiaries and Flow International Corporation ("Flow") as well as the companies acquired since then. The acquisitions in the years ended December 31, 2018 and 2017, are described in "Note 2: Business Combinations." Trademarks and acquired in-process research and development ("IPR&D") have an indefinite life and are not amortized. The fair value of IPR&D acquired in a business combination are capitalized and accounted for as indefinite-lived intangible assets until completed and are then amortized over their remaining useful lives. The Company capitalizes application fees, license fees, legal and other costs of successfully defending a patent from infringement. The remaining costs are expensed as incurred.

Impairment of Goodwill and Other Intangible Assets with Indefinite Lives

Goodwill and other intangible assets with indefinite lives are not amortized; however, they are assessed for impairment at least annually and as triggering events or indicators of potential impairment occur. The Company performs its annual impairment test in the fourth quarter of the year. In the evaluation of goodwill, the Company first performs a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If so, the Company performs a quantitative assessment and compares the fair value of the reporting unit to the carrying amount.

If the fair value of the reporting unit is less than the carrying value of the net assets and related goodwill, the Company performs a second step for that reporting unit to determine the amount of impairment loss, if any. For the years ended December 31, 2018 and 2017, the Company determined that the fair value exceeded the carrying value of intangible assets; therefore, there was no impairment of intangible assets. Impairment losses, limited to the carrying value of goodwill, represent the excess of the carrying amount of a reporting unit's goodwill over its implied fair value. In addition to the guidance indicated above, a qualitative assessment is permitted, whereby the Company may assess all relevant events and circumstances to determine if it is "more likely than not" (meaning a likelihood of more than 50%) that the fair value of the reporting unit's goodwill is less than the carrying amount. If there is a more likely than not assessment, the Company would need to perform the two-step process. As of December 31, 2018 and December 31, 2017, the Company determined that the fair value exceeded the carrying value of goodwill; therefore, there was no impairment of goodwill.

The Company evaluates the recoverability of intangible assets with indefinite lives by comparing the carrying value to the fair value of the related intangible asset. Impairment, if any, is recognized for the excess of the carrying amount of the indefinite-lived intangible asset over its fair value.

Estimates and assumptions used to perform the impairment testing are inherently uncertain and can significantly affect the outcome of the impairment test. Changes in operating results and other assumptions could materially affect these estimates.

Impairment of Long-Lived Assets with Definite Lives

Other than the impairment described in "Note 6: Goodwill and Other Intangible Assets" for the years ended December 31, 2018 and 2017, management determined that no triggering events had occurred and no impairment charge was recorded. Long-lived assets include property, plant and equipment, cost-method investments, and acquired identifiable intangible assets with definite lives as well as internally developed patents and internally developed software and other long-term assets. Acquired identifiable intangible assets with definite lives include customer relationships, order backlog, existing technology and patents acquired as part of the Company's acquisitions as described in "Note 2: Business Combinations". The Company capitalizes application fees, license fees, legal and other costs of successfully defending a patent from infringement, as well as the costs of successfully defending a trademark or trade name from infringement. The remaining costs are expensed as incurred.

Annually, and more frequently if circumstances warrant it, the Company reviews the carrying amount of its long-lived assets to determine if circumstances exist indicating an impairment, or if depreciation or amortization lives should be modified. If facts or circumstances support the possibility of impairment, the Company will prepare a projection of the undiscounted future cash flows of the asset group and determine if the asset group is recoverable. If impairment exists based on these projections, an adjustment will be made to the carrying amounts or remaining lives of the asset group to reflect the amount of impairment. Such analysis necessarily involve significant judgments and estimations on the part of the Company.

Deferred Financing Costs

Financing costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized over the life of the underlying indebtedness using the straight-line method, which approximates the effective interest rate method. In the years ended December 31, 2018 and 2017, the Company recorded amortization of deferred financing costs of \$1.8 million and \$3.2 million, respectively. These amortization costs are included as part of Interest expense in other expense, net in the consolidated statements of operations. See "Note 7: Financing Arrangements" for further information on these financing activities.

Warranty Liability

Products are warranted to be free from material defects for a period not to exceed two years from the date of installation. Provisions for estimated warranty and other related costs are recorded in cost of sales and are periodically adjusted to reflect actual experience. The amount of accrued warranty liability reflects management's best estimate of the expected future costs of honoring the Company's obligations under its limited warranty plans. The costs of fulfilling the Company's warranty obligations principally involve replacement parts, labor and sometimes travel for any field retrofits. Warranty expense is recorded in Cost of sales in the consolidated statements of operations.

Insurance Reserves

Until 2018, the Company was self-insured for a portion of the cost of employee group health insurance, medical, dental, and vision in the United States. As of January 1, 2018, the Company only self-insured employee dental benefits and as of January 1, 2019, the Company was no longer self-insured for any employee benefits.

For self-insured plans, the Company recorded the costs of its health insurance plan which included paid claims, the change in the estimate of incurred but not reported ("IBNR") claims, taxes, and administrative fees (collectively the "Plan Cost"). The Company regularly reviewed its estimates of reported and unreported claims and provided for these losses through insurance reserves. These reserves were influenced by rising costs of health care and other costs, increases in claims, time lag in claim information, and levels of excess loss insurance coverage carried.

The Company's annual Plan Cost was \$537,000, for dental claims only, and \$8.6 million, for medical and dental claims, for the years ended December 31, 2018 and 2017, respectively. The Company did not record an IBNR balance at December 31, 2018, and the liability, including IBNR, recorded in Accounts payable, was \$911,000 as of December 31, 2017.

Income Taxes

The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company records net deferred tax assets to the extent it believes these assets will more likely than not be realized. In making such determination, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In the event the Company was to determine that it would not be able to realize its deferred income tax assets in the future in excess of its net recorded amount, the Company would make an adjustment to the valuation allowance which would increase the provision for income taxes.

The Company's income tax returns are periodically audited by U.S. federal, state and local and foreign tax authorities. These audits include questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. At any one time, multiple tax years are subject to audit by the various tax authorities. In evaluating the tax benefits associated with the Company's various tax filing positions, the Company records a tax benefit for uncertain tax positions using the highest cumulative tax benefit that is more likely than not to be realized. A number of years may elapse before a particular matter, for which a liability has been established, is audited and effectively settled. The Company adjusts its liability for unrecognized tax benefits in the period in which it determines the issue is effectively settled with the tax authorities, the statute of limitations expires for the relevant taxing authority to examine the tax position or when more information becomes available.

The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax benefit line in the accompanying consolidated statements of operations. Accrued interest and penalties are included within Long-term payables in the consolidated balance sheets as the amounts are not material for any of the balance sheet periods presented.

Fair Value Measurements

The fair values of the Company's financial instruments reflect the amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

The Company's financial instruments not required to be adjusted to fair value on a recurring basis consist principally of cash, receivables, cost-method investment, accounts payable, accrued expenses, deferred revenue, customer deposits and debt. The Company believes the carrying amount of receivables, accounts payable, accrued expenses, deferred revenue and customer deposits approximate fair value due to their relatively short maturities.

