Xenon Pharmaceuticals Inc.
Form 10-Q
May 12, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-36687

XENON PHARMACEUTICALS INC.

(Exact name of registrant as specified in its charter)

Canada	98-0661854
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

200-3650 Gilmore Way

Burnaby, British Columbia V5G 4W8

Canada

(Address of principal executive offices)

(604) 484-3300

(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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:

The number of registrant’s common shares outstanding as of May 11, 2015 was 14,228,536

XENON PHARMACEUTICALS INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2015

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

XENON PHARMACEUTICALS INC.

Balance Sheets

(Unaudited)

(Expressed in thousands of U.S. dollars except share data)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$65,917	$72,026
Marketable securities	9,464	12,015
Accounts receivable	1,205	215
Prepaid expenses and other current assets	464	686
	77,050	84,942
Property, plant and equipment, net	2,353	2,476
Total assets	$79,403	$87,418
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses (note 7)	1,530	2,664
Deferred revenue	8,724	11,622
	10,254	14,286
Deferred revenue, less current portion	—	157
Deferred tenant inducements	180	196
	$10,434	$14,639
Shareholders' equity:		
Common shares, without par value; unlimited shares authorized; issued and outstanding: 14,222,275 (December 31, 2014 - 14,181,333)	147,508	147,157
Additional paid-in capital	30,450	30,346
Accumulated deficit	(107,999)	(103,734)
Accumulated other comprehensive loss	(990)	(990)
	$68,969	$72,779
Total liabilities and shareholders' equity	$79,403	$87,418
Collaboration agreements (note 9)		
Commitments and contingencies (note 10)		

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

XENON PHARMACEUTICALS INC.

Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

(Expressed in thousands of U.S. dollars except share and per share data)

	Three Months Ended March 31, 2015	2014
Revenue:		
Collaboration revenue (note 9)	$4,010	$5,001
Operating expenses:		
Research and development	3,427	2,533
General and administrative	1,789	1,436
	5,216	3,969
Income (loss) from operations	(1,206)	1,032
Other income (expense):		
Interest income	152	141
Foreign exchange gain (loss)	(3,171)	200
Net income (loss)	(4,225)	1,373
Net income attributable to participating securities	—	1,373
Net loss attributable to common shareholders	$(4,225)	$—
Net loss per common share:		
Basic and diluted	$(0.30)	$—
Weighted-average shares outstanding:		
Basic and diluted	14,212,579	1,345,312
Other comprehensive income (loss):		
Foreign currency translation adjustment	—	(909)
Comprehensive income (loss)	$(4,225)	$464

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

XENON PHARMACEUTICALS INC.

Statement of Shareholders' Equity (Deficit)

(Unaudited)

(Expressed in thousands of U.S. dollars except per share data)

	Series A convertible preferred shares		Series B convertible preferred shares		Series E convertible preferred shares		Common shares		Additional paid-in capital	Accumulated deficit	Accumulate other comprehen income (loss)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
of r	1,151,468	$2,939	994,885	$8,683	4,322,126	$90,866	1,344,627	$6,147	$29,722	$(116,752)	$2,511
e r										13,018	
n of	(1,151,468)	(2,939)	(994,885)	(8,683)	(4,322,126)	(90,866)	7,725,924	102,488			
r et							5,095,000	38,373			
e nt											(3,501)
on on									760		
							13,365	124	(124)		

. of ion											
							2,417	25	(12)		
of r	—	$—	—	$—	—	$—	14,181,333	$147,157	$30,346	$(103,734)	$(990)
r										(4,225)	
on on									288		
							40,942	351	(184)	(40)	
of	—	$—	—	$—	—	$—	14,222,275	$147,508	$30,450	$(107,999)	$(990)(1)

(1) At March 31, 2015, our accumulated other comprehensive loss is entirely related to historical cumulative translation adjustments from the application of U.S. dollar reporting when the functional currency of the Company was the Canadian dollar. See Note 3 – Changes in significant accounting policies.

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

XENON PHARMACEUTICALS INC.

Statements of Cash Flows

(Unaudited)

(Expressed in thousands of U.S. dollars)

	Three Months Ended March 31,	
	2015	2014
Operating activities:		
Net income (loss)	$(4,225)	$1,373
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	207	175
Stock-based compensation	288	186
Deferred tenant inducements	(16)	(17)
Unrealized foreign exchange loss	3,140	37
Changes in operating assets and liabilities:		
Accounts receivable	(996)	2
Prepaid expenses, and other current assets	220	29
Accounts payable and accrued expenses	(1,110)	(265)
Deferred revenue	(3,055)	(2,362)
Net cash used in operating activities	(5,547)	(842)
Investing activities:		
Purchases of property, plant and equipment	(84)	(480)
Purchase of marketable securities	—	(2,578)
Proceeds from marketable securities	1,575	2,720
Net cash provided by (used in) investing activities	1,491	(338)
Financing activities:		
Deferred financing fees	—	(398)
Proceeds from issuance of common shares	127	5
Net cash provided by (used in) financing activities	127	(393)
Effect of exchange rate changes on cash and cash equivalents	(2,180)	(1,430)
Decrease in cash and cash equivalents	(6,109)	(3,003)
Cash and cash equivalents, beginning of period	72,026	37,950
Cash and cash equivalents, end of period	$65,917	$34,947
Supplemental disclosures:		
Interest received	$121	$125
Supplemental disclosures of non-cash transactions:		

Issuance of common shares on conversion of subscription rights	—	14
Fair value of options exercised on a cashless basis	69	—

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

XENON PHARMACEUTICALS INC.

Notes to Financial Statements

(Unaudited)

(Expressed in thousands of U.S. dollars except numbers of shares)

1. Nature of the business:

Xenon Pharmaceuticals Inc. (the "Company"), incorporated in 1996 under the British Columbia Business Corporations Act and continued federally in 2000 under the Canada Business Corporation Act, is a clinical-stage biopharmaceutical company discovering and developing a pipeline of differentiated therapeutics for orphan indications that it intends to commercialize on its own, and for larger market indications that it intends to partner with global pharmaceutical companies.

On October 1, 2014, the Company effected a 1 for 4.86 reverse share split of its common and Series A, B and E redeemable convertible preferred shares. At the time of the consolidation, there were no outstanding Series C and D preferred shares and therefore such series were not included in the consolidation. Accordingly, (i) every 4.86 common shares were combined into one common share, (ii) every 4.86 redeemable Series A, B and E convertible preferred shares were combined into one redeemable convertible preferred share, (iii) the number of common shares into which each outstanding subscription right was exchangeable into common shares were proportionately decreased on a 1 for 4.86 basis, (iv) the number of common shares into which each outstanding option to purchase common shares was exercisable were proportionately decreased on a 1 for 4.86 basis, and (v) the exercise price for each such outstanding option to purchase common shares was proportionately increased on a 1 for 4.86 basis. All of the share numbers, share prices, and exercise prices prior to October 1, 2014 have been adjusted, on a retroactive basis, to reflect this 1 for 4.86 reverse share split.

On November 10, 2014, the Company completed an initial public offering ("IPO") of 4,600,000 of its common shares at a price to the public of $9.00 per share. On November 10, 2014, the Company also completed a private placement, in which the Company issued 495,000 of its common shares to an affiliate of Genentech, Inc. ("Genentech") at a price of $9.00 per share. Immediately prior to the closing of the IPO, all outstanding convertible preferred shares were converted into 7,725,924 common shares and 10,201 outstanding subscription rights were converted into 10,201 common shares. Following the IPO, there were no preferred shares or subscription rights outstanding.

2. Basis of presentation:

These financial statements are presented in U.S. dollars.

The accompanying unaudited interim financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the audited financial statements and notes for the year ended December 31, 2014 and included in the Company's 2014 Annual Report on Form 10-K filed with the SEC on March 12, 2015.

These unaudited interim financial statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of results for the interim periods presented. The results of operations for the three month periods ended March 31, 2015 and 2014 are not necessarily indicative of results that can be expected for a full year. These unaudited interim financial statements follow the same significant accounting policies as those described in the notes to the audited financial statements of the Company included in the Company's 2014 Annual Report on Form 10-K for the year ended December 31, 2014, with the exception of the change in functional currency described in note 3.

3. Changes in significant accounting policies:

The Company's reporting currency is the U.S. dollar. The functional currency of the Company changed to U.S. dollars from Canadian dollars on January 1, 2015 based on management's analysis of the changes in the primary economic environment in which the Company operates. The change in functional currency is accounted for prospectively from January 1, 2015 and prior year financial statements have not been restated for the change in functional currency. Past translation gains and losses from the application of the U.S. dollar as the reporting currency while the Canadian dollar was the functional currency are included as part of the cumulative foreign currency translation adjustment, which is reported as a component of shareholders' equity under accumulated other comprehensive loss.

For periods commencing January 1, 2015, monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars using exchange rates in effect at the balance sheet date. Opening balances related to non-monetary assets and liabilities are based on prior period translated amounts, and nonmonetary assets and nonmonetary liabilities incurred after January 1, 2015 are translated at the approximate exchange rate prevailing at the date of the transaction. Revenue and expense transactions are translated at the approximate exchange rate in effect at the time of the transaction. Foreign exchange gains and losses are included in the statement of operations as foreign exchange gain (loss).

4. Future changes in accounting policies:

In May 2014, the FASB issued amendments to clarify the principles of recognizing revenue and to develop a common revenue standard that would remove inconsistencies in revenue requirements, leading to improved comparability of revenue recognition practices across entities and industries. The amendments stipulate that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosure will also be required about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. In April 2015, the FASB voted to propose a deferral of the effective date of the new revenue standard by one year. The new guidance would be effective for public entities for fiscal years beginning after December 15, 2017 instead of the originally contemplated effective date of December 15, 2016. Entities are permitted to adopt in accordance with the original effective date if they choose. The Company is currently evaluating the new guidance to determine the impact it will have on the Company’s financial position, results of operations and cash flows.

In August 2014, the FASB issued amendments requiring management to assess an entity’s ability to continue as a going concern. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company’s ability to continue as a going concern within one year from the date the financial statements are issued. These amendments will be effective for public entities for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The adoption of these amendments in fiscal 2017 is not expected to have a material impact on the Company’s financial statements.

5. Net income (loss) per common share:

Basic net income (loss) per common share is computed by dividing the net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per common share is computed by adjusting net income (loss) attributable to common shareholders to reallocate undistributed earnings based on the potential impact of dilutive securities.

