HESKA CORP
Form 10-Q
November 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2018
OR

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

For the transition period from _________________ to _______________________
Commission file number: 0-22427
HESKA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	77-0192527
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3760 Rocky Mountain Avenue	
Loveland, Colorado	80538
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(970) 493-7272

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller Reporting Company ¨
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

7,589,249 shares of the Registrant's Public Common Stock, $.01 par value, were outstanding at November 6, 2018.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	September 30, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$9,236	$9,659
Accounts receivable, net of allowance for doubtful accounts of $234 and $215, respectively	13,647	15,710
Due from – related parties	—	1
Inventories, net	27,639	32,596
Lease receivable, current, net of allowance for doubtful accounts of $36 and $0, respectively	2,777	2,069
Contract acquisition costs, current	840	30
Other current assets	3,904	3,066
Total current assets	58,043	63,131
Property and equipment, net	16,284	17,331
Goodwill and intangible assets, net	28,349	28,645
Deferred tax asset, net	13,851	11,877
Lease receivable, non-current	11,521	9,615
Investments in unconsolidated affiliates	8,089	—
Contract acquisition costs, non-current	1,623	3
Other non-current assets	6,360	5,185
Total assets	$144,120	$135,787
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,545	$9,489
Due to – related parties	280	1,828
Accrued liabilities	10,518	4,417
Current portion of deferred revenue	2,766	3,992
Line of credit and other short-term borrowings	6,019	6,000
Total current liabilities	24,128	25,726
Deferred revenue, net of current portion, and other	8,391	9,621
Total liabilities	32,519	35,347
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $.01 par value, 10,250,000 and 10,000,000 shares authorized, respectively, none issued or outstanding	—	—
	76	73

Public common stock, $.01 par value, 10,250,000 and 10,000,000 shares authorized, 7,552,596 and 7,302,954 shares issued and outstanding, respectively		
Additional paid-in capital	249,755	243,598
Accumulated other comprehensive income	216	232
Accumulated deficit	(138,446)	(143,463)
Total stockholders' equity	111,601	100,440
Total liabilities and stockholders' equity	$ 144,120	$ 135,787

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Core companion animal health	$27,190	$25,578	$80,652	$75,453
Other vaccines, pharmaceuticals and products	3,765	4,758	12,729	17,847
Total revenue, net	30,955	30,336	93,381	93,300
Cost of revenue	16,161	16,783	52,215	51,609
Gross profit	14,794	13,553	41,166	41,691
Operating expenses:				
Selling and marketing	6,215	5,815	18,299	17,908
Research and development	935	601	2,165	1,576
General and administrative	11,239	3,359	20,223	11,081
Total operating expenses	18,389	9,775	40,687	30,565
Operating (loss) income	(3,595)	3,778	479	11,126
Interest and other (income) expense, net	(50)	(6)	37	(186)
(Loss) income before income taxes	(3,545)	3,784	442	11,312
Income tax expense (benefit):				
Current income tax expense	27	8	56	25
Deferred income tax (benefit) expense	(1,902)	693	(1,997)	762
Total income tax (benefit) expense	(1,875)	701	(1,941)	787
Net (loss) income	(1,670)	3,083	2,383	10,525
Net loss attributable to non-controlling interest	—	—	—	(498)
Net (loss) income attributable to Heska Corporation	$(1,670)	$3,083	$2,383	$11,023
Basic (loss) earnings per share attributable to Heska Corporation	$(0.23)	$0.43	$0.33	$1.58
Diluted (loss) earnings per share attributable to Heska Corporation	$(0.23)	$0.40	$0.30	$1.45
Weighted average outstanding shares used to compute basic (loss) earnings per share attributable to Heska Corporation	7,289	7,139	7,194	6,985
Weighted average outstanding shares used to compute diluted (loss) earnings per share attributable to Heska Corporation	7,289	7,668	7,820	7,580

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net (loss) income	$(1,670)	$3,083	$2,383	$10,525
Other comprehensive income (loss):				
Foreign currency translation	15	(45)	(16)	125
Comprehensive (loss) income	(1,655)	3,038	2,367	10,650
Comprehensive loss attributable to non-controlling interest	—	—	—	(498)
Comprehensive (loss) income attributable to Heska Corporation	$(1,655)	$3,038	$2,367	$11,148

