CRAFT BREW ALLIANCE, INC.
Form 10-Q
August 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended June 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to ______________

Commission File Number 0-26542

CRAFT BREW ALLIANCE, INC.
(Exact name of registrant as specified in its charter)

Washington	91-1141254
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

929 North Russell Street
Portland, Oregon 97227
(Address of principal executive offices)

(503) 331-7270
(Registrant's telephone number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) 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, a smaller reporting company, or an emerging growth company. (See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act).
Check one:

Large Accelerated Filer	Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company
	Emerging Growth Company

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

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

The number of shares of the registrant's common stock outstanding as of August 2, 2018 was 19,362,600.

CRAFT BREW ALLIANCE, INC.
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CRAFT BREW ALLIANCE, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except per share amounts)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash, cash equivalents and restricted cash	$5,778	$ 579
Accounts receivable, net	36,999	27,784
Inventory, net	14,522	13,844
Assets held for sale	—	22,946
Other current assets	1,874	4,335
Total current assets	59,173	69,488
Property, equipment and leasehold improvements, net	104,982	106,283
Goodwill	12,917	12,917
Intangible, equity method investment and other assets, net	20,469	20,949
Total assets	$197,541	$ 209,637
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$20,042	$ 14,338
Accrued salaries, wages and payroll taxes	4,673	5,877
Refundable deposits	4,282	4,816
Deferred revenue	4,685	3,385
Other accrued expenses	3,163	2,368
Current portion of long-term debt and capital lease obligations	807	699
Total current liabilities	37,652	31,483
Long-term debt and capital lease obligations, net of current portion	9,946	32,599
Fair value of derivative financial instruments	47	221
Deferred income tax liability, net	12,301	12,886
Other liabilities	1,647	1,657
Total liabilities	61,593	78,846
Commitments and contingencies (Note 12)		
Common shareholders' equity:		
Common stock, $0.005 par value. Authorized 50,000,000 shares; issued and outstanding 19,362,386 and 19,309,829	97	96
Additional paid-in capital	143,004	142,196
Accumulated other comprehensive loss	(35)	(164)
Accumulated deficit	(7,118)	(11,337)
Total common shareholders' equity	135,948	130,791
Total liabilities and common shareholders' equity	$197,541	$ 209,637

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

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CRAFT BREW ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Sales	$65,253	$64,204	$115,338	$110,970
Less excise taxes	3,430	3,654	6,028	6,118
Net sales	61,823	60,550	109,310	104,852
Cost of sales	39,696	42,221	72,112	73,854
Gross profit	22,127	18,329	37,198	30,998
Selling, general and administrative expenses	15,857	15,560	30,605	31,029
Operating income (loss)	6,270	2,769	6,593	(31)
Interest expense	(107)	(173)	(241)	(354)
Other income, net	21	10	55	13
Income (loss) before income taxes	6,184	2,606	6,407	(372)
Income tax provision (benefit)	1,732	882	1,794	(309)
Net income (loss)	$4,452	$1,724	$4,613	$(63)
Basic and diluted net income (loss) per share	$0.23	$0.09	$0.24	$—
Shares used in basic per share calculations	19,334	19,278	19,322	19,270
Shares used in diluted per share calculations	19,517	19,389	19,502	19,270

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

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CRAFT BREW ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	$4,452	$1,724	$4,613	$(63)
Unrealized gain (loss) on derivative hedge transactions, net of tax	46	(3)	129	48
Comprehensive income (loss)	$4,498	$1,721	$4,742	$(15)

