

MOTORCAR PARTS AMERICA INC  
Form 10-Q  
February 09, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2017

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

FOR THE TRANSITION PERIOD FROM TO

Commission File No. 001-33861

MOTORCAR PARTS OF AMERICA, INC.  
(Exact name of registrant as specified in its charter)

New York 11-2153962  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2929 California Street, Torrance, California 90503  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (310) 212-7910

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

|   |                           |
|---|---------------------------|
| Large accelerated filer   | Accelerated filer         |
| Non-accelerated filer (Do not check if a smaller reporting company) | Smaller reporting company |
|   | Emerging growth company   |

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

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

There were 19,073,883 shares of Common Stock outstanding at February 2, 2018.

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MOTORCAR PARTS OF AMERICA, INC.

GLOSSARY

The following terms are frequently used in the text of this report and have the meanings indicated below.

“Used Core” — An automobile part which has been used in the operation of a vehicle. Generally, the Used Core is an original equipment (“OE”) automobile part installed by the vehicle manufacturer and subsequently removed for replacement. Used Cores contain salvageable parts which are an important raw material in the remanufacturing process. We obtain most Used Cores by providing credits to our customers for Used Cores returned to us under our core exchange program. Our customers receive these Used Cores from consumers who deliver a Used Core to obtain credit from our customers upon the purchase of a newly remanufactured automobile part. When sufficient Used Cores cannot be obtained from our customers, we will purchase Used Cores from core brokers, who are in the business of buying and selling Used Cores. The Used Cores purchased from core brokers or returned to us by our customers under the core exchange program, and which have been physically received by us, are part of our raw material or work in process inventory included in long-term core inventory.

“Remanufactured Core” — The Used Core underlying an automobile part that has gone through the remanufacturing process and through that process has become part of a newly remanufactured automobile part. The remanufacturing process takes a Used Core, breaks it down into its component parts, replaces those components that cannot be reused and reassembles the salvageable components of the Used Core and additional new components into a remanufactured automobile part. Remanufactured Cores are included in our on-hand finished goods inventory and in the remanufactured finished good product held for sale at customer locations. Used Cores returned by consumers to our customers but not yet returned to us continue to be classified as Remanufactured Cores until we physically receive these Used Cores. All Remanufactured Cores are included in our long-term core inventory or in our long-term core inventory deposit.

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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

## MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

|  | December 31,<br>2017<br>(Unaudited) | March 31, 2017        |
|--|-------------------------------------|-----------------------|
| <b>ASSETS</b>  |                                     |                       |
| Current assets:  |                                     |                       |
| Cash and cash equivalents  | \$ 10,032,000                       | \$ 9,029,000          |
| Short-term investments   | 2,759,000                           | 2,140,000             |
| Accounts receivable — net  | 3,330,000                           | 26,017,000            |
| Inventory— net   | 80,991,000                          | 67,516,000            |
| Inventory unreturned   | 7,249,000                           | 7,581,000             |
| Prepaid expenses and other current assets  | 12,829,000                          | 9,848,000             |
| Total current assets   | 117,190,000                         | 122,131,000           |
| Plant and equipment — net  | 21,040,000                          | 18,437,000            |
| Long-term core inventory — net   | 296,274,000                         | 262,922,000           |
| Long-term core inventory deposits  | 5,569,000                           | 5,569,000             |
| Long-term deferred income taxes  | 14,422,000                          | 13,546,000            |
| Goodwill   | 2,551,000                           | 2,551,000             |
| Intangible assets — net  | 3,970,000                           | 3,993,000             |
| Other assets   | 6,678,000                           | 6,990,000             |
| <b>TOTAL ASSETS</b>  | <b>\$ 467,694,000</b>               | <b>\$ 436,139,000</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                     |                       |
| Current liabilities:   |                                     |                       |
| Accounts payable   | \$ 69,445,000                       | \$ 85,960,000         |
| Accrued liabilities  | 11,992,000                          | 10,077,000            |
| Customer finished goods returns accrual  | 15,962,000                          | 17,667,000            |
| Accrued core payment   | 16,718,000                          | 11,714,000            |
| Revolving loan   | 36,000,000                          | 11,000,000            |
| Other current liabilities  | 4,614,000                           | 3,300,000             |
| Current portion of term loan   | 3,068,000                           | 3,064,000             |
| Total current liabilities  | 157,799,000                         | 142,782,000           |
| Term loan, less current portion  | 14,670,000                          | 16,935,000            |
| Long-term accrued core payment   | 22,560,000                          | 12,349,000            |
| Long-term deferred income taxes  | 212,000                             | 180,000               |
| Other liabilities  | 3,920,000                           | 15,212,000            |
| Total liabilities  | 199,161,000                         | 187,458,000           |
| Commitments and contingencies  |                                     |                       |
| Shareholders' equity:  |                                     |                       |
| Preferred stock; par value \$.01 per share, 5,000,000 shares authorized; none issued   | -                                   | -                     |
| Series A junior participating preferred stock; par value \$.01 per share, 20,000 shares authorized; none issued  | -                                   | -                     |
| Common stock; par value \$.01 per share, 50,000,000 shares authorized; 19,069,782 and 18,648,854 shares issued and outstanding at December 31, 2017 and March 31, 2017, respectively | 191,000                             | 186,000               |

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|  |                |                |
|--|----------------|----------------|
| Additional paid-in capital                 | 217,089,000    | 205,646,000    |
| Retained earnings                          | 57,411,000     | 50,290,000     |
| Accumulated other comprehensive loss       | (6,158,000     | ) (7,441,000 ) |
| Total shareholders' equity                 | 268,533,000    | 248,681,000    |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 467,694,000 | \$ 436,139,000 |

The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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## MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

(Unaudited)

|  | Three Months Ended |                | Nine Months Ended |                |
|--|--------------------|----------------|-------------------|----------------|
|  | December 31,       |                | December 31,      |                |
|  | 2017               | 2016           | 2017              | 2016           |
| Net sales                                      | \$ 100,127,000     | \$ 112,595,000 | \$ 306,964,000    | \$ 306,843,000 |
| Cost of goods sold                             | 77,583,000         | 80,225,000     | 231,419,000       | 223,424,000    |
| Gross profit                                   | 22,544,000         | 32,370,000     | 75,545,000        | 83,419,000     |
| Operating expenses:                            |                    |                |                   |                |
| General and administrative                     | 11,915,000         | 7,952,000      | 26,717,000        | 21,446,000     |
| Sales and marketing                            | 4,048,000          | 3,234,000      | 10,899,000        | 8,575,000      |
| Research and development                       | 1,678,000          | 1,039,000      | 3,920,000         | 2,813,000      |
| Total operating expenses                       | 17,641,000         | 12,225,000     | 41,536,000        | 32,834,000     |
| Operating income                               | 4,903,000          | 20,145,000     | 34,009,000        | 50,585,000     |
| Interest expense, net                          | 3,953,000          | 3,357,000      | 10,789,000        | 9,365,000      |
| Income before income tax expense               | 950,000            | 16,788,000     | 23,220,000        | 41,220,000     |
| Income tax expense                             | 7,756,000          | 5,678,000      | 16,099,000        | 13,459,000     |
| Net (loss) income                              | \$(6,806,000)      | \$ 11,110,000  | \$ 7,121,000      | \$ 27,761,000  |
| Basic net (loss) income per share              | \$(0.36)           | ) \$0.59       | \$0.38            | \$1.49         |
| Diluted net (loss) income per share            | \$(0.36)           | ) \$0.57       | \$0.37            | \$1.43         |
| Weighted average number of shares outstanding: |                    |                |                   |                |
| Basic  | 19,069,152         | 18,675,125     | 18,814,967        | 18,587,946     |
| Diluted  | 19,069,152         | 19,441,265     | 19,400,744        | 19,399,857     |

The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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## MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

## Consolidated Statements of Comprehensive (Loss) Income

(Unaudited)

|  | Three Months Ended |              | Nine Months Ended |              |
|--|--------------------|--------------|-------------------|--------------|
|  | December 31,       |              | December 31,      |              |
|  | 2017               | 2016         | 2017              | 2016         |
| Net (loss) income  | \$(6,806,000)      | \$11,110,000 | \$7,121,000       | \$27,761,000 |
| Other comprehensive income (loss), net of tax:   |                    |              |                   |              |
| Unrealized gain on short-term investments (net of tax of \$55,000, \$7,000, \$133,000, and \$66,000) | 83,000             | 10,000       | 199,000           | 98,000       |
| Foreign currency translation gain (loss)   | 247,000            | (1,252,000 ) | 1,084,000         | (2,594,000 ) |
| Total other comprehensive gain (loss), net of tax  | 330,000            | (1,242,000 ) | 1,283,000         | (2,496,000 ) |
| Comprehensive (loss) income  | \$(6,476,000)      | \$9,868,000  | \$8,404,000       | \$25,265,000 |

The accompanying condensed notes to consolidated financial statements are an integral part hereof.



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## MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Unaudited)

|   | Nine Months Ended |              |
|---|-------------------|--------------|
|   | December 31,      |              |
|   | 2017              | 2016         |
| Cash flows from operating activities:   |                   |              |
| Net income  | \$7,121,000       | \$27,761,000 |
| Adjustments to reconcile net income to net cash used in operating activities: |                   |              |
| Depreciation  | 2,805,000         | 2,262,000    |
| Amortization of intangible assets   | 517,000           | 456,000      |
| Amortization and write-off of debt issuance costs                             | 864,000           | 538,000      |
| Amortization of interest on accrued core payments                             | 378,000           | 545,000      |
| Gain due to change in fair value of the warrant liability                     | (2,313,000 )      | (5,727,000 ) |
| Gain due to change in fair value of the contingent consideration              | -                 | (16,000 )    |
| Net provision for inventory reserves  | 4,954,000         | 2,327,000    |
| Net provision for customer payment discrepancies                              | 1,194,000         | 612,000      |
| Net provision for (recovery of) doubtful accounts                             | 17,000            | (1,000 )     |
| Deferred income taxes   | (909,000 )        | (1,620,000 ) |
| Share-based compensation expense  | 2,658,000         | 2,555,000    |
| Loss on disposal of plant and equipment                                       | 9,000             | 1,000        |
| Changes in operating assets and liabilities, net of effects of acquisitions:  |                   |              |
| Accounts receivable   | 23,127,000        | (14,685,000) |
| Inventory   | (11,162,000)      | (13,696,000) |
| Inventory unreturned  | 332,000           | 5,422,000    |
| Prepaid expenses and other current assets                                     | (2,093,000 )      | (1,917,000 ) |
| Other assets  | 289,000           | (4,045,000 ) |
| Accounts payable and accrued liabilities                                      | (15,647,000)      | 3,945,000    |
| Customer finished goods returns accrual                                       | (1,705,000 )      | (13,809,000) |
| Long-term core inventory  | (37,222,000)      | (17,893,000) |
| Accrued core payments   | 14,837,000        | (113,000 )   |
| Other liabilities   | 2,146,000         | 6,288,000    |
| Net cash used in operating activities   | (9,803,000 )      | (20,810,000) |
| Cash flows from investing activities:   |                   |              |
| Purchase of plant and equipment   | (4,765,000 )      | (4,127,000 ) |
| Purchase of business, net of cash acquired                                    | (4,993,000 )      | (705,000 )   |
| Change in short-term investments  | (287,000 )        | 11,000       |
| Net cash used in investing activities   | (10,045,000)      | (4,821,000 ) |
| Cash flows from financing activities:   |                   |              |
| Borrowings under revolving loan   | 62,000,000        | 37,001,000   |
| Repayments of revolving loan  | (37,000,000)      | (26,000,000) |
| Repayments of term loan   | (2,344,000 )      | (2,344,000 ) |
| Payments for debt issuance costs  | (462,000 )        | (444,000 )   |
| Payments on capital lease obligations   | (612,000 )        | (406,000 )   |
| Payment of contingent consideration   | -                 | (314,000 )   |
| Exercise of stock options   | 295,000           | 1,475,000    |
| Cash used to net share settle equity awards                                   | (596,000 )        | (1,058,000 ) |
| Settlement of warrant   | 4,000,000         | -            |
| Repurchase of common stock, including fees                                    | (4,476,000 )      | -            |
| Net cash provided by financing activities                                     | 20,805,000        | 7,910,000    |

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|  |               |              |
|--|---------------|--------------|
| Effect of exchange rate changes on cash and cash equivalents | 46,000        | (235,000 )   |
| Net increase (decrease) in cash and cash equivalents         | 1,003,000     | (17,956,000) |
| Cash and cash equivalents — Beginning of period              | 9,029,000     | 21,897,000   |
| Cash and cash equivalents — End of period                    | \$ 10,032,000 | \$ 3,941,000 |
| Supplemental disclosures of cash flow information:           |               |              |
| Cash paid during the period for:                             |               |              |
| Interest, net  | \$9,508,000   | \$ 8,212,000 |
| Income taxes, net of refunds                                 | 16,598,000    | 9,971,000    |
| Non-cash investing and financing activities:                 |               |              |
| Plant and equipment acquired under capital lease             | \$ 582,000    | \$ 802,000   |

The accompanying condensed notes to consolidated financial statements are an integral part hereof.