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

Three Months Ended September 30, 2017 and 2018	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balances, June 30, 2017	7,196	$ 72	$ 241,575	$ 267	$ (145,339)	$ 96,575
Net income	—	—	—	—	3,083	3,083
Issuance of common stock, net of shares withheld for employee taxes	48	—	716	—	—	716
Stock-based compensation	—	—	707	—	—	707
Distribution for Heska Imaging minority interest	—	—	—	—	(9)	(9)
Other comprehensive loss	—	—	—	(45)	—	(45)
Balances, September 30, 2017	7,244	$ 72	$ 242,998	$ 222	$ (142,265)	$ 101,027
Balances, June 30, 2018	7,498	$ 75	$ 246,422	$ 201	$ (136,776)	$ 109,922
Net loss	—	—	—	—	(1,670)	(1,670)
Issuance of common stock, net of shares withheld for employee taxes	55	1	1,927	—	—	1,928
Stock-based compensation	—	—	1,406	—	—	1,406
Other comprehensive income	—	—	—	15	—	15
Balances, September 30, 2018	7,553	$ 76	$ 249,755	$ 216	$ (138,446)	$ 111,601

Nine Months Ended September 30, 2017 and 2018	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balances, December 31, 2016	7,026	$ 70	$ 238,635	$ 97	$ (151,827)	$ 86,975
Net income	—	—	—	—	10,525	10,525
Issuance of common stock, net of shares withheld for employee taxes	218	2	1,425	—	—	1,427
Stock-based compensation	—	—	2,093	—	—	2,093
Accretion of non-controlling interest	—	—	845	—	—	845
Distribution for Heska Imaging minority interest	—	—	—	—	(963)	(963)
Other comprehensive income	—	—	—	125	—	125
Balances, September 30, 2017	7,244	$ 72	$ 242,998	$ 222	$ (142,265)	$ 101,027
Balances, December 31, 2017	7,303	$ 73	$ 243,598	$ 232	$ (143,463)	$ 100,440
Adoption of accounting standards	—	—	—	—	2,634	2,634
Balances, January 1, 2018, as adjusted	7,303	73	243,598	232	(140,829)	103,074
Net income	—	—	—	—	2,383	2,383
	250	3	2,383	—	—	2,386

Issuance of common stock, net of shares withheld for employee taxes						
Stock-based compensation	—	—	3,774	—	—	3,774
Other comprehensive loss	—	—	—	(16)	—	(16)
Balances, September 30, 2018	7,553	$ 76	$ 249,755	$ 216	$ (138,446)	$ 111,601

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$2,383	$10,525
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	3,473	3,586
Deferred income tax (benefit) expense	(1,997)	762
Stock-based compensation	3,774	2,093
Other (income) expense	(2)	7
Changes in operating assets and liabilities:		
Accounts receivable	2,075	7,376
Inventories	3,935	(10,490)
Due from related parties	1	78
Lease receivable, current	(708)	(991)
Other current assets	(778)	(341)
Accounts payable	(4,945)	1,835
Due to related parties	(1,422)	1,145
Accrued liabilities and other	6,102	(3,046)
Lease receivable, non-current	(1,906)	(3,985)
Other non-current assets	(1,256)	(620)
Deferred revenue and other	(2,271)	(1,656)
Net cash provided by operating activities	6,458	6,278
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of minority interest	—	(13,757)
Investments in unconsolidated affiliates	(8,089)	—
Purchases of property and equipment	(1,061)	(1,998)
Proceeds from disposition of property and equipment	24	6
Net cash used in investing activities	(9,126)	(15,749)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	3,627	2,287
Repurchase of common stock	(1,241)	(860)
Proceeds from line of credit borrowings	3,000	40,307
Repayments of line of credit borrowings	(3,000)	(34,666)
Distributions to non-controlling interest members	(126)	(963)
Repayments of other debt	(5)	(78)
Net cash provided by financing activities	2,255	6,027
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(10)	73
DECREASE IN CASH AND CASH EQUIVALENTS	(423)	(3,371)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	9,659	10,794
CASH AND CASH EQUIVALENTS, END OF PERIOD	$9,236	$7,423

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Non-cash transfers of equipment between inventory and property and equipment, net	$1,019	$824

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Heska Corporation and its wholly-owned subsidiaries ("Heska", the "Company", "we" or "our") sell veterinary and animal health diagnostic and specialty products. Our offerings include Point of Care diagnostic laboratory instruments and consumables, digital imaging diagnostic products, software and services, vaccines, local and cloud-based data services, allergy testing and immunotherapy, and single-use offerings such as in-clinic diagnostic tests and heartworm preventive products. Our core focus is on supporting veterinarians in the canine and feline healthcare space.