Prior to the Company’s IPO, net income (loss) per share was calculated under the two-class method as the Company had outstanding shares that met the definition of participating securities. The two-class method determines net income (loss) per share for each class of common and participating securities according to dividends declared or accumulated and participation rights in undistributed earnings. The two-class method requires income available to common shareholders for the period to be allocated between common and participating securities based upon their respective rights to receive dividends as if all income for the period had been distributed. All of the outstanding redeemable convertible preferred shares converted to common shares upon the consummation of the Company’s IPO.

As the Company reported a net loss attributable to common shareholders for the three months ended March 31, 2015 and no net income was attributable to common shareholders for the three months ended March 31, 2014, all stock options were anti-dilutive and were excluded from the diluted weighted average shares outstanding for both periods.

6. Fair value of financial instruments:

U.S. GAAP establishes a fair value hierarchy for inputs to be used to measure fair value of financial assets and liabilities. This hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels: Level 1 (highest priority), Level 2, and Level 3 (lowest priority).

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the balance sheet date.

- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (i.e., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
- Level 3 - Inputs are unobservable and reflect the Company's assumptions as to what market participants would use in pricing the asset or liability. The Company develops these inputs based on the best information available.

The Company's Level 1 assets include cash and cash equivalents and marketable securities with quoted prices in active markets. The carrying amount of accounts receivables, accounts payable and accrued expenses approximates fair value due to the nature and short-term of those instruments.

7. Accounts payable and accrued expenses:

Accounts payable and accrued expenses consisted of the following:

	March 31, 2015	December 31, 2014
Trade payables	$632	$ 553
Employee compensation, benefits, and related accruals	384	1,077
Consulting and contracted research	288	774
Professional fees	171	180
Other	55	80
Total	$1,530	$ 2,664

8. Stock option plan:

The following table presents stock option activity for the period:

	Three Months Ended March 31, 2015	2014
Outstanding, beginning of period	1,484,218	1,333,099
Granted	346,964	157,231
Exercised[1]	(44,656)	(772)
Forfeited and expired	(1,090)	(44,238)
Outstanding, end of period	1,785,436	1,445,320
Exercisable, end of period	1,146,383	999,089

(1) During the three months ended March 31, 2015, 26,910 stock options were exercised for the same number of common shares for cash. In the same period, the Company issued 14,032 common shares for the cashless exercise of 17,746 stock options.

The fair value of each option issued to employees and non-employees is estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended March 31,	
	2015	2014
Average risk-free interest rate	1.71%	1.97%
Average expected term (in years)	6.25	6.20
Expected volatility	75 %	74 %
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	0.00%	0.00%

The weighted-average fair value of options granted during the three months ended March 31, 2015 was $11.84 (three months ended March 31, 2014 - $6.57) per option.

9. Collaboration agreements:

The Company has entered into a number of collaboration agreements with multiple deliverables under which it may have received non-refundable upfront payments. The Company generally recognizes revenue from upfront payments ratably over the term of its estimated period of performance of research under its collaboration agreements in the event that such arrangements represent a single unit of accounting. The collaborations may also include contractual milestone payments, which relate to the achievement of prespecified research, development, regulatory and commercialization events. The milestone events coincide with the progression of product candidates from research and development, to regulatory approval and through to commercialization. The process of successfully discovering a new product candidate, having it selected by the collaborator for development and having it approved and ultimately sold for a profit is highly uncertain. As such, the milestone payments that the Company may earn from its collaborators involve a significant degree of risk to achieve.

The following table is a summary of the revenue recognized from the Company's collaborations for the three months ended March 31, 2015 and 2014:

	Three Months Ended March 31,	
	2015	2014
Teva:		
Recognition of upfront payment	$2,876	$3,025
Research funding	45	80
Genentech:		
Recognition of upfront payment	179	786
Research funding	910	1,110
Total collaboration revenue	$4,010	$5,001

10. Commitments and contingencies:

The Company has entered into license and research agreements with third parties that include indemnification provisions that are customary in the industry. These indemnification provisions generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party claims or damages arising from these transactions.

The maximum amount of potential future indemnification is unlimited; however, the Company currently holds commercial and product liability insurance. This insurance limits the Company's exposure and may enable it to recover a portion of any future amounts paid. Historically, the Company has not made any indemnification payments under such agreements and the Company believes that the fair value of these indemnification obligations is minimal. Accordingly, the Company has not recognized any liabilities relating to these obligations for any period presented.

-9-

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section should be read in conjunction with our unaudited financial statements and related notes included in Part I, Item 1 of this report and our audited financial statements and related notes thereto and management’s discussion and analysis of financial condition and results of operations for the year ended December 31, 2014 included in our Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on March 12, 2015 and with the securities commissions in British Columbia,xt-align: left"> Balance at December 31, 2017 $38,419 Electronics Balance at January 1, 2016 $981 Currency translation (50)Balance at December 31, 2016 $931

The Company’s cumulative goodwill impairment loss since inception was $300,083 at December 31, 2017 and 2016 which includes PST’s goodwill impairment in 2014 and goodwill impairment recorded by the Company’s Control Devices segment in 2008 and 2004.

51

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Other Intangible Assets

Other intangible assets, net at December 31, 2017 and 2016 consisted of the following:

As of December 31, 2017	Acquisition cost	Accumulated amortization	Net
Customer lists	$ 57,672	$ (12,695)	$44,977
Tradenames	23,546	(5,646)	17,900
Technology	17,443	(5,077)	12,366
Other	41	(41)	-
Total	$ 98,702	$ (23,459)	$75,243

As of December 31, 2016	Acquisition cost	Accumulated amortization	Net
Customer lists	$ 27,476	$ (9,138)	$18,338
Tradenames	18,116	(4,558)	13,558
Technology	10,862	(3,498)	7,364
Other	41	(41)	-
Total	$ 56,495	$ (17,235)	$39,260

Other intangible assets, net at December 31, 2017 include customer lists, tradenames and technology of $16,014, $12,448 and $6,558, respectively, related to the PST segment and $28,963, $5,452 and $5,808, respectively, related to the Electronics segment.

The Company recognized $6,440, $3,259 and $3,445 of amortization expense related to intangible assets in 2017, 2016 and 2015, respectively. Amortization expense is included as a component of SG&A on the consolidated statements of operations. Annual amortization expense for intangible assets is estimated to be approximately $6,800 for the years 2018 through 2022. The weighted-average remaining amortization period is approximately 13 years.

Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

As of December 31	2017	2016
Compensation related liabilities	$22,429	$16,329
Product warranty and recall obligations	6,867	6,727
Accrued income taxes	6,897	1,930
Other [(A)]	16,353	16,503
Total accrued expenses and other current liabilities	$52,546	$41,489

(A) "Other" is comprised of miscellaneous accruals, none of which individually contributed a significant portion of the total.

Income Taxes

The Company accounts for income taxes using the liability method. Deferred income taxes reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. Future tax benefits are recognized to the extent that realization of such benefits is more likely than not to occur. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the period that includes the enactment date.

52

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Deferred tax assets are recognized to the extent that these assets are more likely than not to be realized (See Note 5). In making such a determination, the Company considers all available positive and negative evidence, including future release of existing taxable temporary differences, projected future taxable income, tax planning strategies, and results of recent operations. Release of some or all of a valuation allowance would result in the recognition of certain deferred tax assets and a decrease to income tax expense for the period the release is recorded.

The Company's policy is to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. To the extent the Company prevails in matters for which a liability for an unrecognized tax benefit is established or is required to pay amounts in excess of the liability, the Company's effective tax rate in a given financial statement period may be affected.

Currency Translation

The financial statements of foreign subsidiaries, where the local currency is the functional currency, are translated into U.S. dollars using exchange rates in effect at the period end for assets and liabilities and average exchange rates during each reporting period for the results of operations. Adjustments resulting from translation of financial statements are reflected as a component of accumulated other comprehensive loss in the Company’s consolidated balance sheets.

Foreign currency transactions are remeasured into the functional currency using translation rates in effect at the time of the transaction with the resulting adjustments included on the consolidated statements of operations within other expense, net. These foreign currency transaction losses (gains), including the impact of hedging activities, were $500, $(268) and $1,693 for the years ended December 31, 2017, 2016 and 2015, respectively.

Revenue Recognition and Sales Commitments

The Company recognizes revenues from the sale of products, net of actual and estimated returns, at the point of passage of title, which is either at the time of shipment or upon customer receipt based upon the terms of the sale. The

Company recognizes monitoring service revenues as the services are provided to customers. The Company collects certain taxes and fees on behalf of government agencies and remits such collections on a periodic basis. The taxes are collected from customers but are not included in net sales. Estimated returns are based on historical authorized returns. The Company often enters into agreements with its customers at the beginning of a given vehicle's expected production life. Once such agreements are entered into, it is the Company's obligation to fulfill the customers' purchasing requirements for the entire production life of the vehicle. These agreements are subject to potential renegotiation from time to time, which may affect product pricing.

Shipping and Handling Costs

Shipping and handling costs are included in COGS on the consolidated statements of operations.

Product Warranty and Recall Reserves

Amounts accrued for product warranty and recall claims are established based on the Company's best estimate of the amounts necessary to settle existing and future claims on products sold as of the balance sheet dates. These accruals are based on several factors including past experience, production changes, industry developments and various other considerations including insurance coverage. The Company can provide no assurances that it will not experience material claims or that it will not incur significant costs to defend or settle such claims beyond the amounts accrued or beyond what the Company may recover from its suppliers. The current portion of the product warranty and recall reserve is included as a component of accrued expenses and other current liabilities on the consolidated balance sheets. Product warranty and recall includes \$3,112 and \$2,617 of a long-term liability at December 31, 2017 and 2016, respectively, which is included as a component of other long-term liabilities on the consolidated balance sheets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The following provides a reconciliation of changes in the product warranty and recall reserve:

Years ended December 31	2017	2016
Product warranty and recall at beginning of period	$9,344	$6,419
Accruals for products shipped during period	4,933	4,978
Assumed warranty liability related to Orlaco	899	-
Aggregate changes in pre-existing liabilities due to claim developments	4,899	(116)
Settlements made during the period	(10,407)	(1,967)
Foreign currency translation	311	30
Product warranty and recall at end of period	$9,979	$9,344

Design and Development Costs

Expenses associated with the development of new products, and changes to existing products are charged to expense as incurred, and are included in the Company’s consolidated statements of operations as a separate component of costs and expenses. These product development costs amounted to $48,877, $40,212 and $38,792 for the years ended December 31, 2017, 2016 and 2015, respectively, or 5.9%, 5.8% and 6.0% of net sales for these respective periods.