Revenue Recognition

The Company recognizes revenue for sales of advanced manufacturing solutions, which include UHP waterjet systems, UHP pumps, cutting heads and after-market products upon shipment or delivery of the completed product to the customer as specified by the customer purchase order. Certain contracts with customers contain a customer acceptance clause. In these circumstances, the Company recognizes revenue upon customer acceptance provided all revenue recognition criteria have been met. Customer advances for partial payment of products are deferred and accounted for as current liabilities until delivery has occurred and the related revenue is recognized. Revenue from service agreements is recognized as earned when services have been rendered.

The Company recognizes revenue for its advanced manufacturing solutions when the customer has assumed risk of loss of the goods sold and all performance obligations are complete. Advanced manufacturing solutions contain separate revenue components consisting of two separate deliverables consisting of the machine and software that is essential to the functionality of the machine ("the system") and installation services. Additional elements, such as incidental consumable spares, essential software support and upgrades, as well as the Company's standard warranty, are not considered to be significant or separable elements to the arrangement. The Company accounts for the revenue components separately. To determine the relative selling price of each revenue component, the Company uses estimated selling prices for its system hardware and installation services based on a cost plus margin approach.

The Company offers repair and maintenance service contracts to its customers. Services under these contracts include preventive maintenance and intensifier parts exchanges that cover a period of up to two years. These service contracts can be bundled with the Company's UHP waterjet systems and are recognized ratably over their contractual periods, which approximates their pattern of utilization by the customers.

The Company allocates consideration to its revenue components at the inception of an arrangement based on their relative selling price, and the applicable revenue recognition criteria are applied to each of the revenue components. The Company uses the estimated selling price in accordance with the selling price hierarchy to allocate arrangement consideration to each revenue component. Estimated selling prices would be determined by considering multiple factors, which may include existing and forecasted market conditions, internal costs, gross margin objectives, prior pricing practices, and geographic market strategies. The Company uses estimated selling prices in the absence of vendor-specific objective evidence since it is unable to establish comparable third-party evidence of selling price for its revenue components based on limited availability of information and the level of customization and differentiation of similar products. Furthermore, the Company is unable to reliably determine what similar competitor product selling prices are on a cost-plus-margin approach.

Appropriate provisions are made for discounts, returns and sales allowances based on management's best estimate and the historical experience. Sales are recorded net of amounts invoiced for taxes imposed on the customer such as excise or value-added taxes.

The Company also enters into contracts with customers to build customized waterjet cutting systems. Revenue for these contracts are recognized under the percentage-of-completion ("POC") method. Under the POC method, revenue is recognized based on the costs incurred to date as a percentage of the total estimated costs to fulfill the contract. If circumstances arise that change in the original estimate of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are recorded in income in the period in which the circumstances give rise to the revision become known to the Company. The Company performs

ongoing reviews of the profitability of these contracts, and updates their estimates as needed. If at any time these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is immediately recognized on the consolidated statements of operations.

Cost of Sales

Cost of sales is generally recognized when products are shipped or services are delivered. Cost of sales includes direct and indirect costs associated with the manufacture, installation and service of the Company's systems pumps and consumable parts sales, including estimated future warranty obligations. Direct costs include material and labor, while indirect costs include, but are not limited to, depreciation, inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, other costs of the Company's distribution network, and foreign currency exchange gains and losses related to inventory purchases and sales.

Shipping and Handling Fees and Costs

Shipping and handling revenues and costs are reflected in sales and cost of sales, respectively, in the consolidated statements of operations.

Advertising Costs

Advertising costs are expensed as incurred and included in Sales and marketing expense in the consolidated statements of operations and amounted to \$634,000 and \$832,000 for the years ended December 31, 2018 and 2017, respectively.

Research and Development

The majority of research and development expenses are related to research and development efforts undertaken by the Company which are expensed as incurred. Research and development expenses were \$13.5 million and \$15.1 million for the years ended December 31, 2018 and 2017, respectively.

Software Development Costs

Software development include costs to develop applications that are essential to system functionality. These costs are capitalized at the point when software technological feasibility has been established and end when a product is available for general release to customers. The Company establishes technological feasibility when a detailed program design has been created or when a working model has been completed.

Sales and Long-Lived Assets by Region

The table below presents the Company's sales and long-lived assets categorized by geographical region, (in thousands):

| | Years ended December 31, | |
|-----------------------------|-----------------------------|-------------------|
| | 2018 | 2017 |
| Sales by Geographic Region: | | |
| United States | \$ 222,893 | \$ 236,344 |
| Europe, Middle East, Africa | 120,405 | 119,736 |
| Asia Pacific | 50,495 | 46,139 |
| Latin America | 33,176 | 25,948 |
| Canada | 21,748 | 18,666 |
| Total | <u>\$ 448,717</u> | <u>\$ 446,833</u> |
| | | |
| | December 31, | |
| | 2018 | 2017 |
| Long-Lived Assets: | | |
| United States | \$ 166,860 | \$ 166,595 |
| Europe, Middle East, Africa | 44,163 | 49,583 |
| Asia Pacific | 30,447 | 32,081 |
| Latin America | 6,203 | 7,104 |
| Canada | 5,017 | 3,365 |
| Total | <u>\$ 252,690</u> | <u>\$ 258,728</u> |

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued accounting guidance, *Revenue from Contracts with Customers*, which establishes a comprehensive revenue recognition standard for virtually all industries under GAAP and supersedes previously issued revenue recognition requirements as well as most industry-specific guidance. The Company has engaged a third-party consultant to assist with its assessment of the impact of the new revenue guidance on its operations, consolidated financial statements and related disclosures. To date, this assessment has included (1) discussions with management to assist with the identification of our revenue streams, (2) performing contract analyses for each revenue stream identified, and (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard. The new standard will become effective for the Company beginning with the first quarter of 2019, and the Company is evaluating the impact of adopting this guidance.

In February 2016, the FASB issued final accounting guidance, *Leases*, which establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

In January 2017, the FASB issued final accounting guidance, *Simplifying the Test for Goodwill Impairment*, which simplifies the measurement of goodwill impairment by removing step two of the goodwill impairment test that requires the determination of the fair value of individual assets and liabilities of a reporting unit. This standard requires goodwill impairment to be measured as the amount by which a reporting unit's carrying value exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The new standard is effective for fiscal years beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests.

performed after January 1, 2017. The Company is currently assessing the impact of adoption on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In February 2018, the FASB issued accounting guidance, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which requires companies to reclassify the stranded effects in other comprehensive income to retained earnings as a result of the change in the tax rates under the Tax Cuts and Jobs Act. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this guidance is permitted, and the Company is currently evaluating the impact of adopting this guidance.