Basis of Presentation and Consolidation

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments, consisting of normal, recurring adjustments, necessary to present fairly the financial position of the Company as of September 30, 2018 and December 31, 2017, the results of our operations and statements of stockholders' equity for the three and nine months ended September 30, 2018 and 2017, as well as cash flows for the nine months ended September 30, 2018 and 2017.

The unaudited Condensed Consolidated Financial Statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. Our unaudited Condensed Consolidated Financial Statements include our accounts and the accounts of our wholly-owned subsidiaries since their respective dates of acquisitions. All intercompany accounts and transactions have been eliminated in consolidation. Where our ownership of a subsidiary was less than 100%, the non-controlling interest is reported on our Condensed Consolidated Balance Sheets. The non-controlling interest in our consolidated net income is reported as "Net loss attributable to non-controlling interest" on our Condensed Consolidated Statements of Income. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2017 and other financial information filed with the SEC.

Reclassification

To maintain consistency and comparability, certain amounts in the financial statements have been reclassified to conform to current year presentation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are required when establishing the allowance for doubtful accounts and the net realizable value of inventory; determining future costs associated with warranties provided; determining the period over which our obligations are fulfilled under agreements to license product rights and/or technology rights; evaluating long-lived and intangible assets and investments for impairment; estimating the useful lives of instruments under leasing arrangements; determining the allocation of purchase price under purchase accounting; estimating the expense associated with the granting of stock options; and determining the need for, and the amount of a valuation allowance on deferred tax assets.

HESKA CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Critical Accounting Policies
Our accounting policies are described in our audited Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K/A for the year ended December 31, 2017, and other than the recently adopted accounting pronouncements and Investment in Unconsolidated Affiliates policy discussed below, have not changed significantly since such filing.
Investments in Unconsolidated Affiliates
Investments in unconsolidated affiliates are measured and recorded as either non-marketable equity securities or equity method investments. Non-marketable equity securities are equity securities without readily determinable fair value that are measured and recorded using a measurement alternative which measures the securities at cost minus impairment, if any, plus or minus changes from qualifying observable price changes. Equity method investments are equity securities in investees we do not control but over which we have the ability to exercise significant influence. When the equity method of accounting is determined to be appropriate, the initial measurement of the investment includes the cost of the investment and all direct transaction costs incurred to acquire the investment. Equity method investments are measured at cost minus impairment, if any, plus or minus our share of equity method investee income or loss, which will be recorded as a separate line on the income statement. Both types of investments will be evaluated for impairment if a triggering event occurs.
Adoption of New Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which became effective for us beginning January 1, 2018. The new standard made eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. Adoption of this standard did not have a material impact on our financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers and has subsequently issued several supplemental and/or clarifying Accounting Standards Updates or ASUs (collectively “ASC 606”). ASC 606 prescribes a single common revenue standard that replaces most existing GAAP revenue recognition guidance. ASC 606 outlines a five-step model, under which Heska will recognize revenue as performance obligations within customer contracts are satisfied. ASC 606 is intended to provide more consistent interpretation and application of the principles outlined in the standard across filers in multiple industries and within the same industries compared to current practices, which should improve comparability. Along with the issuance of ASC 606, additional cost guidance was issued and codified under ASC 340-40 that outlines the requirement for capitalizing incremental costs of obtaining a contract and costs to fulfill a contract that meet certain capitalization criteria.

On January 1, 2018, we adopted ASC 606 using the modified retrospective method for all customer contracts not yet completed as of the adoption date. Results for reporting periods beginning January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company’s historic accounting under Topic 605, Revenue Recognition.

We recorded an increase to beginning retained earnings of $2.6 million as of January 1, 2018 due to the cumulative impact of adopting ASC 606. The impact to beginning retained earnings was primarily driven by the capitalization of certain costs to obtain our customer contracts, which were primarily sales-related commissions. The adoption of ASC 606 did not have a significant impact on our Condensed Consolidated Financial Statements as of and for the three and nine months ended September 30, 2018. As a result,

comparisons of revenues and operating profit performance between periods are not affected by the adoption of this ASU.

