BLONDER TONGUE LABORATORIES INC
Form 10-Q
November 14, 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 SEPTEMBER 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 1-14120

BLONDER TONGUE LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-1611421** (I.R.S. Employer Identification No.)
One Jake Brown Road, Old Bridge, New Jersey (Address of principal executive offices)	**08857** (Zip Code)

Registrant’s telephone number, including area code: **(732) 679-4000**

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicated 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

Number of shares of common stock, par value $.001, outstanding as of November 6, 2018: 9,284,436

The Exhibit Index appears on page 18.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	(unaudited) September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash	$ 96	$ 168
Accounts receivable, net of allowance for doubtful accounts of $53 and $180 as of September 30, 2018 and December 31,2017, respectively	2,708	2,621
Inventories, current	5,763	5,496
Prepaid benefit costs	314	314
Prepaid and other current assets	666	351
Total current assets	9,547	8,950
Inventories, net non-current	855	850
Property, plant and equipment, net	2,958	3,106
License agreements, net	18	29
Intangible assets, net	1,312	1,441
Goodwill	493	493
Other assets, net	195	305
	$ 15,378	$ 15,174
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit	$ 2,582	$ 2,487
Current portion of long-term debt	254	249
Accounts payable	1,187	700
Accrued compensation	202	307
Other accrued expenses	251	196
Subordinated convertible debt with related parties	202	-
Total current liabilities	4,678	3,939
Subordinated convertible debt with related parties	-	624
Long-term debt, net of current portion	2,915	3,094
Deferred income taxes	104	104
Total liabilities	7,697	7,761

Commitments and contingencies	-	-
Stockholders’ equity:		
Preferred stock, $.001 par value; authorized 5,000 shares; no shares outstanding as of September 30, 2018 and December 31, 2017	-	-
Common stock, $.001 par value; authorized 25,000 shares, 9,914 and 8,465 shares issued, 9,684 and 8,211 shares outstanding as of September 30, 2018 and December 31, 2017, respectively	9	8
Paid-in capital	27,768	26,920
Accumulated deficit	(18,418)	(17,821)
Accumulated other comprehensive loss	(854)	(854)
Treasury stock, at cost, 229 and 253 shares as of September 30, 2018 and December 31, 2017, respectively	(824)	(840)
Total stockholders’ equity	7,681	7,413
	$ 15,378	$ 15,174

See accompanying notes to unaudited condensed consolidated financial statements

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales	$5,626	$5,576	$16,266	$17,713
Cost of goods sold	3,213	3,399	9,439	11,010
Gross profit	2,413	2,177	6,827	6,703
Operating expenses:				
Selling	683	631	1,894	1,941
General and administrative	1,102	956	3,135	2,802
Research and development	672	605	1,972	1,877
	2,457	2,192	7,001	6,620
(Loss) earnings from operations	(44)	(15)	(174)	83
Other expense - net	(155)	(138)	(423)	(581)
Change in derivative liability	-	-	-	(142)
Loss before income taxes	(199)	(153)	(597)	(640)
Provision for income taxes	-	-	-	-
Net loss	$(199)	$(153)	$(597)	$(640)
Basic and diluted net loss per share	$(0.02)	$(0.02)	$(0.07)	$(0.08)
Basic and diluted weighted averages shares outstanding	9,270	8,212	8,836	8,181

See accompanying notes to unaudited condensed consolidated financial statements.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended September 30, 2018			2017		
Cash Flows From Operating Activities:						
Net loss	$	(597	)	$	(640	)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:						
Stock compensation expense		393			292	
Depreciation		235			242	
Amortization		160			264	
Recovery of bad debt expense		(126	)		-	
Amortization of loan fees		108			105	
Non cash interest expense		32			229	
Change in derivative liability		-			142	
Changes in operating assets and liabilities:						
Accounts receivable		39			(353	)
Inventories		(272	)		(454	)
Prepaid and other current assets		(315	)		(59	)
Other assets		2			(23	)
Accounts payable, accrued compensation and other accrued expenses		437			5	
Net cash provided by (used in) operating activities		96			(250	)