Recently Adopted Accounting Pronouncements

In November 2016, the FASB issued final accounting guidance to the presentation of restricted cash within the statement of cash flows. The new guidance requires that restricted cash be included within cash and cash equivalents on the statement of cash flows. This standard is effective retrospectively for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company adopted the standard effective December 31, 2018, and the Company's consolidated statement of cash flows for the year ended December 31, 2017, was adjusted to conform to the new presentation.

In January 2017, the FASB issued final accounting guidance, *Clarifying the Definition of a Business*, which narrows the definition of a business and provides a framework that gives entities a basis for making reasonable judgments about whether a transaction involves an asset or a business. It further states that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. If this initial test is not met, a set cannot be considered a business unless it includes an input and a substantive process that together significantly contribute to the ability to create output. The new standard is effective for fiscal years beginning after December 15, 2017. The Company adopted this standard on January 1, 2018, and it did not have a material effect on its consolidated results of operations, financial position, cash flow and related financial statement disclosures.

In October 2016, the FASB issued final accounting guidance to the accounting for income taxes, *Intra-Entity Transfers of Assets Other Than Inventory*, which requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. For intercompany transfers of inventory, the income tax effects will continue to be deferred until the inventory has been sold to a third party. The Company adopted this standard on January 1, 2018 and it did not have a material effect on its consolidated results of operations, financial position, cash flow and related financial statement disclosures.

Note 2: Business Combinations

In the year ended December 31, 2018, the Company acquired substantially all of the assets, including the customer relationships and trademarks, of a Canadian company participating in the high pressure pascalization market for \$2.3 million. Total consideration included cash paid of \$800,000 and an earn-out provision with an acquisition date fair value of \$1.5 million.

In the year ended December 31, 2017, the Company acquired substantially all of the assets, including the customer relationships and trademarks, of a North American waterjet toolmaking company for \$1.0 million. The Company also acquired all of the assets, including the existing technology, for \$2.1 million consideration, of an Asian waterjet manufacturer. Total consideration included cash paid of \$1.4 million and estimated future commissions of \$710,000.

2016 Acquisition of Aquarese

In 2016, the Company acquired 100% of the equity interest in Aquarese Industries, SA ("Aquarese"), a France-based provider of robotics cutting systems for the European aerospace and automotive industries.

The purchase price includes an escrow of \$553,000, of which \$176,000 and \$175,000 was released to Aquarese's former owners in the years ended December 31, 2018 and 2017, respectively, and the remainder is scheduled to be released in 2019.

The acquisition agreement contained an earn-out provision to pay certain Aquarese owners who became key employees on the acquisition date. A portion of the earn-out provision was deemed to be contingent consideration with an acquisition date fair value of \$1.4 million as it was not dependent on subsequent employment. The remainder of the earn-out provision was deemed to be an incentive compensation for future employment services. The incentive compensation's potential cash payments are based on certain service and performance metrics which are earned over the three years subsequent to the acquisition date. The potential payout for the incentive compensation was initially estimated at \$1.5 million, and the installments for both the contingent consideration and incentive compensation are due on each anniversary date of the acquisition for the three years subsequent to the acquisition.

In the year ended December 31, 2018, the Company paid \$837,000 to settle the liability for the first two years of the earn-out provision, all of which was recorded against the contingent consideration liability. The balance of the incentive compensation liability, recorded in accrued payroll and related liabilities on the consolidated balance sheet, was \$464,000 and \$487,000 at December 31, 2018 and 2017, respectively.

See "Note 12: Fair Value of Financial Instruments" for information on the calculation of the earn-out liability and the balances at December 31, 2018 and 2017.

2016 Acquisition of TOPS

In 2016, the Company acquired 100% of the equity interest in TOPS Co., Ltd. ("TOPS"), a South Korea-based supplier of waterjet cutting systems and manufacturing process solutions.

The purchase price includes an escrow of \$288,000, which was paid out to TOPS's former owners in the year ended December 31, 2017.

Upon the acquisition's completion, the Company entered into a compensation plan with certain key employees, as an incentive for future services. The compensation plan's potential cash payments are based on certain service and performance metrics which are earned over the five years subsequent to the acquisition date ("performance period"). The estimated potential payout is \$2.4 million, which is recognized on the straight-line basis over the performance period with installments due on each anniversary date of the acquisition. The Company recognized \$508,000 and \$588,000 related to the potential incentive compensation for the years ended December 31, 2018 and 2017, respectively, in general and administrative expenses in the consolidated statements of operations. The Company paid \$443,000 and \$336,000 of incentive payments to those key employees in the years ended December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, the accrued liability was \$512,000 and \$483,000, respectively.

2016 Acquisition of Projet Systems Group

In 2016, the Company acquired 100% of the equity interest in Projet Systems Group ("Projet"), a Sweden-based water pump and aftermarket businesses primarily serving European automotive companies, and the consideration included additional consideration of \$1.5 million, which was paid to Projet's former owner in the year ended December 31, 2017.

2015 Acquisition of APS Pressure Systems

On October 30, 2015, the Company acquired 100% of the equity interest in APS Pressure Systems, LLC, a Houston-based manufacturer and distributor of waterblasting equipment and accessories.

The purchase agreement called for a potential earn-out payment to be made within 36 months of the acquisition, based on the average performance, as defined in the agreement, of the acquired business during the 36 months following the acquisition. Because these earnout payments are forfeited if the selling shareholders do not continue their employment with the Company, such earnout payments, if any, are accounted for as compensation expense in the period earned and not part of the acquisition accounting. In the years ended December 31, 2018 and 2017, the Company recorded expense of \$3.3 million and \$2.7 million related to the potential earn-out payment in general and administrative expenses in the consolidated statement of operations. At December 31, 2017, the liability for the earn-out payment was recorded in accrued expenses in the consolidated balance sheets was the \$5.8 million. The final calculated earn-out of \$9.1 million was paid to the former owners in the year ended December 31, 2018.

2015 Acquisition of Tech-Con Automation

On June 15, 2015, the Company acquired 100% of the equity interest in Tech-Con Automation, a Canadian-based provider of palletizing and material handling solutions as well as robotic waterjet cutting cells.

The purchase agreement called for a potential earn-out payment to be made within 24 months of the purchase date, based on the average performance, as defined in the agreement, of the acquired business during the 24 months following the acquisition. Because these earnout payments are forfeited if the selling shareholders do not continue their employment with the Company, such earnout payments were accounted for as compensation expense in the period earned and not part of the original acquisition accounting. In the year ended December 31, 2017, the Company recorded expense of \$1.6 million related to the potential earn-out payment in general and administrative expenses in the consolidated statements of operations, and the \$3.4 million total earn-out was paid in the year ended December 31, 2017.

Note 3: Receivables, net

Receivables, net, consisted of the following (in thousands):

| | December 31, | |
|---|------------------|------------------|
| | 2018 | 2017 |
| Trade accounts receivable | \$ 72,386 | \$ 65,653 |
| Unbilled revenues | 7,872 | 8,058 |
| Costs and estimated earnings in excess of billings on production-type contracts | 5,300 | 9,378 |
| | 85,558 | 83,089 |
| Less: allowance for doubtful accounts | (1,820) | (2,389) |
| Receivables, net | <u>\$ 83,738</u> | <u>\$ 80,700</u> |

Unbilled revenues do not contain any amounts that are expected to be collected after one year.