We generate our Core Companion Animal ("CCA") segment revenue through the sale of products, either by outright purchase by our customers or through a subscription agreement whereby our customers receive instruments and pay us a monthly fee for the usage of the instrument as well as the consumables needed to conduct testing. Outright sales to customers are the majority of both Point of Care imaging diagnostic transactions and the sale of pharmaceuticals and vaccines, while subscription placement is the majority of Point of Care diagnostic laboratory transactions.

For outright sales of products, revenue is recognized when control of the promised product or service is transferred to our customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those products or services (the transaction price). A performance obligation is a promise in a contract to transfer a distinct product or service to a customer and is the unit of account under ASC 606. For instruments, consumables, and most software licenses sold by the Company, control transfers to the customer at a point in time. To indicate the transfer of control, the Company must have a present right to payment, legal title must have passed to the customer, the customer must have the significant risks and rewards of ownership, and where acceptance is not a formality, the customer must have accepted the product or service. Heska's principal terms of sale are FOB Shipping Point, or equivalent, and, as such, we primarily transfer control and record revenue for product sales upon shipment. If a performance obligation to the customer with respect to a sales transaction remains unfulfilled following shipment (typically owed installation or acceptance by the customer), revenue recognition for that performance obligation is deferred until such commitments have been fulfilled. We do not generally allow return of products or instruments. For extended warranty and service plans, control transfers to the customer over the term of the arrangement. Revenue for extended warranties and service is recognized based upon the period of time elapsed under the arrangement.

Our revenue under subscription agreements relate to operating-type lease ("OTL") arrangements or sales-type lease ("STL") arrangements. A STL would result in earlier recognition of instrument revenue as compared to an OTL, which is generally upon installation of the instruments. The cost of the customer-leased instruments is removed from inventory and recognized in the Condensed Consolidated Statements of Income. Determination of an OTL or STL is primarily based on the length of the contract as compared to the estimated useful life of the instrument, among other factors. Leases are outside of the scope of ASC 606 and are therefore accounted for in accordance with ASC 840, Leases. Instrument lease revenue for OTL agreements is recognized on a straight-line basis over the life of the lease, and the costs of customer-leased instruments are recorded within property and equipment in the accompanying Condensed Consolidated Balance Sheets and depreciated over the instrument's estimated useful life. The depreciation expense is reflected in cost of revenue in the accompanying Condensed Consolidated Statements of Income. The OTLs and STLs are not cancellable until after an initial term. Under either type of lease, we often charge a subscription fee and provide a minimum supply credit. OTLs may include a minimum utilization rather than a minimum supply credit.

For contracts with multiple performance obligations, the Company allocates the contracts' transaction price for each performance obligation on a relative standalone selling price basis using our best estimate of the standalone selling price of each distinct product or service in the contract. The primary method used to estimate the standalone selling price is the price observed in standalone sales to customers. However, when prices in standalone sales are not available, we may use a cost-plus margin approach. Allocation of the transaction price is determined at the contracts' inception. The Company does not adjust the transaction price for the effects of a significant financing component when the period between the transfer of the promised good or service to the customer and payment for that good or service by the customer is expected to be one

year or less. This allocation approach also applies to contracts for which a portion of the contract relates to a lease component.

We generate revenue within our Other Vaccines, Pharmaceuticals, and Products (“OVP”) segment through contract manufacturing agreements with customers. The timing of revenue recognition of our customer contracts are generally recognized upon shipment or acceptance by our customer, under the same guidelines noted above for other outright product sales. Heska assessed the over-time criteria within ASC 606 and concluded that because products within this segment have no alternative use to Heska, as Heska is contractually prohibited to redirect the product to other customers, Heska does not have right to payment for performance to date. Therefore, point in time revenue recognition has been determined to be appropriate.

Revenue generated from licensing arrangements is recognized based on the underlying term of the contract.

Refer to Note 2 for additional disclosures required by ASC 606.