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

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CRAFT BREW ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$4,613	$(63)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	5,387	5,468
(Gain) loss on sale or disposal of Property, equipment and leasehold improvements	(494)	146
Deferred income taxes	(629)	(378)
Stock-based compensation	687	554
Other	188	875
Changes in operating assets and liabilities:		
Accounts receivable, net	(9,215)	(3,334)
Inventories	(285)	3,323
Other current assets	1,761	(1,093)
Accounts payable and other accrued expenses	7,889	7,299
Accrued salaries, wages and payroll taxes	(1,204)	(49)
Refundable deposits	(241)	(397)
Net cash provided by operating activities	8,457	12,351
Cash flows from investing activities:		
Expenditures for Property, equipment and leasehold improvements	(4,284)	(4,920)
Proceeds from sale of Property, equipment and leasehold improvements	22,936	91
Restricted cash from sale of Property, equipment and leasehold improvements	515	—
Net cash provided by (used in) investing activities	19,167	(4,829)
Cash flows from financing activities:		
Principal payments on debt and capital lease obligations	(348)	(261)
Net repayments under revolving line of credit	(22,199)	(5,756)
Proceeds from issuances of common stock	206	87
Tax payments related to stock-based awards	(84)	—
Net cash used in financing activities	(22,425)	(5,930)
Increase in Cash, cash equivalents and restricted cash	5,199	1,592
Cash, cash equivalents and restricted cash:		
Beginning of period	579	442
End of period	$5,778	$2,034
Supplemental disclosure of cash flow information:		
Cash paid for interest	$285	$363
Cash paid for income taxes, net	126	176
Supplemental disclosure of non-cash information:		
Purchases of Property, equipment and leasehold improvements with capital leases	$—	$180
Purchases of Property, equipment and leasehold improvements included in Accounts payable at end of period	429	7,550

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

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CRAFT BREW ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The accompanying consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Annual Report”). These consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements are unaudited but, in the opinion of management, reflect all material adjustments necessary to present fairly our consolidated financial position, results of operations and cash flows for the periods presented. All such adjustments were of a normal, recurring nature. The results of operations for such interim periods are not necessarily indicative of the results of operations for the full year.

Reclassifications
Certain reclassifications have been made to the prior year's data to conform to the current year's presentation. None of the changes affect our previously reported consolidated Net sales, Gross profit, Operating income, Net income or Basic or diluted net income per share.

Note 2. Recent Accounting Pronouncements

ASU 2018-02
In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows entities to reclassify accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (the “Act”). This update is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the income tax rate change resulting from the Act is recognized. The early adoption of ASU 2018-02 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2017-12
In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 refines and expands hedge accounting for both financial and commodity risks. Its provisions create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. It also makes certain targeted improvements to simplify the application of hedge accounting guidance. ASU 2017-12 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018, on a prospective basis. We do not expect the adoption of ASU 2017-12 to have a material effect on our financial position, results of operations or cash flows.

ASU 2017-09
In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting." ASU 2017-09 provides clarity and is expected to reduce both diversity in practice and the cost and complexity when accounting for a change to the terms of a stock-based award. ASU 2017-09 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017, on a prospective

basis. The adoption of ASU 2017-09 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2017-04

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if applicable. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit. The same impairment test also applies to any reporting unit with a zero or negative carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, on a prospective

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basis. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. We do not expect the adoption of ASU 2017-04 to have a material effect on our financial position, results of operations or cash flows.

ASU 2016-18
In August 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230) - Restricted Cash." ASU 2016-18 reduces the diversity in practice in the classification and the presentation of restricted cash within an entity's statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, with early adoption permitted. The adoption of ASU 2016-18 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2016-15
In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 addresses eight specific cash flow issues and how they should be reported on the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, with early adoption permitted. The adoption of ASU 2016-15 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2016-13
In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)." ASU 2016-13 addresses accounting for credit losses for assets that are not measured at fair value through net income on a recurring basis. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods, with early adoption permitted for fiscal years beginning after December 15, 2018. We do not expect the adoption of ASU 2016-13 to have a material effect on our financial position, results of operations or cash flows.

ASU 2016-02
In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are currently evaluating the potential impact of the adoption of ASU 2016-02 on our consolidated financial statements. We currently expect the adoption of this standard to result in a material increase to the assets and liabilities on our consolidated balance sheets.

ASU 2016-01
In January 2016, the FASB issued ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10).” ASU 2016-01 enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by addressing certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The amendments simplify certain requirements and also reduce diversity in current practice for other requirements. ASU 2016-01 is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU 2016-01 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2014-09, ASU 2016-10 and ASU 2016-12
In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09, as amended, affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). ASU 2014-09, as amended, is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017.