Activity in the allowance for doubtful accounts was as follows (in thousands):

| | Years ended December 31, | |
|--|-----------------------------|-----------------|
| | 2018 | 2017 |
| Beginning balance | \$ 2,389 | \$ 3,054 |
| Provision (benefit) for doubtful receivables | 430 | (607) |
| Write-offs and adjustments | (999) | (58) |
| Ending balance | <u>\$ 1,820</u> | <u>\$ 2,389</u> |

Note 4: Inventories, net

Inventories consisted of the following (in thousands):

| | December 31, | |
|-------------------------------------|-------------------|-------------------|
| | 2018 | 2017 |
| Raw materials, parts and components | \$ 86,890 | \$ 70,722 |
| Work in process | 4,535 | 9,411 |
| Finished goods | 17,802 | 21,706 |
| Inventories, net | <u>\$ 109,227</u> | <u>\$ 101,839</u> |

Inventory amounts in the table above are shown net of the allowance for obsolete and excess inventory. Raw materials, parts and components include purchased finished components, which are used both in production and sold to customers as aftermarket parts.

Activity in the allowance for obsolete and excess inventory was as follows (in thousands):

| | Years ended December 31, | |
|---|-----------------------------|-----------------|
| | 2018 | 2017 |
| Beginning balance | \$ 5,217 | \$ 4,189 |
| Provision for obsolete and excess inventory | 491 | 729 |
| Write-offs and adjustments | 328 | 299 |
| Ending balance | <u>\$ 6,036</u> | <u>\$ 5,217</u> |

Note 5: Property, Plant, and Equipment, net

Property, plant and equipment are stated at cost. Property, plant and equipment acquired in an acquisition are stated at fair value. Additions, leasehold improvements and major replacements are capitalized. When assets are sold, retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the consolidated statements of operations within operating income. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the related lease term, or the useful life of the asset. Expenditures for maintenance and repairs are charged to expense as incurred.

The carrying value of the Company's property, plant and equipment was as follows (in thousands):

| | Range of useful lives | December 31, | |
|--|---|------------------|------------------|
| | | 2018 | 2017 |
| Land and buildings | 10 - 40 years for buildings, indefinite for land | \$ 23,904 | \$ 16,952 |
| Leasehold improvements | Over the shorter of the life of the asset or the remaining lease term | 3,066 | 1,819 |
| Machinery and equipment | 5 - 7 years | 42,908 | 36,775 |
| Furniture and fixtures | 3 years | 2,130 | 2,024 |
| Computer equipment and software | 3 years | 22,346 | 15,000 |
| Property and equipment not yet placed in service | N/A | 6,921 | 10,687 |
| | | <u>101,275</u> | <u>83,257</u> |
| Accumulated depreciation | | <u>(39,457)</u> | <u>(30,521)</u> |
| Property, plant and equipment, net | | <u>\$ 61,818</u> | <u>\$ 52,736</u> |

Property and equipment not yet placed in service at December 31, 2018 includes \$4.1 million of capitalized software development costs related to software used in waterjet cutting systems that the Company sells, of which \$1.2 million and \$2.3 million were capitalized in the years ended December 31, 2018 and 2017, respectively.

Depreciation expense was recorded as follows (in thousands):

| | Years ended December 31, | |
|----------------------|-----------------------------|----------|
| | 2018 | 2017 |
| Depreciation expense | \$ 11,321 | \$ 9,215 |

Note 6: Goodwill and Other Intangible Assets

The Company recorded goodwill and intangible assets in connection with acquisitions accounted for as business combinations. Additionally, the Company recorded changes in goodwill and other intangible assets as a result of foreign currency translation effect on goodwill and other intangible assets allocated to foreign locations. The following table presents the changes in goodwill (in thousands):

| | Amounts |
|---|-------------------|
| Balance at December 31, 2016 | \$ 109,880 |
| North American waterjet toolmaking company | 405 |
| Aquarese measurement period adjustment | 68 |
| Asian waterjet manufacturer | 340 |
| Foreign currency fluctuation | 2,770 |
| Balance at December 31, 2017 | 113,463 |
| Canadian high pressure processing equipment manufacturer and seller | 818 |
| Foreign currency fluctuation | (2,368) |
| Balance at December 31, 2018 | <u>\$ 111,913</u> |

The Company's intangible assets other than goodwill consisted of the following (in thousands):

| | Weighted average lives in years | December 31, | |
|-------------------------------------|--|---------------------|------------------|
| | | 2018 | 2017 |
| Customer relationships | 10.1 | \$ 84,950 | \$ 85,134 |
| Existing technology | 7.6 | 48,522 | 48,884 |
| Trade names - indefinite lived | Indefinite | 31,926 | 31,644 |
| Trade names - definite lived | 8.0 | 3,055 | 3,157 |
| Patents | 9.2 | 18,624 | 18,875 |
| In-process research and development | Indefinite | 200 | 209 |
| Non-compete agreements | 4.9 | 3,710 | 3,808 |
| | | 190,987 | 191,711 |
| Less: accumulated amortization | | (116,215) | (101,964) |
| Total intangible assets, net | | <u>\$ 74,772</u> | <u>\$ 89,747</u> |

Amortization and impairment expense was recorded as follows (in thousands):

| | Years ended December 31, | |
|--|-------------------------------------|-------------|
| | 2018 | 2017 |
| Amortization and impairment of intangible assets | \$ 15,826 | \$ 22,573 |

The Company did not record any intangible asset impairment charges in the year ended December 31, 2018. In the year ended December 31, 2017, due to supply chain constraints, the Company lost most of the customer relationships that it acquired in the 2016 acquisition of the garnet business division of Opta Minerals, Inc. ("Opta"), a Canadian seller of refined garnet used in abrasive cleaning, waterjet cutting and water filtration applications. In year ended December 31, 2017, the Company determined that the other intangible assets acquired from Opta were fully impaired, and the Company recorded an impairment charge of \$2.1 million in general and administrative expenses in the consolidated statements of operations.

Expected amortization of definite-lived intangible assets held as of December 31, 2018 is as follows (in thousands):

| Year | Amounts |
|------------|------------------|
| 2019 | \$ 13,469 |
| 2020 | 10,462 |
| 2021 | 6,813 |
| 2022 | 4,772 |
| 2023 | 3,557 |
| Thereafter | 3,573 |
| | <u>\$ 42,646</u> |

Note 7: Financing Arrangements

On April 20, 2018, the Company entered into new credit agreements and former agreements were repaid and retired.

New Debt

The new credit agreements consist of term debt (the "Bank Term Debt"), with an original principal amount of \$300.0 million, a related revolving facility with an availability of \$15.0 million, and an ABL facility with an availability of \$60.0 million. The Company's loan proceeds were reduced by a debt discount of \$3.0 million, resulting in net loan proceeds of \$297.0 million.