Accounting Pronouncements Not Yet Adopted

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. This ASU is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with accounting for employee share-based compensation. ASU 2018-07 is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods, with early adoption permitted but no earlier than an entity’s adoption date of Topic 606. We will adopt the provisions of this ASU in the first quarter of 2019. Adoption of the new standard is not expected to have a material impact on our Consolidated Financial Statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU permits companies to elect a reclassification of the disproportionate tax effects in accumulated other comprehensive income ("AOCI") caused by the Tax Cuts and Jobs Act of 2017 to retained earnings. The ASU also requires additional disclosures. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted. We will adopt the provisions of this ASU in the first quarter of 2019. Adoption of the new standard is not expected to have a material impact on our Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326), which require that financial assets measured at amortized cost be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments in this update are effective for fiscal years beginning after December 15, 2019 and interim periods within those annual periods. Early adoption for fiscal year beginning after December 15, 2018 is permitted. We will adopt the provisions of this ASU in the first quarter of 2020. We are currently evaluating the effect of this update on our consolidated financial statements.
In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes ASC 840, Leases. This update requires lessees to recognize a lease liability and a lease asset for all leases, including operating

leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. The accounting for lessors does not fundamentally change except for changes to conform and align guidance to the lessee guidance as well as to the new revenue recognition guidance in ASU 2014-09. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases and ASU 2018-11, Leases, Targeted Improvements, which provide additional clarification and implementation guidance on certain aspects of ASU 2016-02 and have the same effective date and transition requirements. Specifically, ASU 2018-10 provides certain amendments that affect narrow aspects of the guidance issued in ASU 2016-02, and ASU 2018-11 and creates an additional transition method option allowing entities to record a cumulative effect adjustment to the opening retained earnings balance in the year of adoption. ASU 2018-11 also allows lessors to not separate nonlease components from the associated lease component if certain conditions are met. These updates will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the effect of this update on our consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-09, Codification Improvements. This update provides amendments to a wide variety of topics in the FASB's Accounting Standards Codification, which applies to all reporting entities within the scope of the affected accounting guidance. The transition and effective date guidance are based on the facts and circumstances of each amendment. Some of the amendments within ASU 2018-09 do not require transition guidance and were effective upon issuance. However, many amendments do have transition guidance with effective dates for annual periods beginning after December 15, 2018. We are currently evaluating the potential impact of adopting the applicable guidance on our consolidated financial statements.

2. REVENUE

We separate our goods and services among:

- Point of Care laboratory products including instruments, consumables, and services;
- Point of Care imaging products including instruments, software, and services;
- Single use pharmaceuticals, vaccines, and diagnostic tests primarily related to companion animals; and
- Other vaccines and pharmaceuticals.

Revenue from our CCA segment consists of Point of Care laboratory products, including instruments and consumables, Point of Care imaging products, and single use diagnostic and other tests, pharmaceuticals and biologicals. Point of Care laboratory products are generally sold under a long-term subscription agreement with the instrument portion of the sale accounted for under Topic 840, Leases, as either an OTL or STL. For STL, we apply the provisions of ASC 606 to determine the point in time when control is transferred to the customer, generally when installation of the instrument occurs. Related profit and derecognition of the asset from the Company's balance sheet follows prescribed guidance under ASC 840. Revenue recognized under this topic was approximately $1.2 million and $4.6 million in the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2018, we recognized approximately $1.4 million and $3.5 million, respectively, of instrument sales related to the outright sale of instruments to customers, which also included shipping and preparation fees. Consumables are critical to the use of the Point of Care laboratory instruments and are used one-time, requiring frequent replacement in the customer's operating cycle. Revenue recorded related to sales of consumables was $11.6 million and $33.9 million in the three and nine months ended September 30, 2018, respectively. Other services, such as extended service plans and repairs, resulted in approximately $0.4 million and $1.2 million of revenue in the three and nine months ended September 30, 2018, respectively.
Point of Care imaging instruments and software are generally sold outright to customers and recognized upon shipment, which is generally the point in time when control transfers to customers. Revenue of approximately $4.4 million and $13.2 million was recognized in the three and nine months ended September 30, 2018, respectively. Rental agreements, generally accounted for as OTLs under Topic 840, Leases, resulted in approximately $0.3 million and $0.9 million of rental revenue in the three and nine months ended September 30, 2018, respectively. Service revenue, including extended warranty revenue, of approximately $0.6 million and $1.7 million was recognized in the three and nine months ended September 30, 2018, respectively.
Revenue from single use diagnostic and other tests, pharmaceuticals and biologicals as well as research and development, licensing and royalty revenue, represented approximately $7.3 million of our revenue for the three months ended September 30, 2018, and $21.6 million of our revenue for the nine months ended September 30, 2018. Of those amounts, approximately $0.1 million and $0.3 million related to license and royalty income for the three and nine months ended September 30, 2018, respectively.