Research and Development Activities

The Company’s Electronics and Control Devices segments enter into research and development contracts with certain customers, which generally provide for reimbursement of costs. The Company incurred and was reimbursed for contracted research and development costs of $14,946, $12,764 and $9,659 for the years ended December 31, 2017, 2016 and 2015, respectively.

Share-Based Compensation

At December 31, 2017, the Company had two types of share-based compensation plans: (1) Long-Term Incentive Plan for employees and (2) the Amended Directors' Restricted Shares Plan, for non-employee directors. The Long-Term Incentive Plan is made up of the Long-Term Incentive Plan which expired on June 30, 2007, the Amended and Restated Long-Term Incentive Plan, as amended, which expired on April 24, 2016 and the 2016 Long-Term Incentive Plan that was approved by shareholders on May 10, 2016, and expires on May 10, 2026.

Total compensation expense recognized as a component of SG&A expense on the consolidated statements of operations for share-based compensation arrangements was $7,265, related to higher attainment of performance-based awards and accelerated expense associated with the retirement of eligible employees, $6,134, including $545 related to the modification of the retirement notice provisions of certain awards, and $7,224, including $2,225 from the accelerated vesting in connection with the retirement of the Company's former President and Chief Executive Officer, for the years ended December 31, 2017, 2016 and 2015, respectively. Of these amounts, $11, $(117) and $828 for the years ended December 31, 2017, 2016 and 2015, respectively, were related to the Long-Term Cash Incentive Plan "Phantom Shares" discussed in Note 8. There was no share-based compensation expense capitalized in inventory during 2017, 2016 or 2015.

Financial Instruments and Derivative Financial Instruments

Financial instruments, including derivative financial instruments, held by the Company include cash and cash equivalents, accounts receivable, accounts payable, long-term debt and foreign currency forward contracts. The carrying value of cash and cash equivalents, accounts receivable and accounts payable is considered to be representative of fair value because of the short maturity of these instruments. See Note 9 for fair value disclosures of the Company's financial instruments.

Common Shares Held in Treasury

The Company accounts for Common Shares held in treasury under the cost method (applied on a FIFO basis) and includes such shares as a reduction of total shareholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Earnings Per Share

Basic earnings per share was computed by dividing net income attributable to Stoneridge Inc. by the weighted-average number of Common Shares outstanding for each respective period. Diluted earnings per share was calculated by dividing net income attributable to Stoneridge, Inc. by the weighted-average of all potentially dilutive Common Shares that were outstanding during the periods presented.

Actual weighted-average Common Shares outstanding used in calculating basic and diluted net income per share were as follows:

Years ended December 31	2017	2016	2015
Basic weighted-average Common Shares outstanding	28,082,114	27,763,990	27,337,954
Effect of dilutive shares	689,531	544,932	621,208
Diluted weighted-average Common Shares outstanding	28,771,645	28,308,922	27,959,162

There were 134,250 performance-based restricted Common Shares outstanding at December 31, 2015. There were no performance-based restricted Common Shares outstanding at December 31, 2017 or 2016. There were also 766,538, 843,140 and 573,885 performance-based right to receive Common Shares outstanding at December 31, 2017, 2016 and 2015. These performance-based restricted and right to receive Common Shares are included in the computation of diluted earnings per share based on the number of Common Shares that would be issuable if the end of the year were the end of the contingency period.

Deferred Financing Costs, net

Deferred financing costs are amortized over the life of the related financial instrument using the straight-line method, which approximates the effective interest method. Deferred finance cost amortization and debt discount accretion for the years ended December 31, 2017, 2016 and 2015 was $324, $355 and $388, respectively, and is included as a component of interest expense, net in the consolidated statements of operations. As permitted by ASU 2015-03, the Company has elected to continue to present deferred financing costs related to the Credit Facility within long-term assets in the Company’s consolidated balance sheets. Deferred financing costs, net, were $1,208 and $1,471, as of

December 31, 2017 and 2016, respectively.

55

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Changes in Accumulated Other Comprehensive Loss by Component

Changes in accumulated other comprehensive loss for the years ended December 31, 2017 and 2016 were as follows:

	Foreign currency translation	Unrealized gain (loss) on derivatives	Benefit plan adjustment	Total
Balance at January 1, 2017	$ (67,895)	$ (18)	$ -	$ (67,913)
Other comprehensive income before reclassifications	15,473	509	-	15,982
Amounts reclassified from accumulated other comprehensive loss	-	(634)	-	(634)
Net other comprehensive income (loss), net of tax	15,473	(125)	-	15,348
Reclassification of foreign currency translation associated with noncontrolling interest acquired	(16,995)	-	-	(16,995)
Balance at December 31, 2017	$ (69,417)	$ (143)	$ -	$ (69,560)
Balance at January 1, 2016	$ (70,296)	$ 390	$ 84	$ (69,822)
Other comprehensive income (loss) before reclassifications	2,401	(572)	-	1,829
Amounts reclassified from accumulated other comprehensive loss	-	164	(84)	80
Net other comprehensive income (loss), net of tax	2,401	(408)	(84)	1,909
Balance at December 31, 2016	$ (67,895)	$ (18)	$ -	$ (67,913)

Reclassifications

Certain prior period amounts have been reclassified to conform to their 2017 presentation in the consolidated financial statements.

Recently Adopted Accounting Standards

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-12, "Derivatives and Hedging (Topic 815)": Targeted Improvements to Accounting for Hedging Activities" which amends and simplifies existing guidance in order to allow companies to more accurately present the economic effects of risk management activities in the financial statements. As early adoption is permitted, the Company adopted this standard in the third quarter of 2017, which did not have a material impact on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, "Compensation-Stock Compensation (Topic 718)", which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions or the classification of the award changes as a result of the change in terms or conditions. If an award is not probable of vesting at the time a change is made, the new guidance clarifies that no new measurement date will be required if there is no change to the fair value, vesting conditions, and classification. As early adoption is permitted, the Company adopted this standard in the second quarter of 2017, which did not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment (Topic 350)", which eliminates Step 2 from the goodwill impairment test. As a result, an entity should recognize an impairment charge for the amount by which the carrying amount of goodwill exceeds the reporting unit's fair value, not to exceed the carrying amount of goodwill. The Company adopted this standard on January 1, 2017, which did not have a material impact on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

In March 2016, the FASB issued Accounting Standards Update ASU 2016-09, "Compensation - Stock Compensation (Topic 718)", which is intended to simplify several aspects of the accounting for share-based payment award transactions including how excess tax benefits should be classified in the Company's consolidated financial statements. The new standard simplifies the treatment of share based payment transactions by recognizing the impact of excess tax benefits or deficiencies related to exercised or vested awards in income tax expense in the period of exercise or vesting. The new standard also modifies the diluted earnings per share calculation using the treasury stock method by eliminating the excess tax benefits or deficiencies from the calculation. These changes will be recognized prospectively. The new standard also permits companies to recognize forfeitures as they occur as an alternative to utilizing estimated forfeitures rates which has been the required practice. The presentation of excess tax benefits in the statement of consolidated cash flows is also modified to be included with other income tax cash flows as an operating activity. The change can be adopted using a prospective or retrospective transition method. The new standard clarifies that cash paid by an employer when directly withholding shares for tax withholding purposes should be presented as a financing activity in the statement of consolidated cash flows and should be applied retrospectively. This new accounting standard was effective for fiscal years beginning after December 15, 2016, including interim periods within that year. The Company adopted this standard as of January 1, 2017 and had unrecognized tax benefits related to share-based payment awards of $1,729 as of January 1, 2017. This amount was recorded to investments and other long-term assets, net with a corresponding increase to retained earnings associated with the cumulative effect of the accounting change.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory (Topic 330)", which requires that inventory be measured at the lower of cost or net realizable value. Prior to the issuance of the new guidance, inventory was measured at the lower of cost or market. Replacing the concept of market with the single measurement of net realizable value is intended to reduce cost and complexity. The Company adopted this standard as of January 1, 2017, which did not have a material impact on its consolidated financial statements or disclosures.

Recently Issued Accounting Standards Not Yet Adopted as of December 31, 2017

In January 2017, the FASB issued ASU 2017-01, "Clarifying the Definition of a Business (Topic 805)" which revises the definition of a business and provides a framework to evaluate when an input and a substantive process are present in an acquisition to be considered a business. This ASU is effective for annual periods beginning after December 15, 2017. The Company will adopt this standard as of January 1, 2018, which is not expected to have a material impact on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory (Topic 740)". This guidance requires that the tax effects of all intra-entity sales of assets other than inventory be recognized in the period in which the transaction occurs. The new guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption as of the beginning of an annual reporting period is permitted. The guidance is to be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The Company will adopt this standard as of January 1, 2018, which is not expected to have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230)", which provides guidance on the presentation and classification of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in practice. This ASU is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. The Company will adopt this standard as of January 1, 2018, which is not expected to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", which will require that a lessee recognize assets and liabilities on the balance sheet for all leases with a lease term of more than twelve months, with the result being the recognition of a right of use asset and a lease liability. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company expects to adopt this standard as of January 1, 2019. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements, which will require right of use assets and lease liabilities to be recorded in the consolidated balance sheet for operating leases with a lease term of more than twelve months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)", which is the new comprehensive revenue recognition standard that will supersede existing revenue recognition guidance under U.S. GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. To achieve this principle, an entity identifies the contract with a customer, identifies the separate performance obligations in the contract, determines the transaction price, allocates the transaction price to the separate performance obligations and recognizes revenue when each separate performance obligation is satisfied. This ASU allows for both retrospective and prospective methods of adoption. The new standard became effective for annual and interim periods beginning after December 15, 2017. The Company will adopt this standard January 1, 2018 using the modified retrospective transition method and will not have a material impact on its results of operations or financial position; however, the Company will have expanded disclosures consistent with the requirements of the new standard. The Company will continue to evaluate its contracts with customers analyzing the impact, if any, on revenue from the sale of production parts, particularly in regards to material rights, variable consideration and the impact of termination clauses on the timing of revenue recognition.

3. Investments

Minda Stoneridge Instruments Ltd.

The Company has a 49% interest in Minda, a company based in India that manufactures electronics, instrumentation equipment and sensors for the motorcycle, commercial vehicle and automotive markets. The investment is accounted for under the equity method of accounting. The Company's investment in Minda, recorded as a component of investments and other long-term assets, net on the consolidated balance sheets, was $10,131 and $7,952 as of December 31, 2017 and 2016, respectively. Equity in earnings of Minda included in the consolidated statements of operations were $1,636, $1,233 and $608 for the years ended December 31, 2017, 2016 and 2015, respectively.