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MOTORCAR PARTS OF AMERICA, INC. AND SUBSIDIARIES

Condensed Notes to Consolidated Financial Statements

December 31, 2017

(Unaudited)

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended December 31, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2018. This report should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the fiscal year ended March 31, 2017, which are included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on June 14, 2017, as amended by the Form 10-K/A filed with the SEC on July 31, 2017.

The accompanying consolidated financial statements have been prepared on a consistent basis with, and there have been no material changes to, except as noted below, the accounting policies described in Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements that are presented in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

The Company has made certain reclassifications to its prior period consolidated statements of cash flows to conform to the current period presentation. Such reclassifications did not have a material effect on the Company’s consolidated financial statements.

1. Company Background and Organization

Motorcar Parts of America, Inc. and its subsidiaries (the “Company”, or “MPA”) is a leading manufacturer, remanufacturer, and distributor of aftermarket automotive parts. These replacement parts are sold for use on vehicles after initial vehicle purchase. These automotive parts are sold to automotive retail chain stores and warehouse distributors throughout North America and to major automobile manufacturers for both their aftermarket programs and warranty replacement programs (“OES”). The Company’s products include (i) rotating electrical products such as alternators and starters, (ii) wheel hub assemblies and bearings, (iii) brake master cylinders, and (iv) other products which include turbochargers, brake power boosters, and diagnostic equipment. The Company added turbochargers through an acquisition in July 2016. The Company began selling brake power boosters in August 2016. As a result of an acquisition in July 2017, its business also now includes developing and selling diagnostics systems for alternators and starters, electric vehicle power-train and battery technology.

The Company obtains used automotive parts, commonly known as Used Cores, primarily from its customers under the Company’s core exchange program. It also purchases Used Cores from vendors (core brokers). The customers grant credit to the consumer when the used part is returned to them, and the Company in turn provides a credit to the customers upon return to the Company. These Used Cores are an essential material needed for the remanufacturing operations.

The Company has remanufacturing, warehousing and shipping/receiving operations for automotive parts in North America and Asia. In addition, the Company utilizes various third party warehouse distribution centers in North America.

Pursuant to the guidance provided under the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), for segment reporting, the Company has identified its chief executive officer as its chief operating decision maker (“CODM”), has reviewed the documents used by the CODM, and understands how such documents are used by the CODM to make financial and operating decisions. The Company has determined through this review process that it has one reportable segment for purposes of recording and reporting its financial results.

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2. New Accounting Pronouncements

New Accounting Pronouncements Not Yet Adopted

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, codified in ASC 606, “Revenue Recognition - Revenue from Contracts with Customers” (“ASC 606”), which amends the guidance in the former ASC 605, “Revenue Recognition”. ASC 606 is effective for annual periods beginning after December 15, 2016, and interim periods within that reporting period for a public entity. The Company may elect either a full retrospective transition method, which requires the restatement of all periods presented, or a modified retrospective transition method, which requires a cumulative-effect recognized as of the date of initial adoption. In August 2015, the FASB delayed the effective date by one year to annual periods beginning after December 15, 2017, and interim periods within that reporting period for a public entity. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Accordingly, the updated standard is effective for the Company as of April 1, 2018 and the Company does not plan to early adopt. The Company is currently in the process of determining whether it will utilize the full or modified retrospective method of adoption allowed by the new standard and the impact on its consolidated financial statements and footnote disclosures. While the Company anticipates selecting the full retrospective method, that final determination will be driven by the changes required by ASC 606 and the Company’s ability to recast past financial statements based upon those requirements. The Company anticipates completing its assessment of the adoption method by the end of its current fiscal year.

ASC 606 establishes the requirements for recognizing revenue from contracts with customers. The standard requires entities to apportion consideration from contracts to performance obligations on a relative standalone selling price basis, based on a five-step model. Under the new standard, revenue is recognized when a customer obtains control of a promised good or service and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for the good or service. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

Due to the impact the new standard may have on the Company’s business processes, systems, and controls, a project team has been formed to evaluate and guide the implementation process. The Company has performed a preliminary assessment, which has included the identification of the key contractual terms in its primary revenue stream and the comparison of historical accounting policies and practices to the requirements of the new standard by revenue stream. The assessment has resulted in the identification of potential accounting differences that may arise from the application of the new standard. The implementation team has also made substantial progress in the contract review phase of the project which includes identifying the population of contracts for a deeper analysis of the potential accounting impacts of the new standard on individual contracts. During the third quarter, the implementation team continued to identify changes to business processes, systems and controls to support recognition, presentation and disclosure under the new standard. The detailed implementation plan for the second half of fiscal 2018 continues to be executed including such tasks as data gathering, identification of the new journal entries, training, design of new processes and controls as well as testing of the controls.

The Company’s primary revenue stream is derived from the sale of remanufactured products to its customers pursuant to long-term customer contracts. The Company will continue to recognize revenue at a point in time as it satisfies its performance obligation of transferring control of the product to the customer. The Company recognizes revenues net of anticipated returns, marketing allowances, volume discounts and other forms of variable consideration more fully described below. The Company also reviewed customer options to acquire additional goods or services and has preliminarily determined no material rights exist within its contracts. The Company does not currently anticipate that the adoption of ASU 2014-09 to have a material impact on previously reported revenue amounts. See discussion

regarding nominally priced Remanufactured Cores below.

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The Company currently anticipates that the adoption of ASU 2014-09 will primarily impact reclassifications to certain balance sheet accounts to conform to the presentation and disclosure requirements of ASC 606. For example, the Company currently accounts for fully priced Remanufactured Cores anticipated to be returned as long-term core inventory and the refund liability as a contra-account receivable account as illustrated in Note 5 of the condensed notes to consolidated financial statements for the quarter ended December 31, 2017. Under ASC 606, the Company currently anticipates it will reclassify this asset to a contractual asset and recognize a contractual liability for amounts expected to be refunded to customers.

The Company also analyzed specific contractual provisions related sales contracts which include nominally priced Remanufactured Cores. The Company recognizes revenue for sales of cores not expected to be replaced by a similar Used Core sent back under the core exchange program only upon meeting certain criteria as previously described in Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements that are presented in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2017. The adoption of ASU 2014-09, may result in an acceleration of revenue recognition, as it requires the Company to estimate the amount of cores not expected to be returned upon the initial recognition of revenue for contracts which include nominally priced Remanufactured Cores. The Company currently does not expect that the change in the accounting policy for core exchange program to have a significant impact on the consolidated statements of operations.

In order to properly determine the transaction price related to its sales contracts, the Company has also analyzed its various forms of consideration paid to its vendors including up-front payments for future contracts. Based on the analysis completed through the quarter ended December 31, 2017, the Company currently does not anticipate a change to its legacy accounting practices as a result of the adoption of ASU 2014-09 to account for up-front payments to its vendors. Under current accounting practices, if the Company expects to generate future revenues associated with an up-front payment, then an asset is recognized and amortized over the appropriate period of time as a reduction of revenue. If the Company does not expect to generate additional revenue then the up-front payment is recognized in the consolidated statements of operations when payment occurs as a reduction of revenue. The Company analyzes each up-front payment based on the substance and economics of the payment and therefore is not able to make an accounting policy election for such payments, consistent with views expressed by the FASB Transition Resource Group ("TRG") members in related discussions.

ASU 2014-09 also codified the guidance on other assets and deferred costs relating to contracts with customers with the addition of ASC 340-40. This guidance relates to the accounting for costs of an entity to obtain and fulfill a contract to provide goods or services to the customer. Under the new guidance, an entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. In the Company's review of the various costs to obtain contracts with customers, it has preliminarily determined that currently no significant costs are incurred that meet the capitalization criteria. The Company's primary cost to fulfill contracts relates to shipping and handling activities which continue to be expensed as incurred consistent with historical accounting practices.

The new guidance provides several practical expedients, for which the Company anticipates adopting. The first of these practical expedients allows a company to expense incremental costs of obtaining a contract as incurred if the amortization period would have been one year or less. As noted above, the Company has preliminarily concluded that it does not have any such costs that qualify for capitalization but will apply the practical expedient such that costs incurred in prospective periods qualify. Similarly, the Company plans to adopt guidance which allows for the effects of a significant financing component to be ignored if a company expects that the period between the transfer of the goods and services to the customer and payment will be one year or less. Finally, the Company plans to adopt guidance which allows a company to account for shipping and handling activities that occur after control of the related good transfers as fulfillment activities instead of assessing such activities as performance obligations. The Company continues to evaluate the impact of ASU 2014-09, related amendments and interpretive guidance will have on its consolidated financial statements.

While the Company has made substantial progress in identifying the likely impacts of the new standard, it has not yet determined a range of the potential quantitative impacts for the potential differences described above. In summary, the Company does not expect there to be a significant impact to the amount of revenue previously recorded but does anticipate a significant impact related to the classification of certain assets and liabilities for the reasons discussed in the preceding paragraphs.



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### Financial Instruments

In January 2016, the FASB issued guidance that addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. A reporting entity should apply the new guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The Company is currently evaluating the impact of the provisions of this guidance to its consolidated financial statements.

### Leases

In February 2016, the FASB issued new guidance that requires balance sheet recognition of a right-of-use asset and lease liability by lessees for operating leases. The new guidance also requires new disclosures providing additional qualitative and quantitative information about the amounts recorded in the financial statements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The new guidance requires a modified retrospective approach with optional practical expedients. The Company will adopt this guidance in the first quarter of fiscal 2020. The Company is currently evaluating the impact the provisions of this guidance will have on its consolidated financial statements, but expects that it will result in a significant increase to its long-term assets and liabilities on the consolidated balance sheets.

### Business Combinations

In January 2017, the FASB issued guidance which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. A reporting entity should apply the amendment prospectively. The adoption of this guidance is not expected to have any material impact on the Company's consolidated financial statements.

### Goodwill Impairment

In January 2017, the FASB issued guidance which simplifies the test for goodwill impairment. This standard eliminates Step 2 from the goodwill impairment test, instead requiring an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit's fair value. This guidance is effective for interim and annual goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption permitted. This guidance must be applied on a prospective basis. The Company is currently evaluating the impact the provisions of this guidance will have on its consolidated financial statements.

### Modifications to Share-Based Payment Awards

In May 2017, the FASB issued guidance to provide clarity and reduce (i) the diversity in practice and (ii) the cost and complexity when applying the accounting guidance for equity-based compensation to a change to the terms or conditions of a share-based payment award. This update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted. This guidance should be applied prospectively to an award modified on or after that adoption date. The adoption of this guidance is not expected to have any material impact on the Company's consolidated financial statements.

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## Derivatives and Hedging

In August 2017, the FASB issued guidance to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. The amendments in this update also make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; the guidance allows for early adoption in any interim period after issuance of the update. The Company is currently evaluating the impact this guidance will have on its consolidated financial statements.

## 3. Acquisition

Pursuant to a share repurchase agreement dated July 18, 2017, the Company completed the acquisition of all the equity interests of D&V Electronics Ltd. ("D&V") based in Ontario, Canada, a privately held developer and manufacturer of leading edge diagnostics systems for alternators and starters, electric vehicle power-train and battery technology.

The Company allocated the purchase consideration to acquire D&V to finite-lived intangible assets of \$308,000 for developed technology with an estimated useful life of 3 years and \$185,000 for trademarks with an estimated useful life of 2 years, \$3,379,000 for inventory, and other net assets of \$1,121,000. The assets and results of operations of D&V were not significant to the Company's consolidated financial position or results of operations, and thus pro forma information is not presented.