Revenue from our OVP segment consists of revenue generated from contract manufacturing agreements and from other license and research and development. Revenue from contract manufacturing contracts and from other license and research and development was $3.6 million and $0.2 million, respectively, in the three months ended September 30, 2018, and $12.2 million and $0.5 million, respectively, in the nine months ended September 30, 2018.

Remaining Performance Obligations

Remaining performance obligations related to ASC 606 represent the aggregate transaction price allocated to performance obligations with an original contract term greater than one year which are fully or partially unsatisfied at the end of the period. Remaining performance obligations include noncancelable purchase orders, the non-lease portion of minimum purchase commitments under long-term supply arrangements, extended warranty, service and other long-term contracts. Remaining performance obligations do not include revenue from contracts with customers with an original term of one year or less, revenue from long-term supply arrangements with no minimum purchase requirements, revenue expected from purchases made in excess of the minimum purchase requirements, or revenue from instruments leased to customers. While the remaining performance obligation disclosure is similar in concept to backlog, the definition of remaining performance obligations excludes leases and contracts that provide the customer with the right to cancel or

terminate for convenience with no substantial penalty, even if historical experience indicates the likelihood of cancellation or termination is remote. Additionally, the Company has elected to exclude contracts with customers with an original term of one year or less from remaining performance obligations while these contracts are included within backlog.

As of September 30, 2018, the aggregate amount of the transaction price allocated to remaining minimum performance obligations was approximately $81.5 million. As of September 30, 2018, the Company expects to recognize revenue as follows (in thousands):

Year Ending December 31,	Revenue
2018 (remaining)	$ 5,980
2019	21,682
2020	18,084
2021	14,040
2022	10,832
Thereafter	10,843
	$ 81,461

Contract Balances

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (contract assets) and deferred revenue, and customer deposits and billings in excess of revenue recognized (contract liabilities) on the Condensed Consolidated Balance Sheets. In addition, the Company defers certain costs incurred to obtain contracts (contract costs).

Contract Assets

Most of the Company’s long-term contracts are billed as product is shipped. However, during the three and nine months ended September 30, 2018, the Company recognized $1.8 million of revenue prior to invoicing, which is included in Accounts Receivable, net, on the Condensed Consolidated Balance Sheets. Invoicing is expected prior to December 31, 2018.

Contract Liabilities

The Company receives cash payments from customers for licensing fees or other arrangements that extend for a specified term. These contract liabilities are classified as either current or long-term in the Condensed Consolidated Balance Sheets based on the timing of when the Company expects to recognize revenue. As of September 30, 2018 and December 31, 2017, contract liabilities were $9.9 million and $12.3 million, respectively, and are included within the current portion of "Deferred revenue" and the non-current portion of "Deferred revenue, net of current portion, and other" in the accompanying Condensed Consolidated Balance Sheets. The decrease in the contract liability balance during the nine month period ended September 30, 2018 is $3.4 million of revenue recognized during the period, offset by $1.0 million of additional deferred sales in 2018.

Contract Costs

The Company capitalizes certain direct incremental costs incurred to obtain customer contracts, typically sales-related commissions, where the recognition period for the related revenue is greater than one year.

Contract costs are classified as current or non-current "Contract acquisition costs" in the Condensed Consolidated Balance Sheets based on the timing of when the Company expects to recognize the expense and are generally amortized into earnings with a certain percentage recognized immediately based upon placement of the instrument with the remainder recognized on a straight-line basis (which is consistent with the transfer of control for the related goods or services) over the term of the contract. Management assesses these costs for impairment at least quarterly on a contract by contract basis and as “triggering” events occur that indicate it is more likely than not that an impairment exists. The balance of contract costs as of September 30, 2018 and at the date of adoption was $2.5 million and $2.4 million, respectively. Amortization expense for the nine month period ended September 30, 2018 was