Cash Flows From Investing Activities:						
Purchases of property and equipment		(72	)		(100	)
Acquisition of licenses		(20	)		(60	)
Net cash used in investing activities		(92	)		(160	)
Cash Flows From Financing Activities:						
Net borrowings of line of credit		95			307	
Repayments of long-term debt		(189	)		(166	)
Proceeds from exercise of stock options		18			-	
Net cash (used in) provided by financing activities		(76	)		141	
Net decrease in cash		(72	)		(269	)
Cash, beginning of period		168			468	
Cash, end of period	$	96		$	199	
Supplemental Cash Flow Information:						
Cash paid for interest	$	273		$	218	
Non cash investing and financing activities:						
Capital expenditures financed by notes payable	$	15		$	10	
Conversion of subordinated convertible debt to common stock	$	455		$	-	

See accompanying notes to unaudited condensed consolidated financial statements.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

(unaudited)

Note 1 – Company and Basis of Consolidation

Blonder Tongue Laboratories, Inc. (together with its consolidated subsidiaries, the "**Company**") is a technology-development and manufacturing company that delivers television signal encoding, transcoding, digital transport, and broadband product solutions to the cable markets the Company serves, including the multi-dwelling unit market, the lodging/hospitality market and the institutional market, including hospitals, prisons and schools, primarily throughout the United States and Canada. The consolidated financial statements include the accounts of Blonder Tongue Laboratories, Inc. and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements as of September 30, 2018 and for the three and nine months then ended have been prepared in accordance with accounting principles generally accepted in the United States of America ("**GAAP**") for interim financial information and pursuant to the instructions to Form 10-Q and Article 8 of Regulation S-X of the Securities and Exchange Commission ("**SEC**") and on the same basis as the Company prepares its annual audited consolidated financial statements. The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting primarily of normal recurring adjustments, which the Company considers necessary for a fair presentation of the condensed consolidated financial position, operating results and cash flows for the periods presented. The condensed consolidated balance sheet at December 31, 2017 has been derived from audited consolidated financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP for complete financial statements have been condensed or omitted pursuant to SEC rules and regulations. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2017, and notes thereto included in the Company's annual report on Form 10-K, which was filed with the SEC on April 2, 2018. The results of the three and nine months ended September 30, 2018 are not necessarily indicative of results to be expected for the year ending December 31, 2018 or for any future interim period.

Note 2 – Summary of Significant Accounting Policies

(a) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's significant estimates include stock compensation and reserves related to accounts receivable, inventories and deferred tax assets. Actual results could differ from those estimates.

(b) Derivative Financial Instruments

The Company evaluates its convertible instruments to determine if those contracts or embedded components of those contracts qualify as derivative financial instruments to be separately accounted for in accordance with Topic 815 of the Financial Accounting Standards Board ("**FASB**") Accounting Standards Codification (**"ASC**"). The accounting treatment of derivative financial instruments requires that the Company record the embedded conversion option at its fair value as of the inception date of the agreement and at fair value as of each subsequent balance sheet date. Any change in fair value is recorded as non-operating, non-cash income or expense for each reporting period at each balance sheet date. The Company reassesses the classification of its derivative instruments at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

The Black-Scholes Model (which approximates the Binomial Lattice Model) was used to estimate the fair value of the conversion options that is classified as a derivative liability on the condensed consolidated balance sheets. See Note 6 of the Notes to Condensed Consolidated Financial Statements. The model includes subjective input assumptions that can materially affect the fair value estimates. The expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the conversion options.

Conversion options are recorded as a discount to the host instrument and are amortized as interest expense over the life of the underlying instrument.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

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(c) Fair Value of Financial Instruments

The Company measures fair value of its financial assets on a three-tier value hierarchy, which prioritizes the inputs, used in the valuation methodologies in measuring fair value:

Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Other inputs that are directly or indirectly observable in the marketplace.

Level 3 – Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

(d) Earnings (loss) Per Share

Earnings (loss) per share is calculated in accordance with ASC Topic 260 “Earnings Per Share,” which provides for the calculation of “basic” and “diluted” earnings (loss) per share. Basic earnings (loss) per share includes no dilution and is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflect, in periods in which they have a dilutive effect, the effect of potential issuances of common shares. The diluted share base excludes incremental shares related to stock options, restricted stock and convertible debt of 1,527 and 3,174 for the three-month periods ended September 30, 2018 and 2017, respectively and 1,406 and 2,983 for the nine-month periods ended September 30, 2018 and 2017, respectively. These shares were excluded due to their antidilutive effect.

(e) Adoption of Recent Accounting Pronouncements

On January 1, 2018, the Company adopted Accounting Standards Update ("**ASU**") No. 2014-09, *Revenue from Contracts with Customers* **("Topic 606"**) using the modified retrospective method. Under the modified retrospective method, the Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. This adjustment did not have a material impact on the Company's Condensed Consolidated Financial Statements. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under *Revenue Recognition* ("**Topic 605**"). The adoption of Topic 606 did not have a material impact on the Company's Condensed Consolidated Statements of Operations and Condensed Consolidated Balance Sheets.