## 4. Goodwill and Intangible Assets

## Goodwill

The following summarizes the changes in the Company's goodwill:

|                                | Nine Months Ended |             |
|--------------------------------|-------------------|-------------|
|                                | December 31,      |             |
|                                | 2017              | 2016        |
| Balance at beginning of period | \$2,551,000       | \$2,053,000 |
| Goodwill acquired              | -                 | 498,000     |
| Translation adjustment         | -                 | -           |
| Impairment                     | -                 | -           |
| Balance at end of period       | \$2,551,000       | \$2,551,000 |

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## Intangible Assets

The following is a summary of acquired intangible assets subject to amortization:

|   | Weighted<br>Average<br>Amortization<br>Period | December 31, 2017          |                             | March 31, 2017             |                             |
|---|---|----------------------------|-----------------------------|----------------------------|-----------------------------|
|   |   | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Gross<br>Carrying<br>Value | Accumulated<br>Amortization |
| Intangible assets subject to amortization |   |                            |                             |                            |                             |
| Trademarks                                | 9 years                                       | \$890,000                  | \$278,000                   | \$705,000                  | \$191,000                   |
| Customer relationships                    | 13 years                                      | 5,900,000                  | 2,808,000                   | 5,900,000                  | 2,421,000                   |
| Developed technology                      | 3 years                                       | 309,000                    | 43,000                      | -                          | -                           |
| Total                                     |   | \$7,099,000                | \$3,129,000                 | \$6,605,000                | \$2,612,000                 |

Amortization expense for acquired intangible assets is as follows:

|  | Three Months Ended |      | Nine Months Ended |      |
|--|--------------------|------|-------------------|------|
|  | December 31,       |      | December 31,      |      |
|  | 2017               | 2016 | 2017              | 2016 |

Amortization expense \$192,000 \$166,000 \$517,000 \$456,000

The estimated future amortization expense for acquired intangible assets is as follows:

Year Ending March 31,

|                               |             |
|-------------------------------|-------------|
| 2018 - remaining three months | \$194,000   |
| 2019                          | 776,000     |
| 2020                          | 714,000     |
| 2021                          | 614,000     |
| 2022                          | 580,000     |
| Thereafter                    | 1,092,000   |
| Total                         | \$3,970,000 |

## 5. Accounts Receivable — Net

Included in accounts receivable — net are significant offset accounts related to customer allowances earned, customer payment discrepancies, returned goods authorizations (“RGA”) issued for in-transit unit returns, estimated future credits to be provided for Used Cores returned by the customers and potential bad debts. Due to the forward looking nature and the different aging periods of certain estimated offset accounts, the offset accounts may not, at any point in time, directly relate to the balances in the accounts receivable-trade account.

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Accounts receivable — net is comprised of the following:

|   | December 31, 2017 | March 31, 2017 |
|---|-------------------|----------------|
| Accounts receivable — trade                     | \$ 98,571,000     | \$ 76,902,000  |
| Allowance for bad debts                         | (4,160,000)       | (4,140,000)    |
| Customer allowances earned                      | (13,579,000)      | (7,880,000)    |
| Customer payment discrepancies                  | (1,513,000)       | (751,000)      |
| Customer returns RGA issued                     | (28,917,000)      | (12,710,000)   |
| Customer core returns accruals                  | (47,072,000)      | (25,404,000)   |
| Less: total accounts receivable offset accounts | (95,241,000)      | (50,885,000)   |
| Total accounts receivable — net                 | \$ 3,330,000      | \$ 26,017,000  |

## Warranty Returns

The Company allows its customers to return goods that their customers have returned to them, whether or not the returned item is defective (“warranty returns”). The Company accrues an estimate of its exposure to warranty returns based on a historical analysis of the level of this type of return as a percentage of total unit sales. Amounts charged to expense for these warranty returns are considered in arriving at the Company’s net sales. At December 31, 2017 and March 31, 2017, the Company’s total warranty return accrual was \$29,020,000 and \$14,286,000, respectively, of which \$21,410,000 and \$5,303,000, respectively, was included in the customer returns RGA issued balance in the above table for expected credits to be issued against accounts receivable and \$7,610,000 and \$8,983,000, respectively, was included in the customer finished goods returns accrual in the consolidated balance sheets for estimated future warranty returns.

The following summarizes the changes in the Company’s warranty return accrual:

|                                | Three Months Ended |               | Nine Months Ended |               |
|--------------------------------|--------------------|---------------|-------------------|---------------|
|                                | December 31,       |               | December 31,      |               |
|                                | 2017               | 2016          | 2017              | 2016          |
| Balance at beginning of period | \$ 14,799,000      | \$ 13,707,000 | \$ 14,286,000     | \$ 10,845,000 |
| Charged to expense/additions   | 38,269,000         | 22,930,000    | 89,834,000        | 73,803,000    |
| Amounts processed              | (24,048,000)       | (24,772,000)  | (75,100,000)      | (72,783,000)  |
| Balance at end of period       | \$ 29,020,000      | \$ 11,865,000 | \$ 29,020,000     | \$ 11,865,000 |

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## 6. Inventory

Inventory is comprised of the following:

|   | December 31, 2017 | March 31, 2017 |
|---|-------------------|----------------|
| Non-core inventory                                    |                   |                |
| Raw materials   | \$ 26,773,000     | \$ 21,515,000  |
| Work-in-process                                       | 1,548,000         | 641,000        |
| Finished goods  | 56,530,000        | 48,337,000     |
|   | 84,851,000        | 70,493,000     |
| Less allowance for excess and obsolete inventory      | (3,860,000)       | ) (2,977,000)  |
| Total   | \$ 80,991,000     | \$ 67,516,000  |
| Inventory unreturned                                  | \$ 7,249,000      | \$ 7,581,000   |
| Long-term core inventory                              |                   |                |
| Used cores held at the Company's facilities           | \$ 52,804,000     | \$ 38,713,000  |
| Used cores expected to be returned by customers       | 12,637,000        | 11,752,000     |
| Remanufactured cores held in finished goods           | 34,421,000        | 27,667,000     |
| Remanufactured cores held at customers' locations (1) | 198,794,000       | 185,938,000    |
|   | 298,656,000       | 264,070,000    |
| Less allowance for excess and obsolete inventory      | (2,382,000)       | ) (1,148,000)  |
| Total   | \$ 296,274,000    | \$ 262,922,000 |
| Long-term core inventory deposits                     | \$ 5,569,000      | \$ 5,569,000   |

(1) Remanufactured cores held at customers' locations represent the core portion of the Company's customers' finished goods at the Company's customers' locations.

## 7. Significant Customer and Other Information

## Significant Customer Concentrations

The Company's largest customers accounted for the following total percentage of net sales:

| Sales      | Three Months Ended |      | Nine Months Ended |      |      |      |
|------------|--------------------|------|-------------------|------|------|------|
|            | December 31,       |      | December 31,      |      |      |      |
|            | 2017               | 2016 | 2017              | 2016 | 2017 | 2016 |
| Customer A | 42 %               | 42 % | 43 %              | 46 % |      |      |
| Customer B | 27 %               | 21 % | 26 %              | 19 % |      |      |
| Customer C | 16 %               | 14 % | 15 %              | 17 % |      |      |
| Customer D | 3 %                | 5 %  | 4 %               | 4 %  |      |      |
| Customer E | 3 %                | 10 % | 2 %               | 5 %  |      |      |

The Company's largest customers accounted for the following total percentage of accounts receivable—trade:

| Accounts receivable - trade | December 31, 2017 | March 31, 2017 |
|-----------------------------|-------------------|----------------|
| Customer A                  | 29 %              | 33 %           |
| Customer B                  | 25 %              | 18 %           |
| Customer C                  | 20 %              | 12 %           |

|            |    |   |    |   |
|------------|----|---|----|---|
| Customer D | 10 | % | 16 | % |
| Customer E | 2  | % | 3  | % |

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## Geographic and Product Information

The Company's products are predominantly sold in the U.S. and accounted for the following total percentage of net sales:

|                                 | Three Months Ended |      | Nine Months Ended |      | Three Months Ended |      | Nine Months Ended |      |
|---------------------------------|--------------------|------|-------------------|------|--------------------|------|-------------------|------|
|                                 | December 31,       |      | December 31,      |      | December 31,       |      | December 31,      |      |
|                                 | 2017               | 2016 | 2017              | 2016 | 2017               | 2016 | 2017              | 2016 |
| Rotating electrical products    | 76                 | %    | 81                | %    | 77                 | %    | 78                | %    |
| Wheel hub products              | 19                 | %    | 15                | %    | 18                 | %    | 18                | %    |
| Brake master cylinders products | 2                  | %    | 3                 | %    | 3                  | %    | 4                 | %    |
| Other products                  | 3                  | %    | 1                 | %    | 2                  | %    | -                 | %    |
|                                 | 100                | %    | 100               | %    | 100                | %    | 100               | %    |

## Significant Supplier Concentrations

The Company had no suppliers that accounted for more than 10% of inventory purchases for the three and nine months ended December 31, 2017 and 2016.

## 8. Debt

The Company has the following credit agreements.

## Credit Facility

The Company is party to a \$145,000,000 senior secured financing, as amended, (the "Credit Facility") with the lenders party thereto, and PNC Bank, National Association, as administrative agent, consisting of (i) a \$120,000,000 revolving loan facility, subject to borrowing base restrictions and a \$15,000,000 sublimit for letters of credit (the "Revolving Facility") and (ii) a \$25,000,000 term loan facility (the "Term Loans"). The loans under the Credit Facility mature on June 3, 2020. In connection with the Credit Facility, the lenders were granted a security interest in substantially all of the assets of the Company. The Credit Facility permits the payment of up to \$10,000,000 of dividends per calendar year, subject to a minimum availability threshold and pro forma compliance with financial covenants. This amount was increased to \$15,000,000 under the April 2017 amendment to the Credit Facility.

In April 2017, the Company entered into a consent and fourth amendment to the Credit Facility (the "Fourth Amendment") which, among other things, (i) increased the borrowing base limit with respect to inventory located in Mexico, (ii) amended the definition and calculation of consolidated EBITDA to raise the limitation on the add-back for non-capitalized transaction expenses related to the expansion of operations in Mexico, (iii) increased the annual limit on permitted stock repurchases and dividends, and (iv) modifies certain other categories (including increasing certain baskets for permitted acquisitions) and thresholds to, among other things, further accommodate the expansion of operations in Mexico.

In July 2017, the Company entered into a fifth amendment to the Credit Facility (the "Fifth Amendment") which, among other things, amended the definition of permitted acquisitions, permitted indebtedness, and pledge agreements.

The Term Loans require quarterly principal payments of \$781,250. The Credit Facility bears interest at rates equal to either LIBOR plus a margin of 2.50%, 2.75% or 3.00% or a reference rate plus a margin of 1.50%, 1.75% or 2.00%, in each case depending on the senior leverage ratio as of the applicable measurement date. There is also a facility fee of 0.25% to 0.375%, depending on the senior leverage ratio as of the applicable measurement date. The interest rate on the Company's Term Loans and Revolving Facility was 4.12% and 4.33%, respectively, at December 31, 2017 and

3.29% and 3.55%, respectively, at March 31, 2017.

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The Credit Facility, among other things, requires the Company to maintain certain financial covenants including a maximum senior leverage ratio and a minimum fixed charge coverage ratio. The Company was in compliance with all financial covenants as of December 31, 2017.

In addition to other covenants, the Credit Facility places limits on the Company's ability to incur liens, incur additional indebtedness, make loans and investments, engage in mergers and acquisitions, engage in asset sales, redeem or repurchase capital stock, alter the business conducted by the Company and its subsidiaries, transact with affiliates, prepay, redeem or purchase subordinated debt, and amend or otherwise alter debt agreements.

The following summarizes information about the Company's Term Loans at:

|                                   | December 31, 2017 | March 31, 2017 |
|-----------------------------------|-------------------|----------------|
| Principal amount of term loan     | \$ 17,969,000     | \$ 20,312,000  |
| Unamortized financing fees        | (231,000)         | (313,000)      |
| Net carrying amount of term loan  | 17,738,000        | 19,999,000     |
| Less current portion of term loan | (3,068,000)       | (3,064,000)    |
| Long-term portion of term loan    | \$ 14,670,000     | \$ 16,935,000  |

Future repayments of the Company's Term Loans are as follows:

Year Ending March 31,

|                               |               |
|-------------------------------|---------------|
| 2018 - remaining three months | 781,000       |
| 2019                          | 3,125,000     |
| 2020                          | 3,125,000     |
| 2021                          | 10,938,000    |
| Total payments                | \$ 17,969,000 |

The Company had \$36,000,000 and \$11,000,000 outstanding under the Revolving Facility at December 31, 2017 and March 31, 2017, respectively. In addition, \$260,000 was reserved for standby letters of credit for workers' compensation insurance and \$600,000 for commercial letters of credit at December 31, 2017. At December 31, 2017, \$83,140,000, subject to certain adjustments, was available under the Revolving Facility.