PST Eletrônica Ltda.

The Company had a 74% controlling interest in PST from December 21, 2011 through May 15, 2017. On May 16, 2017, the Company acquired the remaining 26% noncontrolling interest in PST for $1,500 in cash along with earn-out consideration. The Company will be required to pay additional earn-out consideration, which is not capped, based on

PST's financial performance in either 2020 or 2021. The estimated fair value of the earn-out consideration as of the acquisition date was $10,180, and was based on discounted cash flows utilizing forecasted EBITDA in 2020 and 2021. This fair value measurement is classified within Level 3 of the fair value hierarchy and is based upon Level 3 discounted cash flow analysis using key inputs of forecasted future sales as well as a growth rate reduced by the market required rate of return. The transaction was accounted for as an equity transaction, and therefore no gain or loss was recognized in the statement of operations or comprehensive income. The noncontrolling interest balance on the May 16, 2017 acquisition date was $14,458, of which $31,453 and ($16,995) was related to the carrying value of the investment and foreign currency translation, respectively, and accordingly these amounts were reclassified to additional paid-in capital and accumulated other comprehensive loss, respectively.

The following table sets forth a summary of the change in noncontrolling interest:

Years ended December 31	2017	2016	2015
Noncontrolling interest at beginning of period	$13,762	$13,310	$22,550
Net loss	(130)	(1,887)	(2,207)
Foreign currency translation	826	2,339	(7,033)
Comprehensive income (loss)	696	452	(9,240)
Acquisition of noncontrolling interest	(14,458)	-	-
Noncontrolling interest at end of period	$-	$13,762	$13,310

PST has dividends payable to former noncontrolling interest holders of 22,330 Brazilian real ($6,742) at December 31, 2017, which includes the dividend declared on May 16, 2017 of 9,610 Brazilian real ($3,092) and 1,879 Brazilian real ($567) in monetary correction, and 10,842 Brazilian real ($3,327) at December 31, 2016. The dividend is payable on or before January 1, 2020, and is subject to monetary correction based on the Brazilian National Extended Consumer Price inflation index ("IPCA"). The dividend payable related to PST is recorded within other long-term liabilities on the consolidated balance sheet.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

4. Debt

	December 31, 2017	December 31, 2016	Interest rates at December 31, 2017	Maturity
Revolving Credit Facility				
Credit Facility	$ 121,000	$ 67,000	2.62% - 2.81%	September 2021
Debt				
PST short-term obligations	-	5,097		
PST long-term notes	8,016	11,452	9.0% - 12.24%	2019-2021
Other	28	137		
Total debt	8,044	16,686		
Less: current portion	(4,192)	(8,626)		
Total long-term debt, net	$ 3,852	$ 8,060		

Revolving Credit Facility

On November 2, 2007, the Company entered into an asset-based credit facility which permitted borrowing up to a maximum level of $100,000. The Company entered into an Amended and Restated Credit and Security Agreement and a Second Amended and Restated Credit and Security Agreement on September 20, 2010 and December 1, 2011, respectively.

On September 12, 2014, the Company entered into a Third Amended and Restated Credit Agreement (the “Amended Agreement”). The Amended Agreement provides for a $300,000 revolving credit facility (the “Credit Facility”), which replaced the Company’s existing $100,000 asset-based credit facility and includes a letter of credit subfacility, swing line subfacility and multicurrency subfacility. The Amended Agreement also has an accordion feature which allows the Company to increase the availability by up to $80,000 upon the satisfaction of certain conditions. The Amended Agreement extended the termination date to September 12, 2019 from December 1, 2016. On March 26, 2015, the Company entered into Amendment No. 1 of the Amended Agreement which amended the definition of Consolidated EBITDA to allow for the add back of cash premiums and other non-cash charges related to the amendment and restatement of the Amended Agreement and the early extinguishment of the Company’s 9.5% Senior Notes totaling $10,507 both of which occurred in second half of 2014. Consolidated EBITDA is used in computing the Company’s leverage ratio and interest coverage ratio which are covenants within the Amended Agreement. On February 23, 2016, the Company entered into Amendment No. 2 of the Amended Agreement which amended and waived any default or potential defaults with respect to the pledging as collateral additional shares issued by a wholly owned subsidiary and newly issued shares associated with the formation of a new subsidiary. On August 12, 2016, the Company entered into Amendment No. 3 of the Amended Agreement which extended the expiration date by two years to September 12, 2021, increased the borrowing sub-limit for the Company’s foreign subsidiaries by $30,000 to $80,000, increased the basket of permitted loans and investments in foreign subsidiaries by $5,000 to $30,000, and provided additional flexibility to the Company for certain permitted corporate transactions involving its foreign subsidiaries as defined, in the Amended Agreement. As a result of Amendment No. 3, the Company capitalized deferred financing costs of $399, which will be amortized over the remaining term of the Credit Facility. On January 30, 2017, the Company entered into Consent and Amendment No. 4 to the Amended Agreement which amended certain definitions, schedules and exhibits of the Credit Facility, consented to a Dutch Reorganization, and consented to the Orlaco acquisition. As a result of Amendment No. 4, the Company capitalized deferred financing costs of $61, which will be amortized over the remaining term of the Credit Facility.

Borrowings under the Amended Agreement will bear interest at either the Base Rate, as defined, or the LIBOR Rate, at the Company’s option, plus the applicable margin as set forth in the Amended Agreement. The Company is also subject to a commitment fee ranging from 0.20% to 0.35% based on the Company’s leverage ratio. The Amended Agreement requires the Company to maintain a maximum leverage ratio of 3.00 to 1.00, and a minimum interest coverage ratio of 3.50 to 1.00 and places a maximum annual limit on capital expenditures. The Amended Agreement also contains other affirmative and negative covenants and events of default that are customary for credit arrangements of this type including covenants which place restrictions and/or limitations on the Company’s ability to borrow money, make capital expenditures and pay dividends.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Borrowings outstanding on the Credit Facility at December 31, 2017 and 2016 were $121,000 and $67,000, respectively. Borrowings increased under the Credit Facility to fund the Orlaco acquisition described in Note 2 during the first quarter of 2017 which were partially offset by subsequent voluntary principal repayments.

The Company has outstanding letters of credit of $2,008 and $3,399 at December 31, 2017 and 2016, respectively.

The Company was in compliance with all Credit Facility covenants at December 31, 2017 and 2016.

Debt

PST maintains several long-term notes used for working capital purposes which have fixed interest rates. As of December 31, 2017 PST did not have any short-term obligations. The weighted-average interest rates of long-term debt of PST at December 31, 2017 was 10.9%. Depending on the specific note, interest is payable either monthly or annually. Scheduled maturities of PST debt at December 31, 2017 are as follows: $4,164 in 2018, $2,700 in 2019, $601 in 2020 and $551 in 2021.

The Company's wholly-owned subsidiary located in Stockholm, Sweden, has an overdraft credit line which allows overdrafts on the subsidiary's bank account up to a maximum level of 20,000 Swedish krona, or $2,439 and $2,196, at December 31, 2017 and 2016, respectively. At December 31, 2017 and 2016, there was no balance outstanding on this bank account.

The Company was in compliance with all debt covenants at December 31, 2017 and 2016.

At December 31, 2017, the future maturities of the Credit Facility and debt were as follows:

Year ended December 31	
2018	$4,192
2019	2,700
2020	601
2021	121,551
2022	-
Total	$129,044

60

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

5. Income Taxes

The income tax expense (benefit) included in the accompanying consolidated statement of operations represents federal, state and foreign income taxes. The components of income (loss) before income taxes and the provision for income taxes consist of the following:

Years ended December 31	2017	2016	2015
Income (loss) before income taxes:			
Domestic	$36,657	$35,088	$22,959
Foreign	15,925	4,097	(2,729)
Total income before income taxes	$52,582	$39,185	$20,230
Provision for income taxes:			
Current:			
Federal	$2,478	$760	$386
State and foreign	11,014	2,575	1,232
Total current expense	$13,492	$3,335	$1,618
Deferred:			
Federal	$(2,585)	$(37,828)	$-
State and foreign	(3,374)	(1,896)	(2,165)
Total deferred benefit	(5,959)	(39,724)	(2,165)
Total income tax (benefit) expense	$7,533	$(36,389)	$(547)

A reconciliation of the Company’s effective income tax rate to the statutory federal tax rate is as follows:

Years ended December 31	2017	2016	2015
Statutory U.S. federal income tax rate	35.0 %	35.0 %	35.0 %
State income taxes, net of federal tax benefit	(0.8)	1.9	0.2
Tax credits	(4.2)	(0.8)	(2.8)
Foreign tax rate differential	(4.5)	(4.7)	(3.3)
Impact of change in enacted tax law	(17.2)	-	-
Change in valuation allowance	4.2	(121.6)	(36.0)
Other	1.8	(2.6)	4.2

Effective income tax rate	14.3 %	(92.8)%	(2.7)%

The Company recognized income tax expense (benefit) of $7,533 or 14.3%, $(36,389) or (92.8)% and $(547) or (2.7)% of income (loss) before income taxes for federal, state and foreign income taxes for the years ended December 31, 2017, 2016 and 2015, respectively. The change in tax expense for the year ended December 31, 2017 compared to the same period for 2016 was predominantly due to the release of the U.S. federal, certain state and foreign valuation allowances in 2016 and the impact of the enactment of the Tax Cuts and Jobs Act ("Tax Legislation") in the United States on December 22, 2017.

The Tax Legislation significantly revises the U.S. corporate income tax by, among other things, lowering corporate income tax rates and imposing a one-time transition tax on deemed repatriated earnings of foreign subsidiaries. The impact of the Tax Legislation was a tax benefit of $(9,062), consisting of an increase in tax expense of $6,207 due to the one-time deemed repatriation tax, offset by the favorable impact of the reduced tax rate on the Company's net deferred tax liabilities and other deferred tax adjustments of $(15,269) related to certain earnings included in the one-time transition tax. Pursuant to the guidance within SEC Staff Accounting Bulletin No. 118 ("SAB 118"), as of December 31, 2017, the Company recognized the provisional effects of the enactment of the Tax Legislation for which measurement could be reasonably estimated. Although the Company continues to analyze certain aspects of the Tax Legislation and refine its assessment, the ultimate impact of the Tax Legislation may differ from these estimates due to continued analysis or further regulatory guidance that may be issued as a result of the Tax Legislation. Pursuant to SAB 118, adjustments to the provisional amounts recorded by the Company as of December 31, 2017 that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The increase in tax benefit for the year ended December 31, 2016 compared to the same period for 2015 was due to the release of the U.S. federal, certain state and foreign valuation allowances in the fourth quarter of 2016.