The Bank Term Debt is secured by certain of the Company's assets. The Bank Term Debt accrues interest at a base rate of 2% plus the Eurodollar interest rate over interest periods ranging from one to six months. Interest is payable on a monthly and quarterly basis and the weighted-average interest rate on the Bank Term Debt for the year ended December 31, 2018 was 5.2%. The credit agreement requires quarterly principal payments of at least \$750,000. The Bank Term Debt's unpaid principal balance at December 31, 2018 was \$298.5 million.

The revolving debt related to the Bank Term Debt has the same interest terms. As of December 31, 2018, there were no borrowings under that revolving debt agreement.

The ABL facility is secured by certain accounts receivable and inventory, net of reserve balances, for certain of the Company's subsidiaries. The ABL facility accrues interest at rates based on Eurocurrency and Canadian prime rates. As of December 31, 2018, there were no borrowings under that revolving debt agreement.

Due to the market-rate interest paid on the Bank Term Debt, its gross carrying value of \$298.5 million at December 31, 2018 approximates its fair value and is categorized as Level 2 in the fair value hierarchy.

At December 31, 2018, the Company's unamortized deferred financing costs related to the Bank Term Debt were \$5.7 million, and were recorded against the Bank Term Debt's long-term principal balance of \$295.5 million, which resulted in a net long-term balance payable of \$289.8 million, and a short-term balance payable of \$3.0 million.

At December 31, 2018, the Company's unamortized deferred financing costs related to the ABL Facility were \$1.3 million, and comprised the balance of deferred financing costs, net on the consolidated balance sheet.

As of December 31, 2018, the Company had availability of a \$54.5 million borrowing base of the \$60.0 million ABL Facility, of which, none was drawn as of December 31, 2018.

Retired Debt

At December 31, 2017, the Company had \$225.0 million in outstanding senior secured notes, which were issued in 2014. Interest accrued at a rate of 7.625% per annum and was payable semi-annually in arrears on February 1 and August 1.

At December 31, 2017, the Company had \$25.6 million in an outstanding revolving loan. The loan accrued interest monthly, based on the London interbank offered rate, and in the year ended December 31, 2017, the loan accrued interest at a weighted-average interest rate of 5.8%.

On April 20, 2018, the senior secured notes and revolving loan were retired in conjunction with issuing the Bank Term Debt. A settlement premium of \$4.3 million was paid to the holders of the senior secured notes, and the Company recorded a loss on retirement of those debts of \$9.9 million in the consolidated statement of operations for the year ended December 31, 2018.

The fair value of the senior secured note was determined based on quoted broker prices and was categorized accordingly as Level 2 in the fair value hierarchy at December 31, 2017. Due to the market-rate interest paid on the revolving loan balance, its gross carrying value of \$25.6 million at December 31, 2017 approximated its fair value and was categorized as Level 2 in the fair value hierarchy.

Bank Term Debt and ABL Facility Covenants

The Bank Term Debt and the ABL facility contains events of default including, but not limited to, nonpayment of principal or interest, violation of covenants, breaches of representations and warranties, cross-default to other debt, bankruptcy and other insolvency events, material judgments, certain events, and certain changes of control of Shape Technologies Group. The Company was in compliance with all its financial covenants during the year ended December 31, 2018.

Other Debt

The Company's other debt is recorded in Other debt, short-term and Other debt, long-term, on the consolidated balance sheets, and accrues interest at rates between 0.0% and 5.0%.

Due to the market interest rates paid on the other debt, their carrying values approximate fair value and were categorized as Level 2 in the fair value hierarchy at December 31, 2018 and 2017.

Aggregate annual principal maturities under the Bank Term Debt, ABL facility, and other debt consist of the following for the years ending (in thousands):

| Year | Amounts |
|---|----------------|
| 2019 | \$ 8,860 |
| 2020 | 5,227 |
| 2021 | 5,084 |
| 2022 | 3,358 |
| 2023 | 3,000 |
| Thereafter | 283,500 |
| | 309,029 |
| Deferred financing costs ⁽¹⁾ | (5,746) |
| Total financing arrangements, net | \$ 303,283 |

(1) Amounts do not include \$1.3 million shown as deferred financing costs, net on the consolidated balance sheet at December 31, 2018, related to revolving debt facilities.

Note 8: Warranties

The following table presents the activity for the Company's warranty obligations (in thousands):

| | Years ended December 31, | |
|--------------------|-----------------------------|-----------------|
| | 2018 | 2017 |
| Beginning balance | \$ 2,173 | \$ 2,663 |
| Warranty provision | 2,190 | 2,194 |
| Settlements made | (2,500) | (2,684) |
| Ending balance | <u>\$ 1,863</u> | <u>\$ 2,173</u> |

The Company's warranty provision balance is included in accrued expenses on the consolidated balance sheets.

Note 9: Income Taxes

The 2017 Tax Act was signed into law on December 22, 2017. The 2017 Tax Act significantly revises U.S. corporate income taxes by lowering the statutory tax rate from 35% to 21%, eliminating certain deductions, imposing a mandatory one-time tax on accumulated earnings of foreign subsidiaries, introducing new tax regimes, and changing how foreign earnings are subject to U.S. tax. The 2017 Tax Act also enhanced, and extended through 2026, the option to claim accelerated depreciation deductions on qualified property.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. As a result of the reduction in the U.S. corporate tax rate from 35% to 21%, under the 2017 Tax Act, the Company revalued its ending net deferred tax liabilities as of December 31, 2017 and increased its tax benefit by \$6.1 million.

The 2017 Tax Act provided for a one-time tax on accumulated earnings of foreign subsidiaries. The Company did not pay any U.S. federal cash taxes under this provision.

Beginning in 2018, global intangible low-taxed income ("GILTI") provisions will be applied providing an incremental tax on low taxed foreign income. The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's tangible assets. Under U.S. GAAP, the Company is required to make an accounting policy election to either (1) treat taxes due related to GILTI as a current-period expense when incurred (the "period cost method") or (2) factor such amounts into the Company's measurement of its deferred taxes (the "deferred method"). The Company has adopted its policy to account for the related impacts as a current-period expense when incurred.