(f)Accounting Pronouncements Issued But Not Yet Effective

In June 2018, the FASB issued ASU No. 2018-07, *Compensation – Stock Compensation ("***Topic 718"***): Improvements to Nonemployee Share-Based Payment Accounting*. The guidance in this ASU expands the scope of ASC Topic 718 to include all share-based payment arrangements related to the acquisition of goods and services from both nonemployees and employees. This amendment will be effective for annual and interim periods beginning after December 31, 2018. The Company does not believe the adoption of ASU 2018-07 will have a material effect on its financial position, results of operations or financial statement disclosure.

In February 2016, the FASB issued ASU 2016-02, *Leases* ("**Topic 842"**). This update requires a lessee to recognize on the balance sheet the right-of-use assets and lease liabilities for leases with a lease term of more than twelve months. This update also requires additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for interim and annual periods beginning after December 15, 2018 and requires a modified retrospective approach to adoption for leases existing at, or entered into after the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Under prior GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease for us as a lessee depend primarily on the lease's classification as a finance or operating lease. For both types of leases, we will recognize a right-of-use asset and a lease liability. For capital or finance leases, we will recognize amortization of the right-of-use asset separately from interest expense on the lease liability.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

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In July 2018, the FASB issued ASU 2018-11, *Leases* (“**Topic 842**”) - *Targeted Improvements*, which provides another transition method that allows entities to apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This transition method option is in addition to the existing transition method of using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating which transition method it will use.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other* (“**Topic 350**”) *Simplifying the Test for Goodwill Impairment*. This standard simplifies the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The revised guidance will be applied prospectively and is effective for calendar year-end SEC filers for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the effect this new standard will have on its financial position, results of operations or financial statement disclosure.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement – Reporting Comprehensive Income* (“**Topic 220**”)*: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* ("**ASU 2018-02**"). ASU 2018-02 provides financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform (or portion thereof) is recorded. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted for any interim period for which financial statements have not been issued. The Company does not believe that the adoption of this guidance will have a material impact on the Company's consolidated financial statements due the presence of a full valuation allowance. The Company does not believe this new guidance will have a material effect on its financial position, results of operations or financial statement disclosures.

Note 3 – Revenue Recognition

The adoption of Topic 606 represents a change in accounting principle that will provide financial statement readers with enhanced revenue recognition disclosures. In accordance with Topic 606, the Company recognizes revenue when goods or services are transferred to customers in an amount that reflects the consideration which it expects to receive in exchange for those goods or services. In determining when and how revenue is recognized from contracts with customers, the Company performs the following five-step analysis: (i) identification of contract with customer (ii) determination of performance obligations (iii) measurement of the transaction price (iv) allocation of the transaction price to the performance obligations and (v) recognition of revenue when (or as) the Company satisfies each performance obligation.

The Company generates revenue through the sale of products and services. Revenue from the sale of products and services is recorded when the performance obligation is fulfilled, usually at the time of shipment or when the service is provided, at the net sales price (transaction price). Estimates of variable consideration, such as volume discounts and rebates, are reviewed and revised periodically by management. The Company elected to present revenue net of sales tax and other similar taxes and account for shipping and handling activities as fulfillment costs rather than separate performance obligations. Payments are typically due in 30 days, following delivery of products or completion of services.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

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Disaggregation of Revenue

The following table presents the Company’s disaggregated revenues by revenue source:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Digital video headend products	$2,814	$2,100	$7,899	$7,330
Data products	1,112	1,782	3,566	5,168
HFC distribution products	843	838	2,345	2,545
Analog video headend products	411	324	1,234	1,360
Contract manufactured products	227	244	606	599
Other	219	288	616	711
	$5,626	$5,576	$16,266	$17,713

All of the Company’s sales are to customers located in North America.