## WX Agreement

In August 2012, the Company entered into a Revolving Credit/Strategic Cooperation Agreement (the "WX Agreement") with Wanxiang America Corporation (the "Supplier") and the discontinued subsidiaries. In connection with the WX Agreement, the Company issued a warrant (the "Supplier Warrant") to the Supplier to purchase up to 516,129 shares of the Company's common stock for an exercise price of \$7.75 per share exercisable at any time after August 22, 2014 and on or prior to September 30, 2017.

On September 8, 2017, the Supplier exercised the Supplier Warrant in full and paid the Company \$4,000,000. As a result of the exercise, the Supplier Warrant is no longer outstanding. The fair value of the Supplier Warrant on the exercise date was \$9,566,000 using level 3 inputs and the Monte Carlo simulation model. The following assumptions were used to calculate the fair value of the Supplier Warrant: dividend yield of 0%, expected volatility of 26.4%, risk-free interest rate of 0.96%, subsequent financing probability of 0%, and an expected life of 0.06 years. The Company recorded a non-cash reclassification of the Supplier Warrant's fair value to shareholders' equity on the exercise date, with no further adjustments to the fair value of the Supplier Warrant being required. The fair value of the Supplier Warrant was \$11,879,000 at March 31, 2017 and was included in other liabilities in the consolidated balance sheet.

During the nine months ended December 31, 2017 and 2016, a gain of \$2,313,000 and \$5,727,000, respectively, was recorded in general and administrative expenses due to the change in the fair value of this warrant liability. A gain of \$962,000 was recorded in general and administrative expenses during the three months ended December 31, 2016 due to the change in the fair value of this warrant liability.

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## 9. Accounts Receivable Discount Programs

The Company uses receivable discount programs with certain customers and their respective banks. Under these programs, the Company may sell those customers' receivables to those banks at a discount to be agreed upon at the time the receivables are sold. These discount arrangements allow the Company to accelerate receipt of payment on customers' receivables.

The following is a summary of the Company's accounts receivable discount programs:

|   | Nine Months Ended |               |   |   |
|---|-------------------|---------------|---|---|
|   | December 31,      |               |   |   |
|   | 2017              | 2016          |   |   |
| Receivables discounted                    | \$263,833,000     | \$254,795,000 |   |   |
| Weighted average days                     | 341               | 341           |   |   |
| Annualized weighted average discount rate | 3.2               | % 2.9         | % | % |
| Amount of discount as interest expense    | \$7,854,000       | \$6,864,000   |   |   |

## 10. Net (Loss) Income Per Share

Basic net (loss) income per share is computed by dividing net (loss) income by the weighted average number of shares of common stock outstanding during the period. Diluted net (loss) income per share includes the effect, if any, from the potential exercise or conversion of securities, such as stock options and warrants, which would result in the issuance of incremental shares of common stock.

The following presents a reconciliation of basic and diluted net (loss) income per share:

|   | Three Months Ended |              | Nine Months Ended |              |
|---|--------------------|--------------|-------------------|--------------|
|   | December 31,       |              | December 31,      |              |
|   | 2017               | 2016         | 2017              | 2016         |
| Net (loss) income                         | \$(6,806,000)      | \$11,110,000 | \$7,121,000       | \$27,761,000 |
| Basic shares                              | 19,069,152         | 18,675,125   | 18,814,967        | 18,587,946   |
| Effect of potentially dilutive securities | -                  | 766,140      | 585,777           | 811,911      |
| Diluted shares                            | 19,069,152         | 19,441,265   | 19,400,744        | 19,399,857   |
| Net (loss) income per share:              |                    |              |                   |              |
| Basic net (loss) income per share         | \$(0.36)           | ) \$0.59     | \$0.38            | \$1.49       |
| Diluted net (loss) income per share       | \$(0.36)           | ) \$0.57     | \$0.37            | \$1.43       |

The effect of dilutive options excludes (i) 1,170,441 shares subject to options with exercise prices ranging from \$4.17 to \$34.17 per share for the three months ended December, 31, 2017, (ii) 292,415 shares subject to options with exercise prices ranging from \$26.47 to \$34.17 per share for the three months ended December, 31, 2016, (iii) 289,572 shares subject to options with exercise prices ranging from \$28.68 to \$34.17 per share for the nine months ended December 31, 2017, and (iv) 291,215 shares subject to options with exercise prices ranging from \$28.68 to \$34.17 per share for the nine months ended December 31, 2016, which were anti-dilutive.

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11. Income Taxes

The Company recorded income tax expense for the three months ended December 31, 2017 and 2016 of \$7,756,000, or an effective tax rate of 816.4%, and \$5,678,000, or an effective tax rate of 33.8%. The Company recorded income tax expenses for the nine months ended December 31, 2017 and 2016 of \$16,099,000, or an effective tax rate of 69.3%, and \$13,459,000, or an effective tax rate of 32.7%, respectively. Effective tax rates for the three and nine months ended December 31, 2017 are blended rates reflecting the estimated benefit of one quarter of Federal tax rate reductions for fiscal 2018. These benefits were partially offset by a net one-time \$6,835,000 unfavorable impact related to the new tax legislation in the United States.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Reform Act") was enacted into law, which changes various corporate income tax provisions within the existing Internal Revenue Code. The Tax Reform Act, among other things, lowered the U.S. corporate tax rate from 35% to 21% effective January 1, 2018, while also repealing the deduction for domestic production activities, implementing a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. U.S. GAAP requires that the impact of tax legislation be recognized in the period in which the law was enacted. As a result, the Company recorded a one-time non-cash tax charge of \$6,290,000 due to the revaluation of deferred tax assets and liabilities and a one-time tax charge of \$545,000 due to the transition tax on deemed repatriation of accumulated foreign income, during the three and nine months ended December 31, 2017. Both of these tax charges represent provisional amounts based upon the Company's current interpretation of the Tax Reform Act and may change as the Company receives additional clarification and implementation guidance. The Company will continue to analyze the effects of the Tax Reform Act on its financial statements and operations. Any additional impacts from the enactment of the Tax Reform Act will be recorded as they are identified during the measurement period as provided for in accordance with Staff Accounting Bulletin No. 118.

The Company is not under examination in any jurisdiction and the years ended March 31, 2017, 2016, and 2015 remain subject to examination. The Company believes no significant changes in the unrecognized tax benefits will occur within the next 12 months.

12. Financial Risk Management and Derivatives

Purchases and expenses denominated in currencies other than the U.S. dollar, which are primarily related to the Company's facilities overseas, expose the Company to market risk from material movements in foreign exchange rates between the U.S. dollar and the foreign currencies. The Company's primary risk exposure is from fluctuations in the value of the Mexican peso and to a lesser extent the Chinese yuan. To mitigate these risks, the Company enters into forward foreign currency exchange contracts to exchange U.S. dollars for these foreign currencies. The extent to which forward foreign currency exchange contracts are used is modified periodically in response to the Company's estimate of market conditions and the terms and length of anticipated requirements.

The Company enters into forward foreign currency exchange contracts in order to reduce the impact of foreign currency fluctuations and not to engage in currency speculation. The use of derivative financial instruments allows the Company to reduce its exposure to the risk that the eventual cash outflow resulting from funding the expenses of the foreign operations will be materially affected by changes in exchange rates between the U.S. dollar and the foreign currencies. The Company does not hold or issue financial instruments for trading purposes. The forward foreign currency exchange contracts are designated for forecasted expenditure requirements to fund foreign operations.

The Company had forward foreign currency exchange contracts with a U.S. dollar equivalent notional value of \$29,263,000 and \$26,880,000 at December 31, 2017 and March 31, 2017, respectively. These contracts generally have a term of one year or less, at rates agreed at the inception of the contracts. The counterparty to this derivative transaction is a major financial institution with investment grade credit rating; however, the Company is exposed to credit risk with this institution. The credit risk is limited to the potential unrealized gains (which offset currency

fluctuations adverse to the Company) in any such contract should this counterparty fail to perform as contracted. Any changes in the fair values of forward foreign currency exchange contracts are reflected in current period earnings and accounted for as an increase or offset to general and administrative expenses.

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The following shows the effect of the Company's derivative instruments on its consolidated statements of operations:

| Derivatives Not Designated as<br>Hedging Instruments | Gain (Loss) Recognized within General and Administrative Expenses |               |   |                 |
|--|---|---------------|---|-----------------|
|  | Three Months Ended<br>December 31,<br>2017                        |               | Nine Months Ended<br>December 31,<br>2016 |                 |
| Forward foreign currency exchange contracts          | \$ (1,784,000   | ) \$ (964,000 | ) \$ (1,062,000                           | ) \$ (2,150,000 |

The fair value of the forward foreign currency exchange contracts of \$635,000 is included in other current liabilities in the consolidated balance sheet at December 31, 2017. The fair value of the forward foreign currency exchange contracts of \$427,000 is included in prepaid and other current assets in the consolidated balance sheet at March 31, 2017.

## 13. Fair Value Measurements

The following summarizes the Company's financial assets and liabilities measured at fair value, by level within the fair value hierarchy:

|   | December 31, 2017                                     |             |           |         | March 31, 2017  |             |           |              |
|---|---|-------------|-----------|---------|---|-------------|-----------|--------------|
|   | Fair Value Measurements<br>Using Inputs Considered as |             |           |         | Fair Value Measurements<br>Using Inputs Considered as |             |           |              |
|   | Fair Value  | Level 1     | Level 2   | Level 3 | Fair Value  | Level 1     | Level 2   | Level 3      |
| <b>Assets</b>                               |   |             |           |         |   |             |           |              |
| Short-term investments                      |   |             |           |         |   |             |           |              |
| Mutual funds                                | \$2,759,000   | \$2,759,000 | -         | -       | \$2,140,000   | \$2,140,000 | -         | -            |
| Prepaid expenses and other current assets   |   |             |           |         |   |             |           |              |
| Forward foreign currency exchange contracts |   |             |           |         |   |             |           |              |
|   | -   | -           | -         | -       | 427,000   | -           | \$427,000 | -            |
| <b>Liabilities</b>                          |   |             |           |         |   |             |           |              |
| Other current liabilities                   |   |             |           |         |   |             |           |              |
| Forward foreign currency exchange contracts |   |             |           |         |   |             |           |              |
|   | 635,000   | -           | \$635,000 | -       | -   | -           | -         | -            |
| Deferred compensation                       |   |             |           |         |   |             |           |              |
|   | 2,759,000   | 2,759,000   | -         | -       | 2,140,000   | 2,140,000   | -         | -            |
| Other liabilities                           |   |             |           |         |   |             |           |              |
| Warrant liability                           | -   | -           | -         | -       | 11,879,000  | -           | -         | \$11,879,000 |

## Short-term Investments and Deferred Compensation

The Company's short-term investments, which fund its deferred compensation liabilities, consist of investments in mutual funds. These investments are classified as Level 1 as the shares of these mutual funds trade with sufficient frequency and volume to enable the Company to obtain pricing information on an ongoing basis.

#### Forward Foreign Currency Exchange Contracts

The forward foreign currency exchange contracts are primarily measured based on the foreign currency spot and forward rates quoted by the banks or foreign currency dealers. During the three months ended December 31, 2017 and 2016, a loss of \$1,784,000 and \$964,000, respectively, was recorded in general and administrative expenses due to the change in the value of the forward foreign currency exchange contracts. During the nine months ended December 31, 2017 and 2016, a loss of \$1,062,000 and \$2,150,000, respectively, was recorded in general and administrative expenses due to the change in the value of the forward foreign currency exchange contracts.

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## Level 3 Fair Value Measurements

The following summarizes the activity for Level 3 fair value measurements:

|   | Three Months Ended December 31, |                          |                  | Nine Months Ended December 31, |                          |                  |                          |            |
|---|---------------------------------|--------------------------|------------------|--------------------------------|--------------------------|------------------|--------------------------|------------|
|   | 2017                            | 2016                     |                  | 2017                           | 2016                     |                  |                          |            |
|   | Supplier Warrant                | Contingent Consideration | Supplier Warrant | Supplier Warrant               | Contingent Consideration | Supplier Warrant | Contingent Consideration |            |
| Beginning balance                               | \$ -                            | \$ -                     | \$ 10,878,000    | \$ -                           | \$ 11,879,000            | \$ -             | \$ 15,643,000            | \$ 330,000 |
| Newly issued                                    | -                               | -                        | -                | -                              | -                        | -                | -                        | -          |
| Total (gain) loss included in net income (loss) | -                               | -                        | (962,000 )       | -                              | (2,313,000 )             | -                | (5,727,000 )             | (16,000 )  |
| Exercises/settlements (1)                       | -                               | -                        | -                | -                              | (9,566,000 )             | -                | -                        | (314,000 ) |
| Net transfers in (out) of Level 3               | -                               | -                        | -                | -                              | -                        | -                | -                        | -          |
| Ending balance                                  | \$ -                            | \$ -                     | \$ 9,916,000     | \$ -                           | \$ -                     | \$ -             | \$ 9,916,000             | \$ -       |

(1) Represents the fair value of the Supplier Warrant as of the exercise date (see Note 8).