The Company has not provided deferred taxes related to the undistributed earnings of foreign subsidiaries for which management does not intend to indefinitely reinvest, as these earnings are subject to the one-time transition tax and are not subject to additional U.S. tax upon repatriation. Any foreign tax on repatriation of earnings not intended to be indefinitely reinvested is expected to be immaterial. At December 31, 2017, the aggregate undistributed earnings of our foreign subsidiaries amounted to $47,860.

Significant components of the Company's deferred tax assets and liabilities were as follows:

As of December 31	2017	2016
Deferred tax assets:		
Inventories	$1,921	$2,156
Employee compensation and benefits	2,647	4,785
Insurance	-	245
Accrued liabilities and reserves	5,187	4,758
Property, plant and equipment	1,045	1,310
Tax loss carryforwards	10,929	28,952
Tax credit carryforwards	29,744	14,135
Other	416	2,851
Gross deferred tax assets	51,889	59,192
Less: Valuation allowance	(11,986)	(11,125)
Deferred tax assets less valuation allowance	39,903	48,067
Deferred tax liabilities:		
Property, plant and equipment	(3,489)	(1,651)
Intangible assets	(22,067)	(13,260)
Outside basis difference in foreign subsidiary	(13,750)	(31,016)
Other	(3,243)	(1,358)
Gross deferred tax liabilities	(42,549)	(47,285)
Net deferred tax assets (liabilities)	$(2,646)	$782

The balance sheet classification of our net deferred tax asset is shown below:

Years ended December 31	2017	2016
Long-term deferred tax assets	$16,228	$10,542
Long-term deferred tax liabilities	(18,874)	(9,760)
Net deferred tax assets (liabilities)	$(2,646)	$782

Based on the Company’s review of both positive and negative evidence regarding the realizability of deferred tax assets at December 31, 2017, a valuation allowance continues to be recorded against certain deferred tax assets based upon the conclusion that it was more likely than not they would not be realized. The valuation allowance at December 31, 2017 and 2016 relates primarily to PST.

62

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

In 2016, the financial results for the U.S. operation improved significantly due to the earnings growth of Control Devices segment as well as a significant reduction in interest expense as a result of the Company's refinancing activities in the fall of 2014. The U.S. operation was in a three year cumulative income position at December 31, 2016. Based on the available positive and negative evidence and the weight accorded to that evidence at December 31, 2016, the Company determined that the significant positive evidence outweighed the negative evidence. Therefore, the Company concluded that it was more likely than not that the U.S. federal deferred tax assets would be realized (including those that carry expiration dates) and accordingly would no longer provide a valuation allowance against its domestic deferred tax assets. In addition, the Company concluded that it was more likely than not that the certain state and foreign, deferred tax assets would be realized, and as such the previously provided valuation allowances were released.

The Company has net operating loss carry forwards of $42,571 and $35,075 for U.S. state and foreign tax jurisdictions, respectively. The U.S. state net operating losses expire at various times and the foreign net operating losses expire at various times or have indefinite lives. The Company has general business and foreign tax credit carry forwards of $27,336, $1,753 and $1,023 for U.S. federal, state and foreign jurisdictions respectively. The U.S. federal general business credits, if unused, begin to expire in 2023, and the state and foreign tax credits expire at various times.

The Company is required to provide a deferred tax liability corresponding to the difference between the financial reporting basis (which was remeasured to fair value upon the acquisition of an additional 24% of PST in 2011) and the tax basis in the previously held 50% ownership interest in PST (the "outside" basis difference). At December 31, 2017, the outside basis difference was reduced by $8,100 as a result of the one-time transition tax. In 2017, the Company acquired the remaining 26% interest in PST. This outside basis difference will generally remain fixed until (1) dividends from the subsidiary exceed the parent's share of earnings subsequent to the date it became a subsidiary or (2) there is a transaction that affects the Company's ownership of PST.

The following is a reconciliation of the Company's total gross unrecognized tax benefits:

	2017	2016	2015
Balance as of January 1	$3,839	$4,304	$3,888
Tax positions related to the current year:			
Additions	31	208	201

Tax positions related to the prior years:			
Additions	-	-	523
Reductions	(176)	(61)	-
Expirations of statutes of limitation	(49)	(612)	(308)
Balance as of December 31	$3,645	$3,839	$4,304

At December 31, 2017, the Company has classified $444 as a noncurrent liability and $3,218 as a reduction to non-current deferred income tax assets. The amount of unrecognized tax benefits is not expected to change significantly during the next 12 months. Management is currently unaware of issues under review that could result in a significant change or a material deviation in this estimate.

If the Company’s tax positions are sustained by the taxing authorities in favor of the Company, the amount that would affect the Company’s effective tax rate is approximately $3,645 and $3,821 at December 31, 2017 and 2016, respectively.

The Company classifies interest expense and, if applicable, penalties which could be assessed related to unrecognized tax benefits as a component of income tax expense (benefit). For the years ended December 31, 2017, 2016 and 2015, the Company recognized approximately $(33), $(59) and $(90) of gross interest and penalties, respectively. The Company has accrued approximately $32 and $64 for the payment of interest and penalties at December 31, 2017 and 2016, respectively.

63

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The Company conducts business globally and, as a result, files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The following table summarizes the open tax years for each jurisdiction:

Jurisdiction	**Open Tax Years**
U.S. Federal	2014-2017
Brazil	2012-2017
China	2014-2017
France	2016-2017
Germany	2014-2017
Italy	2012-2017
Mexico	2012-2017
Netherlands	2014-2017
Spain	2013-2017
Sweden	2012-2017
United Kingdom	2016-2017

6. Operating Lease Commitments

The Company leases equipment, vehicles and buildings from third parties under operating lease agreements. For the years ended December 31, 2017, 2016 and 2015, lease expense totaled $6,261, $5,290 and $5,532, respectively.

Future minimum operating lease commitments as of December 31, 2017 were as follows:

Year ended December 31	
2018	$5,560
2019	4,555
2020	3,058
2021	2,622
2022	1,780
Thereafter	5,954
Total	$23,529

7. Share-Based Compensation Plans

In April 2006, the Company's shareholders approved the Amended and Restated Long-Term Incentive Plan (the "2006 Plan") and reserved 1,500,000 Common Shares of which the maximum number of Common Shares which may be issued subject to incentive stock options is 500,000. In May 2010, shareholders approved an amendment to the 2006 Plan to increase the number of shares by 1,500,000 to 3,000,000, and in May 2013, shareholders approved another amendment to this plan to increase the number of shares by 1,500,000 to 4,500,000. As the 2006 Plan expired in May 2016, there were no shares available for grant at December 31, 2017 or 2016. As of December 31, 2017, there are 782,368 shares granted subject to future vesting of which 260,775 shares were time-based and 521,593 were performance-based.

In May 2016, the Company's shareholders approved the 2016 Long-Term Incentive Plan (the "2016 Plan") and reserved 1,800,000 Common Shares (of which the maximum number of Common Shares which may be issued). Under the 2016 Plan, as of December 31, 2017, the Company has granted 428,328 share units, of which 170,793 were time-based with cliff vesting using the straight-line method and 257,535 were performance-based. There are 1,390,708 shares available to be granted under the 2016 Plan at December 31, 2017.

In 2016 and 2015, pursuant to the 2006 Plan and in 2017, pursuant to the 2016 Plan, the Company granted time-based and performance-based share units. The time-based share units cliff vest three years after the date of grant. The performance based share units vest and are no longer subject to forfeiture upon the recipient remaining an employee of the Company for three years from the date of grant and, for a portion of the annual awards, upon the Company attaining certain targets of performance measured against a peer group's three year performance in terms of total shareholder return and, for the remaining portion of the annual awards, upon achieving certain annual earnings per share targets established by the Company during the performance period of the award.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The allocation of performance shares granted between total shareholder return and earnings per share were as follows for the years ended December 31:

	2017	2016	2015
Total shareholder return	62 %	55 %	36 %
Earnings per share	38 %	45 %	64 %

In April 2005, the Company adopted the Directors' Restricted Shares Plan (the "Director Share Plan") and reserved 500,000 Common Shares for issuance under the Director Share Plan. In May 2013, shareholders approved an amendment to the Director Share Plan to increase the number of shares for issuance by 200,000 to 700,000. Under the Director Share Plan, the Company has cumulatively issued 616,113 restricted Common Shares. As such, there are 83,887 restricted Common Shares available to be issued at December 31, 2017. Shares issued annually under the Director Share Plan vest one year after the date of grant.

Restricted Shares

The fair value of the non-vested time-based restricted Common Share awards was calculated using the market value of the Common Shares on the date of issuance. The weighted-average grant-date fair value of time-based restricted Common Shares granted during the years ended December 31, 2017, 2016 and 2015 was $18.73, $13.52 and $11.41, respectively.

The fair value of the non-vested performance-based restricted Common Share awards with a performance condition requiring the Company to obtain certain earnings per share targets was estimated using the market value of the shares on the date of grant. The fair value of non-vested performance-based restricted Common Share awards with a market condition requiring the Company to obtain a total shareholder return target relative to a group of peer companies was estimated using a Monte Carlo valuation model taking into consideration the probability of achievement using multiple simulations. The awards that use earnings per share as the performance target are expensed beginning when it is probable that the Company will meet the underlying performance condition.

A summary of the status of the Company's non-vested share units as of December 31, 2017 and the changes during the year then ended, are presented below:

	Time-based awards		Performance-based awards	
	Common Shares	Weighted-average grant date fair value	Common Shares	Weighted-average grant date fair value
Non-vested as of December 31, 2016	612,037	$ 12.32	825,140	$ 12.14
Granted	177,664	$ 18.73	217,495	$ 21.54
Vested	(310,207)	$ 12.05	(165,783)	$ 11.72
Forfeited or cancelled	(36,342)	$ 13.23	(132,664)	$ 12.52
Non-vested as of December 31, 2017	443,152	$ 15.01	744,188	$ 14.92

As of December 31, 2017, total unrecognized compensation cost related to non-vested time-based share units granted was $2,543. That cost is expected to be recognized over a weighted-average period of 1.18 years.

For the years ended December 31, 2017, 2016 and 2015, the total fair value of awards vested was $8,718, $5,394 and $9,101, respectively.