The Company is a technology-development and manufacturing company that delivers a wide range of products and services to the cable entertainment and media industry. Digital video headend products (including encoders) are used by a system operator for acquisition, processing, compression, encoding and management of digital video. Data products give service providers, integrators, and premises owners a means to deliver data, video, and voice-over-coaxial in locations such as hospitality, MDU's, and college campuses, using IP technology. HFC distribution products are used to transport signals from the headend to their ultimate destination in a home, apartment unit, hotel room, office or other terminal location along a fiber optic, coax or HFC distribution network. Analog video headend products are used by a system operator for signal acquisition, processing and manipulation to create an analog channel lineup for further transmission. Contract-manufactured products, provides manufacturing, research and development and product support services for other companies’ products. The Company also provides technical services, including hands-on training, system design engineering, on-site field support and complete system verification testing.

Note 4 – Inventories

Inventories are summarized as follows:

	September 30, 2018	December 31, 2017
Raw Materials	$ 2,370	$ 1,869
Work in process	1,913	1,793
Finished Goods	2,335	2,684
	6,618	6,346
Less current inventories	(5,763)	(5,496)
	$ 855	$ 850

Inventories are stated at the lower of cost, determined by the first-in, first-out (“**FIFO**”) method, or net realizable value.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

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The Company periodically analyzes anticipated product sales based on historical results, current backlog and marketing plans. Based on these analyses, the Company anticipates that certain products will not be sold during the next twelve months. Inventories that are not anticipated to be sold in the next twelve months have been classified as non-current.

Approximately 45% and 51% of the non-current inventories were comprised of finished goods at September 30, 2018 and December 31, 2017, respectively. The Company has established a program to use interchangeable parts in its various product offerings and to modify certain of its finished goods to better match customer demands. In addition, the Company has instituted additional marketing programs to dispose of the slower moving inventories.

The Company continually analyzes its slow-moving and excess inventories. Based on historical and projected sales volumes for finished goods, historical and projected usage of raw materials and anticipated selling prices, the Company writes down inventory to net realizable value. Inventory that is in excess of current and projected use is reduced by an allowance to a level that approximates its estimate of future demand. Products that are determined to be obsolete are written down to net realizable value.

Note 5 – Debt

On December 28, 2016, the Company entered into a Loan and Security Agreement (the “**Sterling Agreement**”) with Sterling National Bank (“**Sterling**”). The Sterling Agreement provides the Company with a credit facility in an aggregate amount of $8,500 (the “**Sterling Facility**”), consisting of a $5,000 asset-based revolving line of credit (the “**Revolver**”) and a $3,500 amortizing term loan (the “**Term Loan**”). The Sterling Facility expires in December 2019. Interest on the Revolver is variable, based upon the 30-day LIBOR rate (2.26% at September 30, 2018) plus a margin of 4.00%. Interest on the Term Loan also is variable, based upon the 30-day LIBOR rate (2.26% at September 30, 2018) plus a margin of 4.50%. The Term Loan will amortize at the rate of $19 per month. On March 30, 2017, the Company and Sterling entered into a certain First Amendment to Loan and Security Agreement (the “**First Amendment**”), pursuant to which, among other things, the parties amended the definitions of certain items used in the calculation of the fixed charge coverage ratio, deferred the first measurement period of the financial covenants contemplated by the Sterling Agreement, until January 31, 2017, and modified certain terms relating to permitted investments by the Company. At September 30, 2018 and December 31, 2017, the outstanding balances under the Revolver and the Term Loan were $2,582 and $3,111 and $2,487 and $3,286, respectively. All outstanding indebtedness under the Sterling Agreement is secured by all of the assets of the Company and its subsidiaries.

The Sterling Agreement contains customary covenants, including restrictions on the incurrence of additional indebtedness, encumbrances on the Company's assets, the payment of cash dividends or similar distributions, the repayment of any subordinated indebtedness and the sale or other disposition of the Company's assets. In addition, the Company must maintain (i) a fixed charge coverage ratio of not less than 1.1 to 1.0 for any fiscal month (determined as of the last day of each fiscal month on a rolling twelve-month basis, as calculated for the Company and its consolidated subsidiaries) and (ii) a leverage ratio of not more than 2.0 to 1.0 for any fiscal month (determined as of the last day of each fiscal month, as calculated for the Company and its consolidated subsidiaries. At September 30, 2018, the Company was in compliance with all financial covenants under the Sterling Agreement.