During the three and nine months ended December 31, 2017, the Company had no significant measurements of assets or liabilities at fair value on a nonrecurring basis subsequent to their initial recognition.

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the short-term nature of these instruments. The carrying amounts of the revolving loan, term loan and other long-term liabilities approximate their fair value based on the variable nature of interest rates and current rates for instruments with similar characteristics.

#### 14. Share-based Payments

##### Stock Options

The Company granted options to purchase 169,000 and 184,000 shares of common stock during the nine months ended December 31, 2017 and 2016, respectively. The cost associated with stock options is estimated using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions including the expected volatility of the underlying stock and the expected holding period of the option. These subjective assumptions are based on both historical and other information. Changes in the values assumed and used in the model can materially affect the estimate of fair value.

The following assumptions were used to derive the weighted average fair value of the stock options granted:

|  | Nine Months Ended |          |
|--|-------------------|----------|
|  | 2017              | 2016     |
| Weighted average risk free interest rate         | 1.91 %            | 1.38 %   |
| Weighted average expected holding period (years) | 5.82              | 5.84     |
| Weighted average expected volatility             | 47.31 %           | 47.42 %  |
| Weighted average expected dividend yield         | -                 | -        |
| Weighted average fair value of options granted   | \$ 12.66          | \$ 13.07 |



The following is a summary of stock option transactions:

|                                  | Number of<br>Shares | Weighted Average<br>Exercise Price |
|----------------------------------|---------------------|------------------------------------|
| Outstanding at March 31, 2017    | 1,036,359           | \$ 14.92                           |
| Granted                          | 169,000             | \$ 27.32                           |
| Exercised                        | (28,951 )           | \$ 10.15                           |
| Forfeited                        | (5,967 )            | \$ 28.55                           |
| Outstanding at December 31, 2017 | 1,170,441           | \$ 16.76                           |

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At December 31, 2017, options to purchase 324,959 shares of common stock were unvested at the weighted average exercise price of \$28.26.

At December 31, 2017, there was \$3,361,000 of total unrecognized compensation expense related to unvested stock option awards. The compensation expense is expected to be recognized over a weighted average vesting period of approximately 1.9 years.

## Restricted Stock Units (“RSUs”)

During the nine months ended December 31, 2017 and 2016, the Company granted 77,854 and 55,469 shares of RSUs, respectively, with an estimated grant date fair value of \$2,157,000 and \$1,574,000, respectively, which was based on the closing market price on the grant date.

The following is a summary of non-vested RSUs:

|                                 | Number of Shares | Weighted Average<br>Grant Date Fair<br>Value |
|---------------------------------|------------------|--|
| Non-vested at March 31, 2017    | 126,277          | \$ 28.26                                     |
| Granted                         | 77,854           | \$ 27.70                                     |
| Vested                          | (63,868)         | ) \$ 27.21                                   |
| Forfeited                       | (1,434)          | ) \$ 28.37                                   |
| Non-vested at December 31, 2017 | 138,829          | \$ 28.43                                     |

At December 31, 2017, there was \$3,164,000 of unrecognized compensation expense related to these awards, which will be recognized over the remaining vesting period of approximately 2.0 years.

## 15. Accumulated Other Comprehensive Income (Loss)

The following summarizes changes in accumulated other comprehensive income (loss):

|  | Three Months Ended December 31, 2017                  |                                    |               | Three Months Ended December 31, 2016                  |                                    |               |
|--|---|------------------------------------|---------------|---|------------------------------------|---------------|
|  | Unrealized<br>Gain<br>on<br>Short-Term<br>Investments | Foreign<br>Currency<br>Translation | Total         | Unrealized<br>Gain<br>on<br>Short-Term<br>Investments | Foreign<br>Currency<br>Translation | Total         |
| Balance at beginning of period   | \$ 644,000  | \$(7,132,000)                      | \$(6,488,000) | \$ 420,000  | \$(6,526,000)                      | \$(6,106,000) |
| Other comprehensive income (loss), net of tax                              | 83,000  | 247,000                            | 330,000       | 10,000  | (1,252,000)                        | (1,242,000)   |
| Amounts reclassified from accumulated other comprehensive loss, net of tax | -   | -                                  | -             | -   | -                                  | -             |
| Balance at end of period   | \$ 727,000  | \$(6,885,000)                      | \$(6,158,000) | \$ 430,000  | \$(7,778,000)                      | \$(7,348,000) |
|  | Nine Months Ended December 31, 2017                   |                                    |               | Nine Months Ended December 31, 2016                   |                                    |               |
|  | Unrealized<br>Gain<br>on<br>Short-Term                | Foreign<br>Currency<br>Translation | Total         | Unrealized<br>Gain<br>(Loss)                          | Foreign<br>Currency<br>Translation | Total         |

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|  | Investments |                |                | on<br>Short-Term<br>Investments |                |                |
|--|-------------|----------------|----------------|---------------------------------|----------------|----------------|
| Balance at beginning of period   | \$ 528,000  | \$(7,969,000 ) | \$(7,441,000 ) | \$ 332,000                      | \$(5,184,000 ) | \$(4,852,000 ) |
| Other comprehensive income<br>(loss), net of tax                                 | 199,000     | 1,084,000      | 1,283,000      | 98,000                          | (2,594,000 )   | (2,496,000 )   |
| Amounts reclassified from<br>accumulated other<br>comprehensive loss, net of tax | -           | -              | -              | -                               | -              | -              |
| Balance at end of period   | \$ 727,000  | \$(6,885,000 ) | \$(6,158,000 ) | \$ 430,000                      | \$(7,778,000 ) | \$(7,348,000 ) |

#### 16. Share Repurchase Program

As of December 31, 2017, the Company's board of directors had approved a stock repurchase program of up to \$15,000,000 of its common stock. As of December 31, 2017, \$6,855,000 of the \$15,000,000 had been utilized and \$8,145,000 remained available to repurchase shares under the authorized share repurchase program. The Company retired the 303,665 shares repurchased under this program through December 31, 2017. The Company's share repurchase program does not obligate it to acquire any specific number of shares and shares may be repurchased in privately negotiated and/or open market transactions.

#### 17. Subsequent Event

##### Share Repurchase Program

On February 2, 2018, the Company's board of directors increased the share repurchase program authorization from \$15,000,000 to \$20,000,000 of its common stock. The Company's share repurchase program does not obligate it to acquire any specific number of shares and shares may be repurchased in privately negotiated and/or open market transactions.

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

The following discussion and analysis presents factors that Motorcar Parts of America, Inc. and its subsidiaries ("our," "we" or "us") believe are relevant to an assessment and understanding of our consolidated financial position and results of operations. This financial and business analysis should be read in conjunction with our March 31, 2017 audited consolidated financial statements included in our Annual Report on Form 10-K filed with the SEC on June 14, 2017, as amended by the Form 10-K/A filed with the SEC on July 31, 2017.

Disclosure Regarding Private Securities Litigation Reform Act of 1995

This report contains certain forward-looking statements with respect to our future performance that involve risks and uncertainties. Various factors could cause actual results to differ materially from those projected in such statements. These factors include, but are not limited to: concentration of sales to a small number of customers, changes in the financial condition of or our relationship with any of our major customers, increases in the average accounts receivable collection period, the loss of sales to customers, delays in payments by customers, the increasing customer pressure for lower prices and more favorable payment and other terms, lower revenues than anticipated from new and existing contracts, the increasing demands on our working capital, the significant strain on working capital associated with large inventory purchases from customers, any meaningful difference between expected production needs and ultimate sales to our customers, investments in operational changes or acquisitions, our ability to obtain any additional financing we may seek or require, our ability to maintain positive cash flows from operations, potential future changes in our previously reported results as a result of the identification and correction of errors in our accounting policies or procedures or the potential material weaknesses in our internal controls over financial reporting, our failure to meet the financial covenants or the other obligations set forth in our credit agreement and the lenders' refusal to waive any such defaults, increases in interest rates, the impact of high gasoline prices, consumer preferences and general economic conditions, increased competition in the automotive parts industry including increased competition from Chinese and other offshore manufacturers, difficulty in obtaining Used Cores and component parts or increases in the costs of those parts, political, criminal or economic instability in any of the foreign countries where we conduct operations, currency exchange fluctuations, unforeseen increases in operating costs, risks associated with cyber-attacks, risks associated with conflict minerals, and other factors discussed herein and in our other filings with the SEC.

Management Overview

We are a leading manufacturer, remanufacturer, and distributor of aftermarket automotive parts for import and domestic cars, light trucks, heavy duty, agricultural and industrial applications. We sell our products predominantly in North America to the largest auto parts retail and traditional warehouse chains and to major automobile manufacturers for both their aftermarket programs and their OES programs. Our products include (i) rotating electrical products such as alternators and starters, (ii) wheel hub assemblies and bearings, (iii) brake master cylinders, and (iv) other products which include turbochargers, brake power boosters, and diagnostic equipment. We added turbochargers through an acquisition in July 2016. We began selling brake power boosters in August 2016. As a result of an acquisition in July 2017, our business also now includes developing and selling diagnostics systems for alternators and starters, electric vehicle power-train and battery technology.

The aftermarket for automobile parts is divided into two markets. The first is the DIY market, which is generally serviced by the large retail chain outlets. Consumers who purchase parts from the DIY channel generally install parts into their vehicles themselves. In most cases, this is a less expensive alternative than having the repair performed by a professional installer. The second is the professional installer market, commonly known as the DIFM market. This market is generally serviced by the traditional warehouse distributors, the dealer networks, and the commercial divisions of retail chains. Generally, the consumer in this channel is a professional parts installer. Our products are distributed to both the DIY and DIFM markets.

Pursuant to the guidance provided under the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), for segment reporting, we have identified our chief executive officer as our chief operating decision maker (“CODM”), have reviewed the documents used by the CODM, and understand how such documents are used by the CODM to make financial and operating decisions. We have determined through this review process that we have one reportable segment for purposes of recording and reporting our financial results.

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## Results of Operations for the Three Months Ended December 31, 2017 and 2016

The following discussion and analysis should be read together with the financial statements and notes thereto appearing elsewhere herein.

The following summarizes certain key operating data:

|  | Three Months Ended |   |             |   |
|--|--------------------|---|-------------|---|
|  | December 31,       |   |             |   |
|  | 2017               |   | 2016        |   |
| Gross profit percentage                    | 22.5               | % | 28.7        | % |
| Cash flow (used in) provided by operations | \$(1,655,000)      |   | \$1,506,000 |   |
| Finished goods turnover (annualized) (1)   | 5.2                |   | 6.3         |   |

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(1) Annualized finished goods turnover for the fiscal quarter is calculated by multiplying cost of goods sold for the quarter by 4 and dividing the result by the average between beginning and ending non-core finished goods inventory values for the fiscal quarter. We believe this provides a useful measure of our ability to turn our inventory into revenues.

## Net Sales and Gross Profit

The following summarizes net sales and gross profit:

|                         | Three Months Ended |   |               |   |
|-------------------------|--------------------|---|---------------|---|
|                         | December 31,       |   |               |   |
|                         | 2017               |   | 2016          |   |
| Net sales               | \$100,127,000      |   | \$112,595,000 |   |
| Cost of goods sold      | 77,583,000         |   | 80,225,000    |   |
| Gross profit            | 22,544,000         |   | 32,370,000    |   |
| Gross profit percentage | 22.5               | % | 28.7          | % |

Net Sales. Our net sales for the three months ended December 31, 2017 decreased by \$12,468,000, or 11.1%, to \$100,127,000 compared to net sales for the three months ended December 31, 2016 of \$112,595,000. Our prior year net sales were positively impacted by \$9,261,000 due to the change in our estimate for anticipated stock adjustment returns. Our net sales of wheel hub products and diagnostics systems, which resulted from our July 2017 acquisition, were higher during the three months ended December 31, 2017 compared to the prior year period. We have experienced year-over-year market share growth in rotating electrical. However, sales for the quarter were soft due to lower replenishment orders and customer inventory reduction initiatives. We believe that these factors are temporary. The remaining decrease in net sales was due to certain customer allowances as discussed below in the Gross Profit paragraph.