The income tax benefit is based on loss before income taxes reported for financial statement purposes. The components of income (loss) before income taxes, based on tax jurisdiction, are as follows (in thousands):

| | Years ended December 31, | |
|--------------------------------|-----------------------------|-------------------|
| | 2018 | 2017 |
| Loss before income taxes: | | |
| United States loss | \$ (35,357) | \$ (8,622) |
| Foreign income | 18,727 | 5,121 |
| Total loss before income taxes | <u>\$ (16,630)</u> | <u>\$ (3,501)</u> |

The income tax benefit (expense) is comprised of the following (in thousands):

| | Years ended December 31, | |
|------------------------------|-------------------------------------|-----------------|
| | 2018 | 2017 |
| Federal | \$ (1,106) | \$ 270 |
| State | (402) | (450) |
| Foreign | (5,133) | (7,203) |
| Current tax expense | (6,641) | (7,383) |
| Federal | 662 | 11,230 |
| State | 295 | 317 |
| Foreign | 4 | 4,033 |
| Deferred tax benefit | 961 | 15,580 |
| Income tax benefit (expense) | <u>\$ (5,680)</u> | <u>\$ 8,197</u> |

The reconciliation between the Company's effective tax rate on loss before income taxes and the statutory tax rate is as follows:

| | Years ended December 31, | |
|--|-------------------------------------|-----------------|
| | 2018 | 2017 |
| Income tax provision at federal statutory rate | (21.0)% | (35.0)% |
| State and local taxes net of federal taxes | 1.6 % | 2.8 % |
| Nondeductible/nontaxable items | 2.4 % | 26.5 % |
| Foreign operations | 18.9 % | 25.8 % |
| Valuation allowance | 25.9 % | 2.2 % |
| Tax return to provision adjustments | 9.7 % | 11.6 % |
| Unrecognized tax benefits | 5.9 % | 32.0 % |
| Undistributed earnings | (6.1)% | (7.4)% |
| Research and development credits | (3.1)% | (118.8)% |
| US statutory tax rate change | — % | (173.1)% |
| Other, net | — % | (0.7)% |
| Income tax provision (benefit) | <u>34.2 %</u> | <u>(234.1)%</u> |

Components of the net deferred tax assets (liabilities) consisted of the following (in thousands):

| | December 31, | |
|----------------------------------|--------------|-----------|
| | 2018 | 2017 |
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 8,642 | \$ 10,139 |
| Inventory | 2,768 | 2,575 |
| Interest | 4,697 | — |
| Revenue | — | 1,165 |
| Reserves | — | 1,047 |
| Compensation | 1,767 | 2,697 |
| Research and development credits | 4,681 | 4,160 |
| Other | 6,713 | 5,988 |
| Deferred tax assets | 29,268 | 27,771 |
| Valuation allowance | (8,001) | (3,879) |
| Total deferred tax assets | \$ 21,267 | \$ 23,892 |

| | December 31, | |
|-------------------------------------|--------------|------------|
| | 2018 | 2017 |
| Deferred tax liabilities: | | |
| Foreign earnings | \$ — | \$ (1,175) |
| Intangible assets | (18,840) | (21,343) |
| Property, plant and equipment | (2,316) | (1,284) |
| Other | (5,608) | (5,935) |
| Deferred income tax liabilities | (26,764) | (29,737) |
| Net deferred income tax liabilities | \$ (5,497) | \$ (5,845) |

The \$4.1 million change in the valuation allowance for deferred tax assets between December 31, 2018 and 2017 is primarily related to the new US tax law, the Tax Cuts and Jobs Act of 2017, which places limitations on the deductibility of interest.

As of December 31, 2018, the Company had \$1.3 million of federal and \$17.9 million of state net operating loss carryforwards reported on the consolidated financial statements. A company's ability to utilize a portion of its net operating loss carryforwards to offset future taxable income may be subject to limitation under Section 382 of the Internal Revenue Code due to changes in the equity ownership of the company. The Company conducted a Section 382 analysis and determined that an ownership change occurred in a prior period and the Company's net operating loss utilization amount is limited to \$14.0 million on an annual basis. State net operating losses will expire between 2021 and 2034 while the federal net operating losses have an indefinite carryforward. As of December 31, 2018, the Company had net operating loss carryforwards in foreign jurisdictions of \$21.9 million reported on the consolidated financial statements available to offset future taxable income. Certain foreign net operating losses expire between 2023 and 2034. As of December 31, 2018, the Company's research and development tax credit carryforwards for income tax purposes were \$4.7 million. If not utilized, a portion of the research and development tax credit carryforwards will begin to expire in 2030.

The Company currently repatriates the earnings of its foreign subsidiaries.

The following is a tabular reconciliation of the total amounts of the Company's unrecognized tax benefits (in thousands):

| | Years ended December 31, | |
|---|-----------------------------|------------------|
| | 2018 | 2017 |
| Balance, beginning of year | \$ 14,086 | \$ 13,272 |
| Decreases related to cash settlements | — | (48) |
| Gross increases - tax positions in current period | 1,062 | 596 |
| Gross increases - tax positions in prior periods | — | 330 |
| Gross increases (decreases) in tax positions due to currency fluctuations | (20) | 1 |
| Gross decreases in tax positions due to lapse of statute of limitations | (126) | (65) |
| Balance, end of year | <u>\$ 15,002</u> | <u>\$ 14,086</u> |

The \$15.0 million of unrecognized tax benefits as of December 31, 2018, if recognized, would affect the effective tax rate and would result in adjustments to other tax accounts, primarily deferred taxes. The Company estimated a range of \$900,000 to \$1.0 million for which it is reasonably possible the total amount of uncertain tax benefits will change in the next 12 months related to transfer pricing due to the expiration of the statute of limitations. In addition, the unrecognized tax benefit balance can fluctuate due to the outcome of the research and development credit study.

The Company recorded interest and penalties of \$1.4 million and \$1.1 million in long-term payables in the consolidated balance sheets as of December 31, 2018 and 2017, respectively, related to uncertain tax positions. During the years ended December 31, 2018 and 2017 the Company recorded net interest expense of \$273,000 and \$305,000, respectively, which is included in Income tax benefit on the consolidated statements of operations.

The Company is subject to taxation in the United States, various state and foreign jurisdictions. The Company is no longer subject to examinations by tax authorities for years prior to year 2001.

Note 10: Stock-Based Compensation

Stock-Based Compensation

In October 2014, Shape Technologies Group Parent Holdings, Inc., the Company's parent, adopted an equity compensation plan (the "Plan") to promote the growth and success of the business by aligning long-term interests of employees with those of shareholders. There are 21,500 shares authorized for issuance under the Plan in the form of stock, stock units, stock options, stock appreciation rights, or cash awards. As of December 31, 2018, the Parent Company had 1,329 shares of common stock available for future issuance under its Plan.

Stock Options

The Company's parent grants stock options to employees in certain management positions of the Company with service and/or performance conditions. For options granted under the Plan, 50% of them vest ratably at 10% or 12.5% each vesting date, which is an anniversary of a date established when granted, which is a month-end after the grant date, during the calendar year of the grant, and the vast majority of awards vest at 10% per annum. The remaining 50% will vest upon a change of control event provided the transaction price exceeds various thresholds. The awards are exercisable upon a change of control event or, in the case of the time vested options, immediately prior to their expiration date if a change of control event has not occurred. The compensation cost of stock options expected to vest is based on their fair value at the date of grant, net of expected forfeitures, and recognized ratably over the vesting period for the time vested options. No compensation cost will be recorded for the performance based awards until it is deemed probable that a change of control event will occur at a price in excess of the performance thresholds.