Note 6 – Subordinated Convertible Debt with Related Parties

On March 28, 2016, the Company and its wholly-owned subsidiary, R.L. Drake Holdings, LLC (**"Drake"**), as borrowers and Robert J. Pallé, as agent (in such capacity "**Agent**") and as a lender, together with Carol M. Pallé, Steven Shea and James H. Williams as lenders (collectively, the "**Subordinated Lenders**") entered into a certain Amended and Restated Senior Subordinated Convertible Loan and Security Agreement (the "**Subordinated Loan Agreement**"), pursuant to which the Subordinated Lenders agreed to provide the Company with a delayed draw term loan facility of up to $750 ("**Subordinated Loan Facility**"), under which individual advances in amounts not less than $50 may be drawn by the Company. Interest on the outstanding balance under the Subordinated Loan Facility from time to time, accrues at 12% per annum (subject to increase under certain circumstances) and is payable monthly in-kind by the automatic increase of the principal amount of the loan on each monthly interest payment date, by the amount of the accrued interest payable at that time ("**PIK Interest**"); provided, however, that at the option of the Company, it may pay interest in cash on any interest payment date, in lieu of PIK Interest. The Subordinated Lenders have the option of converting the principal balance of the loan, in whole (unless otherwise agreed by the Company), into shares of the Company's common stock at a conversion price of $0.54 per share (subject to adjustment under certain circumstances). This conversion right was subject to stockholder approval as required by the rules of the NYSE MKT, which approval was obtained on May 24, 2016 at the Company's annual meeting of stockholders. The obligations of the Company and Drake under the Subordinated Loan Agreement are secured by substantially all of the Company's and Drake's assets, including by a mortgage against the Old Bridge Facility (the "**Subordinated Mortgage"**). The Subordinated Loan Agreement terminates three years from the date of closing, at which time the accreted principal balance of the loan (by virtue of the PIK Interest) plus any other accrued unpaid interest, will be due and payable in full.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

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On April 17, 2018, Robert J. Pallé and Carol Pallé exercised their conversion rights and converted $455 ($350 principal and $105 of accrued interest) of their loan (representing the entire amount of principal and interest outstanding and held by Mr. and Mrs. Pallé on that date) into 842 shares of the Company's common stock.

In connection with the Subordinated Loan Agreement, the Company, Drake, the Subordinated Lenders and Sterling entered into a Subordination Agreement (the "**Subordination Agreement**"), pursuant to which the rights of the Subordinated Lenders under the Subordinated Loan Agreement and the Subordinated Mortgage are subordinate to the rights of Sterling under the Sterling Agreement and related security documents. The Subordination Agreement precludes the Company from making cash payments of interest in lieu of PIK Interest, in the absence of the prior written consent of Sterling.

As of both September 30, 2018 and December 31, 2017, the Subordinated Lenders had advanced $500 to the Company. In addition, $157 and $124 of PIK interest was accrued as of September 30, 2018 and December 31, 2017, respectively. As noted above, in April 2018, $455 under the Subordinated Loan Facility was converted by certain Subordinated Lenders. The Company evaluated the conversion option embedded in the Subordinated Loan Agreement issued in December 2016 in accordance with the provisions of ASC Topic 815, *Derivatives and Hedging*, and determined that the conversion option had all of the characteristics of a derivative in its entirety and did not qualify for an exception to the derivative accounting rules. Specifically, prior to the adoption of the First Sub-Debt Amendment, pursuant to Section 4.4(e)(ii) of the Subordinated Debt Agreement, the exercise price of the conversion option entitled the Subordinated Lenders to an adjustment of the exercise price in the event that the Company subsequently issued equity securities or equity linked securities at prices more favorable to a new investor than the exercise price of the conversion option embedded in the Subordinated Loan Agreement (the "**Price Protection Provision**"). Accordingly, the conversion option was not indexed to the Company's own stock. Due to the derivative treatment of the conversion option, the Company recorded $260 derivative liability at December 31, 2016. On March 21, 2017, the Company, Drake, and the Subordinated Lenders entered into a certain First Amendment to Amended and Restated Convertible Loan and Security Agreement (the "**First Sub-Debt Amendmen**t"), pursuant to which the Subordinated Loan Agreement was amended to eliminate the Price Protection Provision, effective as of such date. The First Sub-Debt Amendment also eliminated certain defined terms related to the Price Protection Provision. As a result of the First Sub-Debt Amendment, during the first quarter of 2017, the Company recorded a change in the derivative liability (expense) of $142, the fair value of the liability at the date of the modification and reclassed the aggregate value of the derivative liability at the date of modification in the amount of $402 additional paid-in capital. In addition, during the three months and nine months ended September 30, 2018 and 2017, the Company incurred interest of $6 and $33 and $ 18 and $52, respectively, related to these loans.

BLONDER TONGUE LABORATORIES, INC. AND SUBSIDIARIES