Gross Profit. Our gross profit percentage was 22.5% for the three months ended December 31, 2017 compared to 28.7% for the three months ended December 31, 2016. Gross profit for the three months ended December 31, 2017 was impacted by \$3,242,000 for customer allowances related to new business, transition expenses of \$803,000 in connection with the expansion of our operations in Mexico, and a cost of goods sold impact of \$40,000 for inventory step-up in connection with our July 2017 acquisition. In addition, our gross profit for the three months ended December 31, 2017 was further impacted by higher returns as a percentage of sales (see Net Sales above), lower production volume impacting overhead absorption, and product mix. Our gross profit for the three months ended December 31, 2016 was impacted by volume and stock update discounts for rotating electrical products and by

\$258,000 for customer allowances related to new business. In addition, our gross profit for the three months ended December 31, 2016 was positively impacted by \$4,066,000, or 1.3%, due to the change in estimate relating to stock adjustments.

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The lower of cost or net realizable value revaluation for remanufactured cores held at customers' locations was \$2,187,000 for the three months ended December 31, 2017 and \$1,295,000 for the three months ended December 31, 2016.

## Operating Expenses

The following summarizes operating expenses:

|                            | Three Months Ended<br>December 31, |             |
|----------------------------|------------------------------------|-------------|
|                            | 2017                               | 2016        |
| General and administrative | \$11,915,000                       | \$7,952,000 |
| Sales and marketing        | 4,048,000                          | 3,234,000   |
| Research and development   | 1,678,000                          | 1,039,000   |

## Percent of net sales

|                            |      |   |     |   |
|----------------------------|------|---|-----|---|
| General and administrative | 11.9 | % | 7.1 | % |
| Sales and marketing        | 4.0  | % | 2.9 | % |
| Research and development   | 1.7  | % | 0.9 | % |

**General and Administrative.** Our general and administrative expenses for the three months ended December 31, 2017 were \$11,915,000, which represents an increase of \$3,963,000, or 49.8%, from general and administrative expenses for the three months ended December 31, 2016 of \$7,952,000. This increase was primarily due to (i) \$1,043,000 of increased employee-related expenses to support our growth initiatives, (ii) \$820,000 of increased loss recorded due to the change in the fair value of the forward foreign currency exchange contracts, (iii) \$453,000 of increased legal expense due primarily to timing of our annual shareholders' meeting, (iv) \$346,000 of increased general and administrative expenses at our offshore locations to support our growth initiatives, and (v) \$299,000 of general and administrative expenses attributable to our July 2017 acquisition. In addition, the three months ended December 31, 2016 included \$962,000 of gain recorded due to the change in the fair value of the warrant liability, which was settled on September 8, 2017.

**Sales and Marketing.** Our sales and marketing expenses for the three months ended December 31, 2017 increased \$814,000, or 25.2%, to \$4,048,000 from \$3,234,000 for the three months ended December 31, 2016. The increase was due primarily to \$626,000 of sales and marketing expenses attributable to our July 2017 acquisition and \$201,000 for personnel added to support our growth initiatives.

**Research and Development.** Our research and development expenses increased by \$639,000, or 61.5%, to \$1,678,000 for the three months ended December 31, 2017 from \$1,039,000 for the three months ended December 31, 2016, primarily attributable to our July 2017 acquisition.

## Interest Expense

**Interest Expense, net.** Our interest expense, net for the three months ended December 31, 2017 increased \$596,000, or 17.8%, to \$3,953,000 from \$3,357,000 for the three months ended December 31, 2016. The increase in interest expense was due primarily to increased use of our accounts receivable discount programs, the write-off of \$231,000 of debt issuance costs, and increased average outstanding borrowings as we build our inventory levels to support anticipated higher sales.





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## Provision for Income Taxes

Income Tax. Our income tax expense for the three months ended December 31, 2017 and 2016 was \$7,756,000, or an effective tax rate of 816.4%, and \$5,678,000, or an effective tax rate of 33.8%, respectively. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Reform Act") was enacted into law, which changed various corporate income tax provisions within the existing Internal Revenue Code. The Tax Reform Act, among other things, lowered the U.S. corporate tax rate from 35% to 21% effective January 1, 2018, while also repealing the deduction for domestic production activities, implementing a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. As a result, we recorded a one-time non-cash tax charge of \$6,290,000 related to the revaluation of deferred tax assets and liabilities and a one-time tax charge of \$545,000 due to the transition tax on deemed repatriation of accumulated foreign income, during the three months ended December 31, 2017.

In addition, our income tax rate for the three months for both periods includes the required adjustments to reflect the appropriate nine-month rate for each fiscal year.

## Results of Operations for the Nine Months Ended December 31, 2017 and 2016

The following discussion and analysis should be read together with the financial statements and notes thereto appearing elsewhere herein.

The following summarizes certain key operating data:

|  | Nine Months Ended<br>December 31, |   |                |   |
|--|-----------------------------------|---|----------------|---|
|  | 2017                              |   | 2016           |   |
| Gross profit percentage                  | 24.6                              | % | 27.2           | % |
| Cash flow used in operations             | \$(9,803,000)                     |   | \$(20,810,000) |   |
| Finished goods turnover (annualized) (1) | 5.9                               |   | 6.4            |   |

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(1) Annualized finished goods turnover for the fiscal period is calculated by multiplying cost of goods sold for the period by 1.33 and dividing the result by the average between beginning and ending non-core finished goods inventory values for the fiscal period. We believe this provides a useful measure of our ability to turn our inventory into revenues.

## Net Sales and Gross Profit

The following summarizes net sales and gross profit:

|                         | Nine Months Ended<br>December 31, |   |               |   |
|-------------------------|-----------------------------------|---|---------------|---|
|                         | 2017                              |   | 2016          |   |
| Net sales               | \$306,964,000                     |   | \$306,843,000 |   |
| Cost of goods sold      | 231,419,000                       |   | 223,424,000   |   |
| Gross profit            | 75,545,000                        |   | 83,419,000    |   |
| Gross profit percentage | 24.6                              | % | 27.2          | % |

Net Sales. Our net sales for the nine months ended December 31, 2017 increased by \$121,000 to \$306,964,000 compared to net sales for the nine months ended December 31, 2016 of \$306,843,000. Our prior year net sales were positively impacted by \$9,261,000 due to the change in our estimate for anticipated stock adjustment returns. Our net

sales were further impacted by certain customer allowances as discussed below in Gross Profit paragraph.

Gross Profit. Our gross profit percentage was 24.6% for the nine months ended December 31, 2017 compared to 27.2% for the nine months ended December 31, 2016. Gross profit for the nine months ended December 31, 2017 was impacted by \$5,738,000 for customer allowances and initial return and stock adjustment accruals related to new business less a cost of goods sold offset of \$362,000, transition expenses of \$803,000 in connection with the expansion of our operations in Mexico, and a cost of goods sold impact of \$269,000 for inventory step-up in connection with our July 2017 acquisition. In addition, our gross profit for the nine months ended December 31, 2017 was further impacted by higher returns, lower purchasing volume impacting overhead absorption, and product mix. Our gross profit for the nine months ended December 31, 2016 was impacted by \$12,215,000 for customer allowances and initial return and stock adjustment accruals related to new business less a cost of goods sold offset of \$568,000, and a cost of goods sold impact of \$140,000 for start-up costs incurred related to our launch of brake power boosters. In addition, our gross profit for the nine months ended December 31, 2016 was positively impacted by \$4,066,000, or 0.5%, due to the change in estimate relating to stock adjustments.

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The lower of cost or net realizable value revaluation for remanufactured cores held at customers' locations was \$6,263,000 for the nine months ended December 31, 2017 and \$3,488,000 for the nine months ended December 31, 2016.

## Operating Expenses

The following summarizes operating expenses:

|                            | Nine Months Ended<br>December 31, |              |
|----------------------------|-----------------------------------|--------------|
|                            | 2017                              | 2016         |
| General and administrative | \$26,717,000                      | \$21,446,000 |
| Sales and marketing        | 10,899,000                        | 8,575,000    |
| Research and development   | 3,920,000                         | 2,813,000    |

## Percent of net sales

|                            |     |   |     |   |
|----------------------------|-----|---|-----|---|
| General and administrative | 8.7 | % | 7.0 | % |
| Sales and marketing        | 3.6 | % | 2.8 | % |
| Research and development   | 1.3 | % | 0.9 | % |

**General and Administrative.** Our general and administrative expenses for the nine months ended December 31, 2017 were \$26,717,000, which represents an increase of \$5,271,000, or 24.6%, from general and administrative expenses for the nine months ended December 31, 2016 of \$21,446,000. The increase was primarily due to (i) a gain of \$2,313,000 recorded during the nine months ended December 31, 2017 due to the change in the fair value of the warrant liability compared to a gain of \$5,727,000 recorded during the nine months ended December 31, 2016, (ii) \$984,000 of increased employee-related expenses to support our growth initiatives, (iii) \$917,000 of increased general and administrative expenses at our offshore locations, and (iv) \$589,000 of general and administrative expenses attributable to our July 2017 acquisition. These increases were partially offset by \$1,088,000 of decreased loss recorded due to the change in the fair value of the forward foreign currency exchange contracts.

**Sales and Marketing.** Our sales and marketing expenses for the nine months ended December 31, 2017 increased \$2,324,000, or 27.1%, to \$10,899,000 from \$8,575,000 for the nine months ended December 31, 2016. The increase was due primarily (i) \$905,000 of sales and marketing expenses attributable to our July 2017 acquisition, (ii) \$596,000 for personnel added to support our growth initiatives, and (iii) \$558,000 of increased commissions.

**Research and Development.** Our research and development expenses increased by \$1,107,000, or 39.4%, to \$3,920,000 for the nine months ended December 31, 2017 from \$2,813,000 for the nine months ended December 31, 2016, due primarily to \$1,015,000 attributable to our July 2017 acquisition and \$289,000 for personnel added to support our growth initiatives partially offset by \$120,000 of decreased expense for supplies.

## Interest Expense

**Interest Expense, net.** Our interest expense, net for the nine months ended December 31, 2017 increased \$1,424,000, or 15.2%, to \$10,789,000 from \$9,365,000 for the nine months ended December 31, 2016. The increase in interest expense was due primarily to increased use of our accounts receivable discount programs, increased average outstanding borrowings as we build our inventory levels to support anticipated higher sales, and the write-off of \$231,000 of debt issuance costs.



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Provision for Income Taxes

Income Tax. Our income tax expense for the nine months ended December 31, 2017 and 2016 was \$16,099,000, or an effective tax rate of 69.3%, and \$13,459,000, or an effective tax rate of 32.7%, respectively. On December 22, 2017, the Tax Reform Act was enacted into law, which changed various corporate income tax provisions within the existing Internal Revenue Code. The Tax Reform Act, among other things, lowered the U.S. corporate tax rate from 35% to 21% effective January 1, 2018, while also repealing the deduction for domestic production activities, implementing a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. As a result, we recorded a one-time non-cash tax charge of \$6,290,000 related to the revaluation of deferred tax assets and liabilities and a one-time tax charge of \$545,000 due to the transition tax on deemed repatriation of accumulated foreign income, during the nine months ended December 31, 2017.

In addition, the effective tax rate for the nine months ended December 31, 2017 is a blended rate reflecting the estimated benefit of one quarter of the federal tax rate reduction for fiscal 2018.

Liquidity and Capital Resources

Overview

At December 31, 2017 and March 31, 2017, we had negative working capital (current assets minus current liabilities) of \$40,609,000 and \$20,651,000, respectively, and a ratio of current assets to current liabilities of 0.74:1.00 and 0.86:1.00, respectively. The long-term classification of our core inventory, new business with existing and potential new customers, and the addition of any new products lines will continue to require the use of working capital to grow our business.

We generated cash during the nine months ended December 31, 2017 from the use of receivable discount programs with certain of our major customers and their respective banks, as well as from our credit facility. The cash generated from these activities was used primarily to build our inventory levels to support anticipated higher sales.

We believe our cash and cash equivalents, short-term investments, use of receivable discount programs, amounts available under our credit facility, and other sources are sufficient to satisfy our expected future working capital needs, repayment of the current portion of our term loans, and lease and capital expenditure obligations over the next 12 months.