As of December 31, 2017, total unrecognized compensation cost related to non-vested performance-based share units granted was $3,324 for shares probable to vest. That cost is expected to be recognized over a weighted-average period of 0.94 years dependent upon the achievement of performance conditions. As noted above, the Company has issued and outstanding performance-based restricted Common Share awards that use different performance targets (total shareholder return and earnings per share).

65

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The tax benefit realized for the tax deductions from the vesting of restricted Common Shares and option exercises of the share-based payment arrangements was $858, $977 and $0 for the years ended December 31, 2017, 2016 and 2015.

8. Employee Benefit Plans

The Company has certain defined contribution profit sharing and 401(k) plans covering substantially all of its employees in the United States and Europe. The Company provides matching contributions to the Company’s 401(k) plan. Company contributions are generally discretionary. For the years ended December 31, 2017, 2016 and 2015, expenses related to these plans amounted to $2,601, $1,601 and $1,487, respectively.

Long-Term Cash Incentive Plan

In 2009, the Company adopted the Stoneridge, Inc. Long-Term Cash Incentive Plan (the “LTCIP”) and granted awards to certain officers and key employees. Awards under the LTCIP provided recipients with the right to receive cash three years from the date of grant depending on the Company’s earnings per share performance for the defined performance period. If the participant voluntarily terminated employment or was discharged for cause, as defined in the LTCIP, the award would be forfeited.

The Company granted Phantom Share awards under the LTCIP in 2013 that vested in February 2016 and were paid in March 2016 based on the Company’s earnings per share performance for each fiscal year of 2013, 2014 and 2015. As of December 31, 2017 and 2016, the Company recorded a liability of $0 for the performance based awards granted under the LTCIP. There were no performance based awards granted under the LTCIP during the years ended December 31, 2017, 2016 or 2015.

9. Financial Instruments and Fair Value Measurements

Financial Instruments

A financial instrument is cash or a contract that imposes an obligation to deliver, or conveys a right to receive cash or another financial instrument. The carrying values of cash and cash equivalents, accounts receivable and accounts payable are considered to be representative of fair value because of the short maturity of these instruments. The fair value of debt approximates the carrying value of debt.

Derivative Instruments and Hedging Activities

On December 31, 2017, the Company had open foreign currency forward contracts which are used solely for hedging and not for speculative purposes. Management believes that its use of these instruments to reduce risk is in the Company's best interest. The counterparties to these financial instruments are financial institutions with investment grade credit ratings.

Foreign Currency Exchange Rate Risk

The Company conducts business internationally and therefore is exposed to foreign currency exchange rate risk. The Company uses derivative financial instruments as cash flow and fair value hedges to manage its exposure to fluctuations in foreign currency exchange rates by reducing the effect of such fluctuations on foreign currency denominated intercompany transactions, inventory purchases and other foreign currency exposures. The currencies hedged by the Company during 2017, 2016 and 2015 include the euro and Mexican peso. In addition, the Company hedged the U.S. dollar against the Swedish krona and euro on behalf of its European subsidiaries in 2016 and 2015.

These forward contracts were executed to hedge forecasted transactions and were accounted for as cash flow hedges. As such, the effective portion of the unrealized gain or loss was deferred and reported in the Company's consolidated balance sheets as a component of accumulated other comprehensive loss. The cash flow hedges were highly effective. The effectiveness of the transactions has been and will be measured on an ongoing basis using regression analysis and forecasted future purchases of the currency.

In certain instances, the foreign currency forward contracts do not qualify for hedge accounting or are not designated as hedges, and therefore are marked to market with gains and losses recognized in the Company's consolidated statements of operations as a component of other expense (income), net.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The Company’s foreign currency forward contracts are designed to offset some of the gains and losses realized on the underlying foreign currency denominated transactions as follows:

Euro-denominated Foreign Currency Forward Contracts

At December 31, 2017 and 2016, the Company held foreign currency forward contracts with an underlying notional amount of $1,486 and $1,601, respectively, to reduce the exposure related to the Company’s euro-denominated intercompany loans. These contracts expires in June 2018. The euro-denominated foreign currency forward contract was not designated as a hedging instrument. For the years ended December 31, 2017, 2016, and 2015, the Company recognized a loss of $174 and gains of $57 and $336, respectively, in the consolidated statements of operations as a component of other expense (income), net related to the euro-denominated contract.

U.S. dollar-denominated Foreign Currency Forward Contracts – Cash Flow Hedge

The Company entered into on behalf of one of its European Electronics subsidiaries whose functional currency is the Swedish krona, U.S. dollar-denominated currency contracts with a notional amount at December 31, 2015 of $10,007 which expired ratably on a monthly basis from January 2016 through December 2016. There were no contracts entered into as of December 31, 2017 or 2016.

The Company entered into on behalf of one of its European Electronics subsidiaries whose functional currency is the euro, U.S. dollar-denominated currency contracts with a notional amount at December 31, 2015 of $2,421 which expired ratably on a monthly basis from January 2016 through December 2016. There were no contracts entered into as of December 31, 2017 or 2016.

The Company evaluated the effectiveness of the U.S. dollar-denominated foreign currency forward contracts held as of December 31, 2015 and during 2016 and concluded that the hedges were effective.

Mexican peso-denominated Foreign Currency Forward Contracts – Cash Flow Hedge

The Company holds Mexican peso-denominated foreign currency contracts with notional amounts at December 31, 2017 of $9,143 which expire ratably on a monthly basis from January 2018 through December 2018, compared to $5,699 at December 31, 2016.

The Company evaluated the effectiveness of the Mexican peso-denominated foreign currency forward contracts held as of December 31, 2017 and 2016, and the years then ended, and concluded that the hedges were effective.

The notional amounts and fair values of derivative instruments in the consolidated balance sheets were as follows:

	Notional amounts (A)		Accrued expenses and other current liabilities	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Derivatives designated as hedging instruments:				
Cash flow hedges:				
Forward currency contracts	$ 9,143	$ 5,699	$ 221	$ 28
Derivatives not designated as hedging instruments:				
Forward currency contracts	$ 1,486	$ 1,601	$ 48	$ 3

(A) Notional amounts represent the gross contract / notional amount of the derivatives outstanding.

67

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Gross amounts recorded for the cash flow hedges in other comprehensive loss in shareholders' equity and in net income for the years ended December 31 were as follows:

	Gain (loss) recorded in other comprehensive income (loss)			Gain (loss) reclassified from other comprehensive income **(loss) into net income** [(A)]		
	2017	2016	2015	2017	2016	2015
Derivatives designated as cash flow hedges:						
Forward currency contracts	$ 441	$ (582)	(671)	$ 634	$ (164)	(1,060)

(A) Gains and losses reclassified from comprehensive loss into net income were recognized in COGS in the Company's consolidated statements of operations.

The net deferred loss of $221 on the cash flow hedge derivatives will be reclassified from other comprehensive income (loss) to the consolidated statements of operations in 2018. The Company has measured the ineffectiveness of the forward currency contracts and any amounts recognized in the consolidated financial statements were immaterial for the years ended December 31, 2017, 2016 and 2015.

Fair Value Measurements

The Company's assets and liabilities are measured at fair value on a recurring basis and are categorized using the three levels of the fair value hierarchy based on the reliability of the inputs used. Fair values estimated using Level 1 inputs consist of quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Fair values estimated using Level 2 inputs, other than quoted prices, are observable for the asset or liability, either directly or indirectly and include among other things, quoted prices for similar assets or liabilities in markets that are active or inactive as well as inputs other than quoted prices that are observable. For forward currency contracts, inputs include foreign currency exchange rates. Fair values estimated using Level 3 inputs consist of significant unobservable inputs.

The following table presents our liabilities that are measured at fair value on a recurring basis and are categorized using the three levels of the fair value hierarchy based on the reliability of inputs used.

	December 31, 2017				December 31, 2016
		Fair values estimated using			
	Fair value	Level 1 inputs	Level 2 inputs	Level 3 inputs	Fair value
Financial liabilities carried at fair value:					
Forward currency contracts	$ 269	$ -	$ 269	$ -	$ 31
Earn-out consideration	20,746	-	-	20,746	-
Total financial liabilities carried at fair value	$ 21,015	$ -	$ 269	$ 20,746	$ 31

The following table sets forth a summary of the change in fair value of the Company's Level 3 financial liabilities related to earn-out consideration that are measured at fair value on a recurring basis.

	Orlaco	PST	Total
Balance at December 31, 2016	$-	$-	$-
Fair value on acquisition date	3,243	10,180	13,423
Change in fair value	4,853	2,632	7,485
Foreign currency adjustments	541	(703)	(162)
Balance at December 31, 2017	$8,637	$12,109	$20,746

68

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

The earn-out considerations related to Orlaco and PST are recorded within other long-term liabilities on the consolidated balance sheet. The change in fair value of the earn-out considerations are recorded within SG&A expense on the consolidated statements of operations.

The increase in fair value of earn-out consideration related to the Orlaco acquisition is primarily due to actual performance exceeding forecasted performance as well as the reduced time from the period presented to the payment date and foreign currency movements. The increase in fair value of earn-out consideration for PST was due to an increase in expected performance and the reduced time from the period presented to the payment date, which was partially offset by foreign currency. The fair value of the Orlaco and PST earn-out consideration is based on forecasted EBITDA during the performance periods.

There were no transfers in or out of Level 3 from other levels in the fair value hierarchy for the year ended December 31, 2017.

Except for the fair value of assets acquired and liabilities assumed related to the Orlaco acquisition discussed in Note 2, no non-recurring fair value adjustments were required for nonfinancial assets for the years ended December 31, 2017 and 2016.

10. Commitments and Contingencies

In the ordinary course of business, the Company is subject to a broad range of claims and legal proceedings that relate to contractual allegations, product liability, tax audits, patent infringement, employment-related matters and environmental matters. The Company establishes accruals for matters which it believes that losses are probable and can be reasonably estimated. Although it is not possible to predict with certainty the outcome of these matters, the Company is of the opinion that the ultimate resolution of these matters will not have a material adverse effect on its consolidated results of operations or financial position.