In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing." ASU 2016-10 clarifies aspects of Topic 606 related to identifying performance obligations and the licensing implementation guidance, while retaining the related core principles for those areas. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements in ASU 2014-09.

In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients." ASU 2016-12 clarifies aspects of Topic 606 related to the guidance on assessing collectibility, presentation of sales taxes, non-cash consideration, and completed contracts and contract modifications. The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements in ASU 2014-09.

The standards permit either the retrospective or the modified retrospective (cumulative effect) transition method. On January 1, 2018, we adopted the new accounting standard Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers" and all the related amendments to all contracts using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis.

See also Note 8.

Note 3. Cash, Cash Equivalents and Restricted Cash

We maintain cash balances with financial institutions that may exceed federally insured limits. We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of June 30, 2018 and December 31, 2017, we did not have any cash equivalents.

As part of our cash management system, we use a controlled disbursement account to fund cash distribution checks presented for payment by the holder. Checks issued but not yet presented to banks may result in overdraft balances for accounting purposes. As of June 30, 2018 and December 31, 2017, there were no bank overdrafts. Changes in bank overdrafts from period to period are reported in the Consolidated Statements of Cash Flows as a component of operating activities within Accounts payable and Other accrued expenses.

Cash and cash equivalents that are restricted as to withdrawal or use under terms of certain contractual agreements are recorded in Cash, cash equivalents and restricted cash on our Consolidated Balance Sheets. Restricted cash of $0.5 million at June 30, 2018 represents funds held in an escrow account from the sale of our Woodinville brewery related to a lien; we expect that the lien will be resolved in our favor and the restriction will be removed. We did not have any restricted cash at December 31, 2017.

Note 4. Inventories

Inventories are stated at the lower of standard cost or net realizable value.

We regularly review our inventories for the presence of obsolete product attributed to age, seasonality and quality. If our review indicates a reduction in utility below the product’s carrying value, we reduce the product to a new cost basis. We record the cost of inventory for which we estimate we have more than a twelve-month supply as a component of Intangible, equity method investment and other assets, net on our Consolidated Balance Sheets.

Inventories consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Raw materials	$3,247	$ 4,290
Work in process	2,616	1,960
Finished goods	6,120	5,009
Packaging materials	1,322	956
Promotional merchandise	714	1,161
Brewpub food, beverages and supplies	503	468
	$14,522	$ 13,844

Work in process is beer held in fermentation tanks prior to the filtration and packaging process.

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Note 5. Related Party Transactions

As of June 30, 2018 and December 31, 2017, Anheuser-Busch, LLC ("A-B") owned approximately 31.3% and 31.4%, respectively, of our outstanding common stock.

Transactions with A-B, Ambev and Anheuser-Busch Worldwide Investments, LLC ("ABWI")
In December 2015, we partnered with Ambev, the Brazilian subsidiary of Anheuser-Busch InBev SA, to distribute Kona beers into Brazil. In August 2016, we also entered into an International Distribution Agreement with ABWI, an affiliate of A-B, pursuant to which ABWI distributes our malt beverage products in jurisdictions outside the United States, subject to the terms and conditions of our prior agreement with our other international distributor, CraftCan Travel LLC, and certain other limitations.

Contract Brewing Arrangement with Anheuser-Busch Companies, LLC ("ABC")
On January 30, 2018, we entered into a Contract Brewing Agreement (the "Brewing Agreement") with ABC, an affiliate of A-B, pursuant to which we brew, package, and palletize certain malt beverage products of A-B's craft breweries at our Portland, Oregon, and Portsmouth, New Hampshire, breweries as selected by ABC. Under the terms of the Brewing Agreement, ABC pays us a per barrel fee that varies based on the annual volume of the specified product brewed by us, plus (a) our actual incremental costs of brewing the product and (b) certain capital costs and costs of graphics and labeling that we incur in connection with the brewed products.