Share Repurchase Program

As of December 31, 2017, our board of directors had approved a stock repurchase program of up to \$15,000,000 of our common stock. As of December 31, 2017, \$6,855,000 of the \$15,000,000 had been utilized and \$8,145,000 remained available to repurchase shares under the authorized share repurchase program. On February 2, 2018, our board of directors increased the share repurchase program authorization from \$15,000,000 to \$20,000,000 of our common stock. Our share repurchase program does not obligate us to acquire any specific number of shares and shares may be repurchased in privately negotiated and/or open market transactions.

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## Cash Flows

The following summarizes cash flows as reflected in the consolidated statements of cash flows:

|   | Nine Months Ended<br>December 31, |                |
|---|-----------------------------------|----------------|
|   | 2017                              | 2016           |
| Cash provided by (used in):                           |                                   |                |
| Operating activities                                  | \$(9,803,000 )                    | \$(20,810,000) |
| Investing activities                                  | (10,045,000)                      | (4,821,000 )   |
| Financing activities                                  | 20,805,000                        | 7,910,000      |
| Effect of exchange rates on cash and cash equivalents | 46,000                            | (235,000 )     |
| Net increase (decrease) in cash and cash equivalents  | \$1,003,000                       | \$(17,956,000) |
| Additional selected cash flow data:                   |                                   |                |
| Depreciation and amortization                         | \$3,322,000                       | \$2,718,000    |
| Capital expenditures                                  | 4,765,000                         | 4,127,000      |

Net cash used in operating activities was \$9,803,000 and \$20,810,000 during the nine months ended December 31, 2017 and 2016, respectively. The significant changes in our operating activities were due primarily to (i) decreases in accounts receivable and accounts payable during the nine months ended December 31, 2017 compared to increases during the nine months ended December 31, 2016 and (ii) increased payments of income taxes. In addition, our prior year operating activities were impacted by payments made in connection with new business.

Net cash used in investing activities was \$10,045,000 and \$4,821,000 during the nine months ended December 31, 2017 and 2016, respectively. This change was due primarily to our acquisition-related activities and increased capital expenditures.

Net cash provided by financing activities was \$20,805,000 and \$7,910,000 during the nine months ended December 31, 2017 and 2016, respectively. This change was due mainly to increased net borrowing primarily to build our inventory levels to support anticipated higher sales. The cash used to repurchase shares of our common stock under our share repurchase program was mostly offset by cash received upon exercise of the Supplier Warrant during the nine months ended December 31, 2017.

## Capital Resources

## Debt

We are party to the following credit agreements.

Credit Facility

We are a party to a \$145,000,000 senior secured financing, as amended, (the "Credit Facility") with the lenders party thereto, and PNC Bank, National Association, as administrative agent, consisting of (i) a \$120,000,000 revolving loan facility, subject to borrowing base restrictions and a \$15,000,000 sublimit for letters of credit (the "Revolving Facility") and (ii) a \$25,000,000 term loan facility (the "Term Loans"). The loans under the Credit Facility mature on June 3, 2020. In connection with the Credit Facility, the lenders were granted a security interest in substantially all of our assets. Our Credit Facility permits the payment of up to \$10,000,000 of dividends per calendar year, subject to a minimum availability threshold and pro forma compliance with financial covenants. This amount was increased to \$15,000,000 under the April 2017 amendment to the Credit Facility.

In April 2017, we entered into a consent and fourth amendment to the Credit Facility (the “Fourth Amendment”) which, among other things, (i) increased the borrowing base limit with respect to inventory located in Mexico, (ii) amended the definition and calculation of consolidated EBITDA to raise the limitation on the add-back for non-capitalized transaction expenses related to the expansion of operations in Mexico, (iii) increased the annual limit on permitted stock repurchases and dividends, and (iv) modifies certain other categories (including increasing certain baskets for permitted acquisitions) and thresholds to, among other things, further accommodate the expansion of operations in Mexico.



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In July 2017, we entered into a fifth amendment to the Credit Facility (the “Fifth Amendment”) which, among other things, amended the definition of permitted acquisitions, permitted indebtedness, and pledge agreements.

The Term Loans require quarterly principal payments of \$781,250. The Credit Facility bears interest at rates equal to either LIBOR plus a margin of 2.50%, 2.75% or 3.00% or a reference rate plus a margin of 1.50%, 1.75% or 2.00%, in each case depending on the senior leverage ratio as of the applicable measurement date. There is also a facility fee of 0.25% to 0.375%, depending on the senior leverage ratio as of the applicable measurement date. The interest rate on our Term Loans and Revolving Facility was 4.12% and 4.33%, respectively, at December 31, 2017 and 3.29% and 3.55%, respectively, at March 31, 2017.

The Credit Facility, among other things, requires us to maintain certain financial covenants including a maximum senior leverage ratio and a minimum fixed charge coverage ratio. We were in compliance with all financial covenants as of December 31, 2017.

The following summarizes the financial covenants required under the Credit Facility:

|                                     | Calculation as of<br>December 31, 2017 | Financial covenants<br>required under the<br>Credit Facility |
|-------------------------------------|--|--|
| Maximum senior leverage ratio       | 0.63                                   | 2.50   |
| Minimum fixed charge coverage ratio | 1.64                                   | 1.15   |

In addition to other covenants, the Credit Facility places limits on our ability to incur liens, incur additional indebtedness, make loans and investments, engage in mergers and acquisitions, engage in asset sales, redeem or repurchase capital stock, alter the business conducted by us and our subsidiaries, transact with affiliates, prepay, redeem or purchase subordinated debt, and amend or otherwise alter debt agreements.

We had \$36,000,000 and \$11,000,000 outstanding under the Revolving Facility at December 31, 2017 and March 31, 2017, respectively. In addition, \$260,000 was reserved for standby letters of credit for workers’ compensation insurance and \$600,000 for commercial letters of credit at December 31, 2017. At December 31, 2017, \$83,140,000, subject to certain adjustments, was available under the Revolving Facility.

WX Agreement

In August 2012, we entered into a Revolving Credit/Strategic Cooperation Agreement (the “WX Agreement”) with Wanxiang America Corporation (the “Supplier”) and the discontinued subsidiaries. In connection with the WX Agreement, we issued a warrant (the “Supplier Warrant”) to the Supplier to purchase up to 516,129 shares of our common stock for an exercise price of \$7.75 per share exercisable at any time after August 22, 2014 and on or prior to September 30, 2017.

On September 8, 2017, the Supplier exercised the Supplier Warrant in full and paid us \$4,000,000. As a result of the exercise, the Supplier Warrant is no longer outstanding. The fair value of the Supplier Warrant on the exercise date was \$9,566,000 using level 3 inputs and the Monte Carlo simulation model. The following assumptions were used to calculate the fair value of the Supplier Warrant: dividend yield of 0%, expected volatility of 26.4%, risk-free interest rate of 0.96%, subsequent financing probability of 0%, and an expected life of 0.06 years. We recorded a non-cash reclassification of the Supplier Warrant’s fair value to shareholders’ equity on the exercise date, with no further adjustments to the fair value of the Supplier Warrant being required. The fair value of the Supplier Warrant was \$11,879,000 at March 31, 2017 and was included in other liabilities in the consolidated balance sheet.



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During the nine months ended December 31, 2017 and 2016, a gain of \$2,313,000 and \$5,727,000, respectively, was recorded in general and administrative expenses due to the change in the fair value of this warrant liability. During the three months ended December 31, 2016, a gain of \$962,000 was recorded in general and administrative expenses due to the change in the fair value of this warrant liability.

## Receivable Discount Programs

We use receivable discount programs with certain customers and their respective banks. Under these programs, we have options to sell those customers' receivables to those banks at a discount to be agreed upon at the time the receivables are sold. These discount arrangements allows us to accelerate receipt of payment on customers' receivables. While these arrangements have reduced our working capital needs, there can be no assurance that these programs will continue in the future. Interest expense resulting from these programs would increase if interest rates rise, if utilization of these discounting arrangements expands, if customers extend their payment to us, or if the discount period is extended to reflect more favorable payment terms to customers.

The following is a summary of the receivable discount programs:

|   | Nine Months Ended |               |     |   |
|---|-------------------|---------------|-----|---|
|   | December 31,      |               |     |   |
|   | 2017              | 2016          |     |   |
| Receivables discounted                    | \$263,833,000     | \$254,795,000 |     |   |
| Weighted average days                     | 341               | 341           |     |   |
| Annualized weighted average discount rate | 3.2               | %             | 2.9 | % |
| Amount of discount as interest expense    | \$7,854,000       | \$6,864,000   |     |   |

## Off-Balance Sheet Arrangements

At December 31, 2017, we had no off-balance sheet financing or other arrangements with unconsolidated entities or financial partnerships (such as entities often referred to as structured finance or special purpose entities) established for purposes of facilitating off-balance sheet financing or other debt arrangements or for other contractually narrow or limited purposes.

## Capital Expenditures and Commitments

## Capital Expenditures

Our capital expenditures for our current operations were \$2,413,000 and \$3,850,000 for the nine months ended December 31, 2017 and 2016, respectively. These capital expenditures primarily represent the purchase of equipment for our office, manufacturing and warehouse facilities. We expect our fiscal 2018 capital expenditures to be approximately \$7,500,000 to support our current operations. In addition, our capital expenditures for the expansion of our operations in Mexico were \$2,352,000 and \$277,000 for the nine months ended December 31, 2017 and 2016, respectively. We expect to invest approximately \$11,000,000 in capital expenditures in connection with this expansion during fiscal 2018. We expect to use our working capital and/or incur additional capital lease obligations to finance these capital expenditures.

## Subsequent Event

## Share Repurchase Program

On February 2, 2018, our board of directors increased the share repurchase program authorization from \$15,000,000 to \$20,000,000 of our common stock. Our share repurchase program does not obligate us to acquire any specific number of shares and shares may be repurchased in privately negotiated and/or open market transactions.

#### Litigation

There have been no material changes to our litigation matters that are presented in our Annual Report on Form 10-K for the year ended March 31, 2017, which was filed on June 14, 2017 and as amended by the Form 10-K/A filed with the SEC on July 31, 2017.

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### Critical Accounting Policies

There have been no material changes to our critical accounting policies and estimates that are presented in our Annual Report on Form 10-K for the year ended March 31, 2017, which was filed on June 14, 2017, except as discussed below.

### New Accounting Pronouncements Not Yet Adopted

#### Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, codified in ASC 606, “Revenue Recognition - Revenue from Contracts with Customers” (“ASC 606”), which amends the guidance in the former ASC 605, “Revenue Recognition”. ASC 606 is effective for annual periods beginning after December 15, 2016, and interim periods within that reporting period for a public entity. We may elect either a full retrospective transition method, which requires the restatement of all periods presented, or a modified retrospective transition method, which requires a cumulative-effect recognized as of the date of initial adoption. In August 2015, the FASB delayed the effective date by one year to annual periods beginning after December 15, 2017, and interim periods within that reporting period for a public entity. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Accordingly, the updated standard is effective for us as of April 1, 2018 and we do not plan to early adopt. We are currently in the process of determining whether we will utilize the full or modified retrospective method of adoption allowed by the new standard and the impact on our consolidated financial statements and footnote disclosures. While we anticipate selecting the full retrospective method, that final determination will be driven by the changes required by ASC 606 and our ability to recast past financial statements based upon those requirements. We anticipate completing our assessment of the adoption method by the end of our current fiscal year.

ASC 606 establishes the requirements for recognizing revenue from contracts with customers. The standard requires entities to apportion consideration from contracts to performance obligations on a relative standalone selling price basis, based on a five-step model. Under the new standard, revenue is recognized when a customer obtains control of a promised good or service and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for the good or service. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

Due to the impact the new standard may have on our business processes, systems, and controls, a project team has been formed to evaluate and guide the implementation process. We have performed a preliminary assessment, which has included the identification of the key contractual terms in our primary revenue stream and the comparison of historical accounting policies and practices to the requirements of the new standard by revenue stream. The assessment has resulted in the identification of potential accounting differences that may arise from the application of the new standard. The implementation team has also made substantial progress in the contract review phase of the project which includes identifying the population of contracts for a deeper analysis of the potential accounting impacts of the new standard on individual contracts. During the third quarter, the implementation team continued to identify changes to business processes, systems and controls to support recognition, presentation and disclosure under the new standard. The detailed implementation plan for the second half of fiscal 2018 continues to be executed including such tasks as data gathering, identification of the new journal entries, training, design of new processes and controls as well as testing of the controls.