As a result of environmental studies performed at the Company’s former facility located in Sarasota, Florida, the Company became aware of soil and groundwater contamination at this site. The Company engaged an environmental engineering consultant to assess the level of contamination and to develop a remediation and monitoring plan for the site. Soil remediation at the site was completed during the year ended December 31, 2010. Upon approval of the remedial action plan by the Florida Department of Environmental Protection, ground water remediation began in the fourth quarter of 2015. During the years ended December 31, 2017, 2016 and 2015, environmental remediation costs incurred were immaterial. At December 31, 2017 and 2016, the Company had accrued an undiscounted liability of $265 and $446, respectively, related to future remediation costs. At December 31, 2017 and 2016, $253 and $370, respectively, were recorded as a component of accrued expenses and other current liabilities on the consolidated balance sheets while the remaining amounts were recorded as a component of other long-term liabilities. Costs associated with the recorded liability will be incurred to complete the groundwater remediation, with the balance relating to monitoring costs to be incurred over multiple years. The recorded liability is based on assumptions in the remedial action plan. Although the Company sold the Sarasota facility in December 2011, the liability to remediate the site contamination remains the responsibility of the Company. Due to the ongoing site remediation, the closing terms of the sale agreement included a requirement for the Company to maintain a $2,000 letter of credit for the benefit of the buyer.

During the third quarter of 2017, the Company resolved a legal proceeding, *Verde v. Stoneridge, Inc. et al.*, that was pending in the United States District Court for the Eastern District of Texas, Cause No. 6:14-cv-00225- KNM. The Plaintiff filed this putative class action against the Company and others on March 26, 2014. The Plaintiff had alleged that the Company was involved in the vertical chain of manufacture, distribution, and sale of a control device (“CD”) that was incorporated into a Dodge Ram truck purchased by the Plaintiff in 2006. The Plaintiff had alleged that the Company breached express warranties and indemnification provisions by supplying a defective CD that was not capable of performing its intended function. In May 2017, the District Court denied the Plaintiff’s motion for class certification. On October 2, 2017, the Company and Plaintiff agreed to settle this matter, and the proceeding was dismissed with prejudice on November 17, 2017. The settlement amount was $3.

69

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

Royal v. Stoneridge, Inc. et al. is a legal proceeding currently pending in the United States District Court for the Western District of Oklahoma, Case No. 5:14-cv-01410-F. The Plaintiffs filed this putative class action against the Company, Stoneridge Control Devices, Inc., and others on December 19, 2014. The Plaintiffs allege that the Company was involved in the vertical chain of manufacture, distribution, and sale of a CD that was incorporated into Dodge Ram trucks purchased by the Plaintiffs between 1999 and 2006. The Plaintiffs allege that the Company and Stoneridge Control Devices, Inc. breached various express and implied warranties, including the implied warranty of merchantability. The Plaintiffs also seek indemnity from the Company and Stoneridge Control Devices, Inc. The putative class consists of all owners of vehicles equipped with the subject CD, which includes various Dodge Ram trucks and other manual transmission vehicles manufactured from 1997–2007, which Plaintiffs allege is more than one million vehicles. The Plaintiffs seek recovery of economic loss damages associated with inspecting and replacing the allegedly defective CD, diminished value of the subject CDs and the trucks in which they were installed, and attorneys' fees and costs. On September 28, 2017, the Company reached an agreement with the Plaintiffs to settle the matter. On January 30, 2018, the Court approved the settlement and entered a final order and judgment consistent with the terms of the settlement agreement. Under the terms of the settlement, the Company will provide a replacement CD to each member of the settlement class who files a claim form with evidence of eligibility to participate. The terms of the settlement do not require the Company to provide members of the settlement class with any cash payments or to reimburse any installation costs associated with replacement of the CDs. Counsel for the Plaintiffs and the settlement class filed a motion with the Court requesting an award of attorneys' fees and costs in an amount not to exceed $375, and the Company has agreed not to object to any request that does not exceed $375 and to pay the amount of any award that does not exceed $375. Counsel for Plaintiffs and the settlement class filed a motion requesting incentive payments to each of the three named Plaintiffs in an amount not to exceed $5 each, and the Company has agreed not to object to any request that does not exceed $15 total and to pay the amount of any award that does not exceed $15 total. The total cost of the settlement remains uncertain because it is difficult to predict how many members of the proposed settlement class will request a replacement CD. The Company believes the likelihood of loss is probable and reasonably estimable (although not certain), and therefore a liability of $525 for these claims has been recorded as a component of accrued expenses and other current liabilities at December 31, 2017.

On May 24, 2013, the State Revenue Services of São Paulo issued a tax deficiency notice against PST claiming that the vehicle tracking and monitoring services it provides should be classified as communication services, and therefore subject to the State Value Added Tax – ICMS. The State Revenue Services assessment imposed the 25.0% ICMS tax on all revenues of PST related to the vehicle tracking and monitoring services during the period from January 2009 through December 2010. The Brazilian real ("R$") and U.S. dollar equivalent ("$") of the aggregate tax assessment is approximately R$99,300 ($30,000) at December 31, 2017 which is comprised of Value Added Tax – ICMS of R$13,200 ($4,000), interest of R$74,700 ($22,600) and penalties of R$11,400 ($3,400).

The Company believes that the vehicle tracking and monitoring services are non-communication services, as defined under Brazilian tax law, subject to the municipal ISS tax, not communication services subject to state ICMS tax as claimed by the State Revenue Services of São Paulo. PST has, and will continue to collect the municipal ISS tax on the vehicle tracking and monitoring services in compliance with Brazilian tax law and will defend its tax position. PST has received a legal opinion that the merits of the case are favorable to PST, determining among other things that the imposition on the subsidiary of the State ICMS by the State Revenue Services of São Paulo is not in accordance with the Brazilian tax code. The Company believes, based on the legal opinion of the Company's Brazilian legal counsel, the Brazil Administrative Court's final ruling on February 27, 2018 in PST's favor for the period from January 2009 through December 2010, and the results of the Brazilian Administrative Court's ruling on another vehicle tracking and monitoring company related to the tax deficiency notice it received, the likelihood of loss is not probable. As a result of the above, as of December 31, 2017 and 2016, no accrual has been recorded with respect to the tax assessment. An unfavorable judgment on this issue for the years assessed and for subsequent years could result in significant costs to the Company and adversely affect our results of operations.

In addition, PST has civil, labor and other non-income tax contingencies for which the likelihood of loss is deemed to be reasonably possible, but not probable, by the Company's legal advisors in Brazil. As a result, no provision has been recorded with respect to these contingencies, which amounted to R$33,800 ($10,200) and R$31,800 ($9,800) at December, 2017 and 2016, respectively. An unfavorable outcome on these contingencies could result in significant cost to PST and adversely affect its results of operations.

Insurance Recoveries

The Company incurred losses and incremental costs related to the damage to assets caused by a storm at its Mexican production facility in the fourth quarter of 2016 and is pursuing recovery of such costs under applicable insurance policies. Anticipated proceeds from insurance recoveries related to losses and incremental costs that have been incurred ("loss recoveries") are recognized when receipt is probable. Anticipated proceeds from insurance recoveries in excess of the net book value of damaged property, plant and equipment ("insurance gain contingencies") are recognized when all contingencies related to the claim have been resolved.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

In 2017, loss recoveries related to the damage of inventory and incremental costs included in costs of sales were $189 and loss recoveries and insurance gain contingencies related to the damage of property, plant and equipment included within SG&A expense were $1,923. Cash proceeds related to the damage of inventory and incremental costs of $500 are included in cash flows from operating activities, while cash proceeds related to the damage of property, plant and equipment of $711 are included in cash flows from investing activities. As of December 31, 2017, the Company had confirmation of the open insurance claim and recorded a receivable of $1,644. The cash payment was subsequently collected in January 2018.

11. Headquarter Relocation and Consolidation

During the fourth quarter of 2016, the Company relocated its corporate headquarters from Warren, Ohio to Novi, Michigan and consolidated its other corporate functions into one location. As a result, the Company incurred relocation costs recorded within SG&A expense, which included employee retention, relocation, severance, recruiting, duplicate wages and professional fees, of $493 and $1,769 for the years ended December 31, 2017 and 2016, respectively.

In connection with the headquarter relocation, the Company was approved for a Michigan Business Development Program grant of up to $1,400 based upon the number of new jobs created in Michigan through 2022. As a result of the attainment of the first milestone, grant income of $338 was recognized during the year ended December 31, 2017 within SG&A expense in the consolidated statements of operations.

12. Restructuring and Business Realignment

In connection with the Electronics segment restructuring initiative, the Company recorded lease related restructuring charges during the years ended December 31, 2017, 2016 and 2015 of $20, $59 and $183, respectively, as part of SG&A expense. At December 31, 2016, the only remaining restructuring accrual related to the terminated property lease in Mitcheldean, United Kingdom, for which the Company accrued $273 on the consolidated balance sheet as a component of other current liabilities. There were no restructuring accruals as of December 31, 2017.

The expenses for the restructuring activities that relate to the Electronics reportable segment include the following:

	2017	2016	2015
Accrued balance at January 1	$273	$458	$733
Charge to expense	20	59	183
Foreign currency translation	3	(69)	3
Cash payments, net	(296)	(175)	(461)
Accrued balance at December 31	$-	$273	$458

The Company regularly evaluates the performance of its businesses and cost structures, including personnel, and makes necessary changes thereto in order to optimize its results. The Company also evaluates the required skill sets of its personnel and periodically makes strategic changes. As a consequence of these actions, the Company incurs severance related costs which are referred to as business realignment charges.

Business realignment charges by reportable segment were as follows:

Years ended December 31	2017	2016	2015
Electronics [(A)]	$1,223	$1,180	$317
PST [(B)]	589	1,437	403
Unallocated Corporate [(C)]	-	-	309
Total business realignment charges	$1,812	$2,617	$1,029

(A) Severance costs for the year ended December 31, 2017 related to COGS and SG&A were $56 and $1,167, respectively. Severance costs for the year ended December 31, 2016 related to SG&A and design and development ("D&D") were $196 and $984, respectively. Severance costs for the year ended December 31, 2015 related to SG&A and D&D were $102 and $215, respectively.

(B) Severance costs for the year ended December 31, 2017 related to COGS, SG&A and D&D were $370, $218 and $1, respectively. Severance costs for the year ended December 31, 2016 related to COGS, SG&A and D&D were $437, $884 and $116, respectively. Severance costs for the year ended December 31, 2015 related to COGS, SG&A and D&D were $172, $117 and $114, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

(C) Severance costs for the year ended December 31, 2015 related to SG&A were $309.

There were no significant restructuring or business realignment expenses related to the Control Devices reportable segment during the years ended December 31, 2017, 2016 or 2015.