The Company uses the Black-Scholes option-pricing model to calculate grant-date fair value of the Parent's stock options using the assumptions noted in the following table. The expected term of the options was computed using the estimated period of time over which the options will be outstanding before being exercised. The risk-free interest rates are determined using the implied yield currently available for zero-coupon U.S. government issues with a remaining term equal to the expected term of the awards. Volatility is calculated using the average volatility of comparable public companies due to the Company's limited historical stock transactions.

The weighted fair value of stock options on the date of grant and the assumptions used to estimate the fair value of the stock options using the Black-Scholes option valuation model, were as follows:

| | Year ended |
|--|---------------------|
| | December 31, |
| | 2017 |
| Expected life from grant date (in years) | 6.3 |
| Risk-free interest rate | 1.9% |
| Volatility | 35% |
| Weighted-average fair value (per share) | \$ 712 |

The Company did not grant any stock options in the year ended December 31, 2018.

The Company has not declared or paid any cash dividends on its common stock and does not anticipate that any dividends will be paid in the foreseeable future based upon management intent.

The following table summarizes stock option activities for the year ended December 31, 2018:

| | Number of Options | Weighted- Average Exercise Price | Weighted- Average Remaining Life (Years) |
|-------------------------------------|------------------------------|---|---|
| Outstanding at beginning of period | 19,709 | \$ 1,247 | 6 |
| Settled | (18) | 1,313 | — |
| Forfeited | (80) | 1,625 | — |
| Outstanding at end of period | <u>19,611</u> | <u>\$ 1,245</u> | <u>6</u> |
| Options exercisable | — | — | — |
| Options vested and expected to vest | 17,108 | 1,228 | 6 |

The Company included the following amounts for stock-based compensation expense, which related to stock options, in the consolidated statements of operations (in thousands):

| | Years ended | |
|----------------------------|---------------------|---------------|
| | December 31, | |
| | 2018 | 2017 |
| Cost of sales | \$ 89 | \$ 84 |
| Sales and marketing | 158 | 147 |
| Research and development | 112 | 113 |
| General and administrative | 719 | 649 |
| Total | <u>\$ 1,078</u> | <u>\$ 993</u> |

Total unrecognized stock compensation expense is \$6.0 million at December 31, 2018, of which, \$730,000 is expected to be recognized over a weighted-average period of 0.9 years with the remaining \$5.3 million to be recognized when, or if, it becomes probable that a change of control event will occur at a price in excess of the performance thresholds, as defined in the agreement.

Note 11: Retirement Plans

The Company has defined contribution 401(k) plans covering substantially all employees in the United States. The plans allow employees to defer a portion of their employment income. Participants age 50 or older may elect to defer additional amounts to the plans as allowed under the Internal Revenue Code. Each employee who elects to participate is eligible to receive Company matching contributions that are based on employee contributions to the plans, subject to certain limitations. Company contributions and expenses under the 401(k) plans were \$1.6 million and \$1.4 million for the years ended December 31, 2018 and 2017, respectively.

Note 12: Fair Value of Financial Instruments

Fair Value of Financial Instruments

The carrying value of the Company's current assets and liabilities approximates fair value due to the short-term maturity of these assets and liabilities. Financial assets and liabilities measured on a nonrecurring basis that are included in consolidated balance sheets consist of a cost-method investment. That financial asset is measured at fair value when impairment indicators exist. Due to significant unobservable inputs, the fair value measures used to evaluate impairment and to calculate a prevailing market interest rate are Level 3 inputs. There were no impairments identified for the years ended December 31, 2018 and 2017.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company discloses and classifies fair value measurements in one of the following three categories:

- Level 1.* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2.* Quoted prices in markets that are not active or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3.* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 and 2017 (in thousands):

December 31, 2018

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2018 |
|--|--|---|--|------------------------------------|
| Earn-out contingent consideration (Note 2) | \$ — | \$ — | \$ 2,840 | \$ 2,840 |

December 31, 2017

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2017 |
|--|--|---|--|------------------------------------|
| Earn-out contingent consideration (Note 2) | \$ — | \$ — | \$ 2,215 | \$ 2,215 |

The earn-out contingent consideration was incurred from various acquisitions in 2016, 2017 and 2018 as described in "Note 2: Business Combinations." The Company generally determined the fair values of the earn-out contingent consideration at December 31, 2018 and December 31, 2017 by using discounted cash flow models for the earn-out payments, weighted by the estimated probability of earn-out payments being earned and paid. The models relied upon certain unobservable inputs, including management's estimate of the range of future EBITDA achieved, the probabilities of achieving them, and the annual discount rates applied to the payments.

The following table presents a reconciliation for the Company's earn-out contingent consideration recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) (in thousands):

| | Years ended December 31, | |
|--|-----------------------------|-----------------|
| | 2018 | 2017 |
| Beginning balance | 2,215 | 1,320 |
| Losses (gains) in other comprehensive income | (61) | 185 |
| Additions | 1,526 | 710 |
| Settlements | (840) | — |
| Ending balance | <u>\$ 2,840</u> | <u>\$ 2,215</u> |

There were no significant transfers between any levels during the years ended December 31, 2018 and 2017.

Cost Method Investment

The Company has a 4.6% ownership stake in Dardi International ("Dardi"), a waterjet manufacturer based in China. This investment is accounted for under the cost method, as the Company does not have the ability to exercise significant influence. The Company acquired this investment as part of its acquisition of Flow and employed independent consultants to provide a third-party appraisal of the acquisition-date fair value based upon unobservable Level 3 inputs. The recorded balance at December 31, 2018 was \$650,000 in other long-term assets on the consolidated balance sheets.

The Company's cost method investment is evaluated on at least an annual basis for other-than-temporary impairment, or when an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. Impairment indicators the Company considers in each reporting period include the following:

- Significant deteriorations in earnings performance, asset quality or business prospects;
- Significant adverse changes in the regulatory, economic, or technological environment;
- Significant adverse changes in the general market condition or geographic area in which the investment operates;
- Industry and sector performance;
- Current equity and credit market conditions;
- Bona fide offers to purchase the investment for less than the carrying value; and
- Factors that raise significant concern, such as negative cash flow from operations or working capital deficiencies.

Based on consideration of the above indicators, the Company estimated that events and changes in circumstances in the year ended December 31, 2018, did not have significant adverse effect on the fair value of the investment. Given this, there was no remeasurement of the fair value during the year ended December 31, 2018. In addition, there was no remeasurement of the fair value during the year ended December 31, 2017.

Since there is no active trading market for this investment, it is relatively illiquid compared to equity instruments traded in active markets. Future changes in market conditions, the future performance of the investment, or new information provided by Dardi's management could affect the recorded value of the investment and the amount realized upon liquidation.