Our primary revenue stream is derived from the sale of remanufactured products to our customers pursuant to long-term customer contracts. We will continue to recognize revenue at a point in time as we satisfy our performance obligation of transferring control of the product to the customer. We recognize revenues net of anticipated returns, marketing allowances, volume discounts and other forms of variable consideration more fully described below. We

also reviewed customer options to acquire additional goods or services and have preliminarily determined no material rights exist within our contracts. We do not currently anticipate that the adoption of ASU 2014-09 to have a material impact on previously reported revenue amounts. See discussion regarding nominally priced Remanufactured Cores below.

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We currently anticipate that the adoption of ASU 2014-09 will primarily impact reclassifications to certain balance sheet accounts to conform to the presentation and disclosure requirements of ASC 606. For example, we currently account for fully priced Remanufactured Cores anticipated to be returned as long-term core inventory and the refund liability as a contra-account receivable account as illustrated in Note 5 of the condensed notes to consolidated financial statements for the quarter ended December 31, 2017. Under ASC 606, we currently anticipate that we will reclassify this asset to a contractual asset and recognize a contractual liability for amounts expected to be refunded to customers.

We also analyzed specific contractual provisions related sales contracts which include nominally priced Remanufactured Cores. We recognize revenue for sales of cores not expected to be replaced by a similar Used Core sent back under the core exchange program only upon meeting certain criteria as previously described in Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements that are presented in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017. The adoption of ASU 2014-09, may result in an acceleration of revenue recognition, as it requires us to estimate the amount of cores not expected to be returned upon the initial recognition of revenue for contracts which include nominally priced Remanufactured Cores. We currently do not expect that the change in the accounting policy for core exchange program to have a significant impact on our consolidated statements of operations.

In order to properly determine the transaction price related to our sales contracts, we have also analyzed our various forms of consideration paid to our vendors including up-front payments for future contracts. Based on the analysis completed through the quarter ended December 31, 2017, we currently do not anticipate a change to our legacy accounting practices as a result of the adoption of ASU 2014-09 to account for up-front payments to our vendors. Under current accounting practices, if we expect to generate future revenues associated with an up-front payment, then an asset is recognized and amortized over the appropriate period of time as a reduction of revenue. If we do not expect to generate additional revenue then the up-front payment is recognized in the consolidated statements of operations when payment occurs as a reduction of revenue. We analyze each up-front payment based on the substance and economics of the payment and therefore we are not able to make an accounting policy election for such payments, consistent with views expressed by the FASB Transition Resource Group ("TRG") members in related discussions.

ASU 2014-09 also codified the guidance on other assets and deferred costs relating to contracts with customers with the addition of ASC 340-40. This guidance relates to the accounting for costs of an entity to obtain and fulfill a contract to provide goods or services to the customer. Under the new guidance, an entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. In our review of the various costs to obtain contracts with customers, we have preliminarily determined that currently no significant costs are incurred that meet the capitalization criteria. Our primary cost to fulfill contracts relates to shipping and handling activities which continue to be expensed as incurred consistent with historical accounting practices.

The new guidance provides several practical expedients, for which we anticipate adopting. The first of these practical expedients allows a company to expense incremental costs of obtaining a contract as incurred if the amortization period would have been one year or less. As noted above, we have preliminarily concluded that we do not have any such costs that qualify for capitalization but will apply the practical expedient such that costs incurred in prospective periods qualify. Similarly, we plan to adopt guidance which allows for the effects of a significant financing component to be ignored if a company expects that the period between the transfer of the goods and services to the customer and payment will be one year or less. Finally, we plan to adopt guidance which allows a company to account for shipping and handling activities that occur after control of the related good transfers as fulfillment activities instead of assessing such activities as performance obligations. We continue to evaluate the impact of ASU 2014-09, related amendments and interpretive guidance will have on our consolidated financial statements.

While we have made substantial progress in identifying the likely impacts of the new standard, we have not yet determined a range of the potential quantitative impacts for the potential differences described above. In summary, we

do not expect there to be a significant impact to the amount of revenue previously recorded but do anticipate a significant impact related to the classification of certain assets and liabilities for the reasons discussed in the preceding paragraphs.

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### Financial Instruments

In January 2016, the FASB issued guidance that addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. A reporting entity should apply the new guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. We are currently evaluating the impact the provisions of this guidance will have on our consolidated financial statements.

### Leases

In February 2016, the FASB issued new guidance that requires balance sheet recognition of a right-of-use asset and lease liability by lessees for operating leases. The new guidance also requires new disclosures providing additional qualitative and quantitative information about the amounts recorded in the financial statements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The new guidance requires a modified retrospective approach with optional practical expedients. We are required to adopt this guidance in the first quarter of fiscal 2020. We are currently evaluating the impact the provisions of this guidance will have on our consolidated financial statements, but expect that it will result in a significant increase to our long-term assets and liabilities on the consolidated balance sheets.

### Business Combinations

In January 2017, the FASB issued guidance which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. A reporting entity should apply the amendment prospectively. The adoption of this guidance is not expected to have any material impact on our consolidated financial statements.

### Goodwill Impairment

In January 2017, the FASB issued guidance which simplifies the test for goodwill impairment. This standard eliminates Step 2 from the goodwill impairment test, instead requiring an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit's fair value. This guidance is effective for interim and annual goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption permitted. This guidance must be applied on a prospective basis. We are currently evaluating the impact the provisions of this guidance will have on our consolidated financial statements.

### Modifications to Share-Based Payment Awards

In May 2017, the FASB issued guidance to provide clarity and reduce (i) the diversity in practice and (ii) the cost and complexity when applying the accounting guidance for equity-based compensation to a change to the terms or conditions of a share-based payment award. This update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted. This guidance should be applied prospectively to an award modified on or after that adoption date. The adoption of this guidance is not expected to have any material impact on our consolidated financial statements.

### Derivatives and Hedging

In August 2017, the FASB issued guidance to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. The amendments in this update also make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; the guidance allows for early adoption in any interim period after issuance of the update. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in market risk from the information provided in Item 7A. “Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K as of March 31, 2017, which was filed with the SEC on June 14, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures designed to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and that such information is accumulated and communicated to management, including our chief executive officer, chief financial officer, and chief accounting officer, as appropriate to allow timely decisions regarding required disclosures.

Under the supervision and with the participation of management, including our chief executive officer, chief financial officer, and chief accounting officer, we have conducted an evaluation of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based on this evaluation, our chief executive officer, chief financial officer, and chief accounting officer concluded that MPA’s disclosure controls and procedures were effective as of December 31, 2017.

Inherent Limitations Over Internal Controls

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rules 13a-15(f) and 15d-15(f).

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America, applying certain estimates and judgments as required.

Internal control over financial reporting includes those policies and procedures that:

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;  
Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
2. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.
- 3.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control Over Financial Reporting

There were no changes in MPA's internal control over financial reporting during the third quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, MPA's internal control over financial reporting.

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## PART II — OTHER INFORMATION

## Item 1. Legal Proceedings

There have been no material changes to our litigation matters that are presented in our Annual Report on Form 10-K for the year ended March 31, 2017, which was filed on June 14, 2017 and as amended by the Form 10-K/A filed with the SEC on July 31, 2017.

## Item 1A. Risk Factors

There have been no material changes in the risk factors set forth in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended March 31, 2017, filed on June 14, 2017 and as amended by the Form 10-K/A filed with the SEC on July 31, 2017.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Limitation on Payment of Dividends

The Credit Facility permits the payment of up to \$15,000,000 of dividends and share repurchases per calendar year, subject to a minimum availability threshold and pro forma compliance with financial covenants.

## Purchases of Equity Securities by the Issuer

Shares repurchased during the three months ended December 31, 2017 were as follows:

| Periods   | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (1) |
|---|----------------------------------|------------------------------|--|--|
| October 1 - October 31, 2017:<br>Open market and privately negotiated purchases   | -                                | \$ -                         | -  | \$ 8,145,000   |
| November 1 - November 30, 2017:<br>Open market and privately negotiated purchases | -                                | \$ -                         | -  | 8,145,000  |
| December 1 - December 31, 2017:<br>Open market and privately negotiated purchases | -                                | \$ -                         | -  | 8,145,000  |
| Total   | -                                | -                            | -  | \$ 8,145,000   |

As of December 31, 2017, \$6,855,000 of the \$15,000,000 had been utilized and \$8,145,000 remained available to repurchase shares under the authorized share repurchase program. On February 2, 2018, our board of directors (1) increased the share repurchase program authorization from \$15,000,000 to \$20,000,000 of our common stock. Our share repurchase program does not obligate us to acquire any specific number of shares and shares may be repurchased in privately negotiated and/or open market transactions.



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## Item 6. Exhibits

## (a) Exhibits:

| Number     | Description of Exhibit   | Method of Filing  |
|------------|--|---|
| 3.1        | Certificate of Incorporation of the Company  | Incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 declared effective on March 22, 1994 (the "1994 Registration Statement"). |
| 3.2        | Amendment to Certificate of Incorporation of the Company   | Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No. 33-97498) declared effective on November 14, 1995.                    |
| <u>3.3</u> | Amendment to Certificate of Incorporation of the Company   | Incorporated by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1997.  |
| <u>3.4</u> | Amendment to Certificate of Incorporation of the Company   | Incorporated by reference to Exhibit 3.4 to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1998 (the "1998 Form 10-K").                   |
| <u>3.5</u> | Amendment to Certificate of Incorporation of the Company   | Incorporated by reference to Exhibit C to the Company's proxy statement on Schedule 14A filed with the SEC on November 25, 2003.  |
| <u>3.6</u> | Amended and Restated By-Laws of Motorcar Parts of America, Inc.  | Incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed on August 24, 2010.  |
| <u>3.7</u> | Certificate of Amendment of the Certificate of Incorporation of the Company                                  | Incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed on April 17, 2014.   |
| <u>3.8</u> | Amendment to the Amended and Restated By-Laws of Motorcar Parts of America, Inc., as adopted on June 9, 2016 | Incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed on June 14, 2016.  |
| <u>3.9</u> | Amendment to the Amended and Restated By-Laws of the Company   | Incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed on February 22, 2017.  |
| <u>4.1</u> | 2003 Long Term Incentive Plan  | Incorporated by reference to Exhibit 4.9 to the Company's Registration Statement on Form S-8 filed with the SEC on April 2, 2004.                                       |
| <u>4.2</u> | 2004 Non-Employee Director Stock Option Plan   | Incorporated by reference to Appendix A to the Proxy Statement on Schedule 14A for the 2004 Annual Shareholders Meeting.  |
| <u>4.3</u> | 2010 Incentive Award Plan  | Incorporated by reference to Appendix A to the Proxy Statement on Schedule 14A filed on December 15, 2010.  |
| <u>4.4</u> |  |   |

Amended and Restated 2010 Incentive Award Plan Incorporated by reference to Appendix A to the Proxy Statement on Schedule 14A filed on March 5, 2013.



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| Number      | Description of Exhibit   | Method of Filing   |
|-------------|--|--|
| <u>4.5</u>  | Second Amended and Restated 2010 Incentive Award Plan  | Incorporated by reference to Appendix A to the Proxy Statement on Schedule 14A filed on March 3, 2014.     |
| <u>4.6</u>  | 2014 Non-Employee Director Incentive Award Plan  | Incorporated by reference to Appendix B to the Proxy Statement on Schedule 14A filed on March 3, 2014.     |
| <u>4.7</u>  | Third Amended and Restated 2010 Incentive Award Plan   | Incorporated by reference to Appendix A to the Proxy Statement on Schedule 14A filed on November 20, 2017. |
| <u>10.1</u> | Fifth Amendment to Loan Agreement, dated as of July 18, 2017, among Motorcar Parts of America, Inc., each lender from time to time party thereto and PNC Bank, National Association, as administrative agent | Incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on July 24, 2017.            |
| <u>31.1</u> | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002   | Filed herewith.  |
| <u>31.2</u> | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002   | Filed herewith.  |
| <u>31.3</u> | Certification of Chief Accounting Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002  | Filed herewith.  |
| <u>32.1</u> | Certifications of Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002  | Filed herewith.  |
| 101.INS     | XBRL Instance Document   |  |
| 101.SCM     | XBRL Taxonomy Extension Schema Document  |  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document  |  |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document   |  |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document  |  |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document   |  |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MOTORCAR PARTS OF  
AMERICA, INC.

Dated: February 9, 2018 By: /s/ David Lee  
David Lee  
Chief Financial Officer

Dated: February 9, 2018 By: /s/ Kevin Daly  
Kevin Daly  
Chief Accounting Officer