The Brewing Agreement will expire on December 31, 2018, unless the arrangement is extended at the mutual agreement of the parties. The Brewing Agreement contains specified termination rights, including, among other things, the right of either party to terminate the Brewing Agreement if (i) the other party fails to perform any material obligation under the Brewing Agreement or any other agreement between the parties, subject to certain cure rights, or (ii) the Master Distributor Agreement is terminated.

Transactions with A-B, Ambev, ABWI and ABC consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Gross sales to A-B and Ambev	$50,283	$49,144	$87,851	$81,785
International distribution fee earned from ABWI	850	850	1,700	1,700
International distribution fee from ABWI, recorded in Deferred revenue	650	400	1,300	800
Contract Brewing fee earned from ABC	395	—	858	—
Margin fee paid to A-B, classified as a reduction of Sales	687	669	1,205	1,157
Inventory management and other fees paid to A-B, classified in Cost of sales	100	101	190	192
Media and other reimbursement from A-B, classified as a reduction of Selling, general and administrative expenses	—	74	—	74

Amounts due to or from A-B and ABWI were as follows (in thousands):

	June 30, 2018	December 31, 2017
Amounts due from A-B related to beer sales pursuant to the A-B distributor agreement	$23,593	$ 15,663
Amounts due from ABWI and A-B related to international distribution fee	3,000	5,000
Refundable deposits due to A-B	(1,982)	(1,619)
Amounts due to A-B for services rendered	(9,002)	(4,836)
Net amount due from A-B and ABWI	$15,609	$ 14,208

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Transactions with Wynwood Brewing Co. ("Wynwood")
As of June 30, 2018 and December 31, 2017, we owned a 24.5% interest in Wynwood. The carrying value of our investment was $2.0 million as of June 30, 2018.

Transactions with Wynwood consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Master distributor fee earned	$ 12	$ —	$ 19	$ —
Share of (gain) loss, classified as a component of Other income (expense), net	(1)	—	22	—
Refund of investment, classified as a reduction in the carrying value of the equity method investment	—	—	23	—

Amounts due to or from Wynwood were as follows (in thousands):

	June 30, 2018	December 31, 2017
Amounts receivable related to raw materials and alternating proprietorship fees	$ 188	$ 148
Amounts receivable related to Brewery representative reimbursements	—	32
Amounts due related to purchases of beer pursuant to the distributor agreement	(123)	(116)
Amounts due related to Royalty fees	—	(4)
Net amount receivable	$ 65	$ 60

Operating Leases
We lease our headquarters office space, restaurant and storage facilities located in Portland, land and certain equipment from two limited liability companies, both of whose members include our former Board Chair, who is also a significant shareholder, and his brother, who continues to be employed by us. Lease payments to these lessors were as follows (in thousands) and are included in the Rent expense under all operating leases above:

Three Months Ended June 30,		Six Months Ended June 30,	
2018	2017	2018	2017
$41	$ 31	$82	$ 61

We hold lease and sublease obligations for certain office space and the land underlying the brewery and pub location in Kona, Hawaii, with a company whose owners include a shareholder who owns more than 5% of our common stock. The sublease contracts expire on various dates through 2020, with an extension at our option for two five-year periods. Lease payments to this lessor were as follows (in thousands) and are included in the Rent expense under all operating leases above:

Three Months Ended June 30,		Six Months Ended June 30,	
2018	2017	2018	2017
$147	$145	$290	$288

Note 6. Derivative Financial Instruments

Interest Rate Swap Contracts

Our risk management objectives are to ensure that business and financial exposures to risk that have been identified and measured are minimized using the most effective and efficient methods to reduce, transfer and, when possible, eliminate such exposures. Operating decisions contemplate associated risks and management strives to structure proposed transactions to avoid or reduce risk whenever possible.

We have assessed our vulnerability to certain business and financial risks, including interest rate risk associated with our variable-rate long-term debt. To mitigate this risk, effective January 23, 2014, we entered into an interest rate swap contract with Bank of America, N.A. (“BofA”) for 75% of the Term Loan balance, to hedge the variability of interest payments associated with our variable-rate borrowings under our Term Loan with BofA. The Term Loan contract and the interest rate swap terminate on

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September 30, 2023. The Term Loan contract had a total notional value of $6.8 million as of June 30, 2018. Through this swap agreement, we pay interest at a fixed rate of 2.86% and receive interest at a floating-rate of the one-month LIBOR, which was 2.07% at June 30, 2018.