Note 13: Commitments and Contingencies

The following table summarizes the Company's known future payments pursuant to certain contracts as of December 31, 2018, and the estimated timing thereof (in thousands):

| | Payment by Year | | | | | | Total |
|---|------------------|------------------|------------------|------------------|------------------|------------------|-------------------|
| | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter | |
| Interest on debt (i) | \$ 16,493 | \$ 16,226 | \$ 15,999 | \$ 15,803 | \$ 15,637 | \$ 20,166 | \$ 100,324 |
| Operating leases (ii) | 4,903 | 2,654 | 1,230 | 579 | 570 | 702 | 10,638 |
| Earn-out and incentive agreements (iii) | 2,347 | 1,476 | 1,801 | — | — | — | 5,624 |
| | <u>\$ 23,743</u> | <u>\$ 20,356</u> | <u>\$ 19,030</u> | <u>\$ 16,382</u> | <u>\$ 16,207</u> | <u>\$ 20,868</u> | <u>\$ 116,586</u> |

- (i) Includes interest on the Bank Term Debt and other debt, based on interest rates at December 31, 2018. See "Note 7: Financing Arrangements."
- (ii) The Company rents certain facilities and equipment treated as operating leases for financial reporting purposes. The majority of leases currently in effect are renewable for periods of two to five years. Total rental expenses for facilities and equipment charged to operations under non-cancelable operating leases were \$5.7 million and \$4.5 million for the years ended December 31, 2018 and 2017, respectively.
- (iii) Earn-out and incentive agreements consist of payments potentially payable to the former owners of businesses acquired in 2016, 2017 and 2018 as well as payments potentially payable to TOPS's key employees, in agreements entered into as a result of the TOPS acquisition, and commissions for an acquisition in 2017. See "Note 2: Business Combinations." As of December 31, 2018, the range of the Company's estimate of the potential payouts is between \$4.5 million and \$6.7 million.

Pledged Assets

The Company has pledged a portion of its cash as collateral for certain of its revenue arrangements and property-lease banking arrangements. The following table provides a reconciliation of the amount of cash and restricted cash reported within the consolidated balance sheets to the total of the same such amounts shown in the consolidated statements of cash flows (in thousands):

| | December 31, | |
|---|------------------|-----------------|
| | 2018 | 2017 |
| Cash | \$ 14,440 | \$ 7,779 |
| Restricted cash in Prepaid expenses and other current assets | 699 | 1,035 |
| Restricted cash in Other long-term assets | 894 | 329 |
| Total cash and restricted cash shown in the consolidated statements of cash flows | <u>\$ 16,033</u> | <u>\$ 9,143</u> |

See "Note 7: Financing Arrangements" for information regarding the Company's assets pledged as collateral to secure its debt.

Product Liability

Currently there are outstanding product liability claims arising out of the sale of current and former products of the Company. To minimize the financial impact of these claims, the Company purchases product liability insurance.

Management periodically evaluates the merit of all claims, including product liability claims, as well as considering unasserted claims. Recoveries, if any, may be realized from indemnitors, codefendants, insurers or insurance guaranty funds. Management believes its insurance coverage is adequate to satisfy any liabilities that are incurred.

Legal Proceedings

The Company is, from time to time, party to various legal proceedings arising out of its business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, the Company's management believes that the Company's ultimate liability, if any, arising from pending legal proceedings, as well as from asserted legal claims and known potential legal claims which are probable of assertion, taking into account established accruals for estimated liabilities, should not be material to its business, financial condition or results of operations.

Personal Injury Actions

Product and general liability claims arise against the Company from time to time in the ordinary course of business. These claims are generally covered by appropriate insurance. Recoveries, if any, may be realized from indemnitors, codefendants, insurers or insurance guaranty funds. There is inherent uncertainty as to the eventual resolution of unsettled claims.

Management, however, believes that any losses will not have a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows.

Note 14: Related-Party Transactions

Flow Aerospace Systems, LLC ("Flow Aerospace"), a division of Ascent Aerospace ("Ascent"), an AIP portfolio company, is a designer and manufacturer of waterjet cutting systems for the aerospace industry that purchases products from the Company. The balances between SHAPE and all related parties are classified as current receivables and payables on the consolidated balance sheets and are settled under customary terms. The Company included the following amounts for transactions with Flow Aerospace, AIP, and other AIP-portfolio companies in the consolidated statements of operations (in thousands):

| | Years ended December 31, | |
|--------------------------------------|-----------------------------|----------|
| | 2018 | 2017 |
| Sales | \$ 1,026 | \$ 1,094 |
| Purchases and expense reimbursements | 866 | 427 |

The Company's balances with Flow Aerospace, AIP, and other AIP-controlled companies consisted of the following (in thousands):

| | December 31, | |
|-------------|--------------|--------|
| | 2018 | 2017 |
| Receivables | \$ 207 | \$ 257 |
| Payables | 15 | 87 |

On October 2, 2017, the Company acquired the aftermarket business of Ascent, consisting of delivery of waterjet related parts and support services for Ascent installed waterjet trimming machines for \$2.7 million in cash. As the Company and Ascent are under common control by AIP, the Company recorded the inventory and miscellaneous assets at amounts equivalent to Ascent's recorded amounts, which totaled \$2.7 million and primarily consisted of inventory. Subsequent to the transaction, the Company recorded charges of \$1.1 million and \$424,000 for estimated obsolescence of the acquired Ascent inventory to General and administrative expense in the years ended December 31, 2018 and 2017, respectively. The transaction included purchasing spare parts inventory, support equipment and intellectual property and excluded the retrofit service business. Under the purchase agreement, Ascent will continue to purchase parts and services from the Company as needed.

Note 15: Restructuring Charges

As part of its integration and optimization efforts, the Company reviews its global footprint and worldwide staffing to ensure that it is best positioned to service its customers. In the year ended December 31, 2018, the Company incurred excess inventory write-offs, personnel termination costs, and facilities movement costs related to the closure of its Kent, Washington, factory and its relocation to Baxter Springs, Kansas, and costs related to one-time improvements of its products. In the year ended December 31, 2017, the Company incurred excess inventory write-offs, personnel termination costs, and loss on sale of building related to the closure of its Jeffersonville, Indiana, facility, and costs related to one-time improvements of its products.

The Company's restructuring charges in conjunction with restructuring its operations consisted of the following (in thousands):

| | Years ended December 31, | |
|-----------------------|-----------------------------|----------|
| | 2018 | 2017 |
| Restructuring charges | \$ 19,525 | \$ 6,601 |

Following is a reconciliation of the beginning and ending balances of the restructuring liability (in thousands):

| | Employee termination benefits | Facilities consolidation costs | Other | Total |
|------------------------------------|-------------------------------------|--------------------------------------|-------------|---------------|
| Balance at December 31, 2017 | \$ 691 | \$ 23 | \$ — | \$ 714 |
| Provision for restructuring events | 1,887 | 16,155 | 1,483 | 19,525 |
| Payments and adjustments | (2,204) | (15,573) | (1,483) | (19,260) |
| Balance at December 31, 2018 | <u>\$ 374</u> | <u>\$ 605</u> | <u>\$ —</u> | <u>\$ 979</u> |

Note 16: Subsequent Events

The Company performed an evaluation of subsequent events through April 22, 2019, the date the financial statements were available to be issued and determined there were no recognized subsequent events that would require disclosure in the consolidated financial statements as of December 31, 2018.