Effective January 4, 2016, we entered into a $9.1 million notional amount interest rate swap contract with BofA, which was set to expire January 1, 2019, to hedge the variability of interest payments associated with our variable-rate borrowings on our line of credit. The notional amount fluctuated based on a predefined schedule based on our anticipated borrowings. This swap agreement was terminated effective January 18, 2018 as we paid off our line of credit, and we received interest of $27,000.

Since the interest rate swaps hedge the variability of interest payments on variable rate debt with similar terms, they qualify for cash flow hedge accounting treatment.

As of June 30, 2018, unrealized net losses of $0.05 million were recorded in Accumulated other comprehensive loss as a result of these hedges. The effective portion of the gain or loss on the derivatives is reclassified into Interest expense in the same period during which we record Interest expense associated with the related debt. There was no hedge ineffectiveness during the first six months of 2018 or 2017.

The fair value of our derivative instruments was as follows (in thousands):

	June 30, 2018	December 31, 2017
Fair value of interest rate swaps	$ (47)	$ (221)

The effect of our interest rate swap contracts that were accounted for as a derivative instrument on our Consolidated Statements of Operations was as follows (in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain Recognized in Accumulated OCI (Effective Portion)	Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion)
Three Months Ended June 30,			
2018	$ 61	Interest expense	$ 17
2017	$ (5)	Interest expense	$ 40
Six Months Ended June 30,			
2018	$ 173	Interest expense	$ 39
2017	$ 77	Interest expense	$ 93

See also Note 7.

Note 7. Fair Value Measurements

Factors used in determining the fair value of our financial assets and liabilities are summarized into three broad categories:

- Level 1 – quoted prices in active markets for identical securities as of the reporting date;
- Level 2 – other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds and credit risk; and
- Level 3 – significant inputs that are generally less observable than objective sources, including our own assumptions in determining fair value.

The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

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The following table summarizes liabilities measured at fair value on a recurring basis (in thousands):

Fair Value at June 30, 2018	Level 1	Level 2	Level 3	Total
Interest rate swap	$ —	$ (47)	$ —	$ (47)
Fair Value at December 31, 2017				
Interest rate swaps	$ —	$ (221)	$ —	$ (221)

We did not have any assets measured at fair value on a recurring basis at June 30, 2018 or December 31, 2017.

The fair value of our interest rate swaps was based on quarterly statements from the issuing bank. There were no changes to our valuation techniques during the six months ended June 30, 2018.

We believe the carrying amounts of Cash, cash equivalents and restricted cash, Accounts receivable, Other current assets, Accounts payable, Accrued salaries, wages and payroll taxes, and Other accrued expenses are a reasonable approximation of the fair value of those financial instruments because of the nature of the underlying transactions and the short-term maturities involved.

We had fixed-rate debt outstanding as follows (in thousands):

	June 30, 2018	December 31, 2017
Fixed-rate debt on Consolidated Balance Sheets	$ 1,718	$ 1,855
Estimated fair value of fixed-rate debt	1,746	1,915

We calculate the estimated fair value of our fixed-rate debt using a discounted cash flow methodology. Using estimated current interest rates based on a similar risk profile and duration (Level 2), the fixed cash flows are discounted and summed to compute the fair value of the debt.

Note 8. Revenue Recognition

On January 1, 2018, we adopted the Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers" and all the related amendments (the "new revenue standard") for all of our revenue contracts, using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of Accumulated deficit. The adoption of ASC 606 did not have a material impact on our consolidated financial statements as of January 1, 2018 or for the three and six-month periods ended June 30, 2018.

The adjustments to our Consolidated Balance Sheets upon adoption of ASC 606, effective January 1, 2018 were as follows (in thousands):

	Balance at December 31, 2017	Adjustments due to ASC 606	Balance at January 1, 2018
Assets:			