Business realignment charges classified by statement of operations line item were as follows:

Years ended December 31	2017	2016	2015
Cost of goods sold	$426	$437	$172
Selling, general and administrative	1,385	1,080	528
Design and development	1	1,100	329
Total business realignment charges	$1,812	$2,617	$1,029

13. Segment Reporting

Operating segments are defined as components of an enterprise that are evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the chief executive officer.

The Company has three reportable segments, Control Devices, Electronics, and PST, which also represent its operating segments. The Control Devices reportable segment produces sensors, switches, valves and actuators. The Electronics reportable segment produces electronic instrument clusters, electronic control units, driver information systems and camera-based vision systems, monitors and related products. The PST reportable segment designs and manufactures electronic vehicle security alarms, convenience accessories, vehicle tracking devices and monitoring services and in-vehicle audio and video devices.

The accounting policies of the Company's reportable segments are the same as those described in Note 2. The Company's management evaluates the performance of its reportable segments based primarily on revenues from external customers, capital expenditures and operating income. Inter-segment sales are accounted for on terms similar to those to third parties and are eliminated upon consolidation.

The financial information presented below is for our three reportable operating segments and includes adjustments for unallocated corporate costs and intercompany eliminations, where applicable. Such costs and eliminations do not meet the requirements for being classified as an operating segment. Corporate costs include various support functions, such as corporate accounting/finance, executive administration, human resources, information technology and legal.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

A summary of financial information by reportable segment is as follows:

Years ended December 31	2017	2016	2015
Net Sales:			
Control Devices	$447,528	$408,132	$333,010
Inter-segment sales	5,044	1,826	2,055
Control Devices net sales	452,572	409,958	335,065
Electronics (D)	282,383	205,256	216,544
Inter-segment sales	39,501	33,361	22,904
Electronics net sales	321,884	238,617	239,448
PST	94,533	82,589	95,258
Inter-segment sales	563	-	-
PST net sales	95,096	82,589	95,258
Eliminations	(45,108)	(35,187)	(24,959)
Total net sales	$824,444	$695,977	$644,812
Operating Income (Loss):			
Control Devices	$72,555	$61,815	$44,690
Electronics (D)	18,119	14,798	13,784
PST	2,661	(3,462)	(7,542)
Unallocated Corporate (A)	(35,965)	(29,069)	(23,117)
Total operating income	$57,370	$44,082	$27,815
Depreciation and Amortization:			
Control Devices	$10,887	$10,276	$9,260
Electronics (D)	8,143	3,971	3,666
PST	8,316	8,559	9,272
Unallocated Corporate	584	452	211
Total depreciation and amortization (B)	$27,930	$23,258	$22,409
Interest Expense, net:			
Control Devices	$103	$226	$326
Electronics	119	142	161
PST	1,812	3,396	2,957
Unallocated Corporate	3,749	2,513	2,921
Total interest expense, net	$5,783	$6,277	$6,365
Capital Expenditures:			
Control Devices	$17,484	$13,261	$15,094
Electronics (D)	8,158	5,665	6,538

PST	3,831	3,213	5,889
Unallocated Corporate[(C)]	2,697	2,337	1,214
Total capital expenditures	$32,170	$24,476	$28,735

73

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

	December 31, 2017	December 31, 2016
Total Assets:		
Control Devices	$ 164,632	$ 150,623
Electronics (D)	252,324	99,964
PST	100,382	107,405
Corporate (C)	377,657	287,031
Eliminations	(335,958)	(250,494)
Total assets	$ 559,037	$ 394,529

The following table presents net sales and long-term assets for the geographic areas in which the Company operates:

Years ended December 31	2017	2016	2015
Net Sales:			
North America	$471,770	$428,046	$369,032
South America	94,533	82,589	95,258
Europe and Other (D)	258,141	185,342	180,522
Total net sales	$824,444	$695,977	$644,812

	December 31, 2017	December 31, 2016
Long-term Assets:		
North America	$ 89,997	$ 73,835
South America	58,989	63,497
Europe and Other (D)	106,682	16,304
Total long-term assets	$ 255,668	$ 153,636

(A) Unallocated Corporate expenses include, among other items, accounting/finance, human resources, information technology and legal costs as well as share-based compensation.

(B) These amounts represent depreciation and amortization on property, plant and equipment and certain intangible assets.

(C) Corporate assets consist primarily of cash, intercompany loan receivables, capital expenditures for the headquarter building and information technology assets, equity investments and investments in subsidiaries.

(D) The amounts for 2017 include the Orlaco business which was acquired on January 31, 2017 as disclosed in Note 2.

74

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

14. Unaudited Quarterly Financial Data

The following is a summary of quarterly results of operations:

				Quarter ended
2017	December 31	September 30	June 30	March 31
Net sales	$ 207,440	$ 203,582	$209,111	$ 204,311
Gross profit	61,026	62,549	63,414	61,151
Operating income	13,234	13,296	15,676	15,164
Income tax (benefit) expense [B]	(6,036)	3,809	5,189	4,571
Net income	18,908	8,049	8,919	9,173
Net loss attributable to noncontrolling interests	-	-	(100)	(30)
Net income attributable to Stoneridge, Inc.	18,908	8,049	9,019	9,203
Earnings per share attributable to Stoneridge, Inc.:				
Basic [A]	$ 0.67	$ 0.29	$0.32	$ 0.33
Diluted [A]	$ 0.65	$ 0.28	$0.32	$ 0.32

				Quarter ended
2016	December 31	September 30	June 30	March 31
Net sales	$ 172,612	$ 173,846	$186,903	$ 162,616
Gross profit	47,779	49,748	52,751	45,161
Operating income	10,170	11,780	13,626	8,506
Income tax (benefit) expense [C]	(39,503)	919	1,350	845
Net income	48,489	9,981	10,995	6,109
Net income (loss) attributable to noncontrolling interests	122	(303)	(576)	(1,130)
Net income attributable to Stoneridge, Inc.	48,367	10,284	11,571	7,239
Earnings per share attributable to Stoneridge, Inc.:				
Basic [A]	$ 1.74	$ 0.37	$0.42	$ 0.26
Diluted [A]	$ 1.70	$ 0.36	$0.41	$ 0.26

(A) Earnings per share for the year may not equal the sum of the four historical quarters earnings per share due to changes in weighted-average basic and diluted shares outstanding.

(B)

The impact of the Tax Legislation was an increase in tax expense of $6.2 million due to the one-time deemed repatriation tax, offset by the favorable impacts of the reduced tax rate on the Company’s net deferred tax liabilities and other deferred tax adjustments of $(15.3) million related to certain earnings included in the one-time transition tax.

(C) The Company recorded the release of a valuation allowance associated with its U.S. federal, certain state and foreign deferred tax assets for the year ended December 31, 2016.

75

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data, unless otherwise indicated)

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

The following schedules provide the activity for accounts receivable reserves and valuation allowance for deferred tax assets for the years ended December 31, 2017, 2016 and 2015:

	Balance at beginning of period	Charged to costs and expenses	Write-offs	Balance at end of period
Accounts receivable reserves:				
Year ended December 31, 2015	$ 2,017	$ 395	$ (1,346)	$ 1,066
Year ended December 31, 2016	1,066	1,604	(1,040)	1,630
Year ended December 31, 2017	1,630	2,173	(2,694)	1,109

	Balance at beginning of period	Net additions charged to expense (benefit)	Exchange rate fluctuations and other items	Balance at end of period
Valuation allowance for deferred tax assets:				
Year ended December 31, 2015	$ 67,907	$ (7,957)	$ (559)	$ 59,391
Year ended December 31, 2016	59,391	(47,659)(A)	(607)	11,125
Year ended December 31, 2017	11,125	874	(13)	11,986

(A) The Company recorded the release of a valuation allowance associated with its U.S. federal, certain state and foreign deferred tax assets of $49.6 million.

Item 9. Changes In and Disagreements With Accountants On Accounting and Financial Disclosure.

There have been no disagreements between the management of the Company and its Independent Registered Public Accounting Firm on any matter of accounting principles or practices of financial statement disclosures, or auditing scope or procedure.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of December 31, 2017, an evaluation was performed under the supervision and with the participation of the Company’s management, including the principal executive officer (“PEO”) and principal financial officer (“PFO”), of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Company’s PEO and PFO, concluded that the Company’s disclosure controls and procedures were effective as of December 31, 2017.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). In evaluating the Company’s internal control over financial reporting, management has adopted the framework in *Internal* Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). On January 31, 2017, the Company acquired Exploitatiemaatschappij Berghaaf B.V. (“Orlaco”) and is currently integrating Orlaco into its compliance programs and internal control processes. As permitted by SEC rules and regulations, the Company has excluded Orlaco from management’s evaluation of internal control over financial reporting as of December 31, 2017. Orlaco constituted approximately 22.9% of the Company’s total assets as of December 31, 2017, and approximately 7.9% of the Company’s net sales for the year then ended. Under the supervision and with the participation of our management, including the PEO and PFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting, as of December 31, 2017. Based on our evaluation under the framework in *Internal Control-Integrated Framework* (2013 Framework), our management has concluded that our internal control over financial reporting was effective as of December 31, 2017.

Because of 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.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2017 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There were no changes to our internal controls over financial reporting during the quarter ended December 31, 2017 that has materially or is reasonably likely to materially affect internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Stoneridge, Inc. and Subsidiaries

Opinion on Internal Control over Financial Reporting

We have audited Stoneridge, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Stoneridge, Inc. and Subsidiaries (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Exploitatiemaatschappij Berghaaf B.V. ("Orlaco"), which was acquired on January 31, 2017 and is included in the 2017 consolidated financial statements of the Company and constituted 22.9% and 38.7% of total and net assets, respectively, as of December 31, 2017 and 7.9% and 7.3% of revenues and net income, respectively, for the year then ended. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of Orlaco.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income (loss), cash flows and shareholders' equity for each of the three years in the period ended December 31, 2017 and the related notes and schedule of the Company and our report dated March 6, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's 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 generally accepted accounting principles. A company's 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; (2) 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 (3) 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.

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.

/s/ Ernst & Young LLP

Detroit, Michigan
March 6, 2018

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this Item 10 regarding our directors is incorporated by reference to the information under the sections and subsections entitled, “Proposal One: Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance” and “Corporate Governance” contained in the Company's Proxy Statement in connection with its Annual Meeting of Shareholders to be held on May 15, 2018. The information required by this Item 10 regarding our executive officers appears as a Supplementary Item following Item 1 under Part I, hereof.

Item 11. Executive Compensation.

The information required by this Item 11 is incorporated by reference to the information under the sections and subsections “Compensation Committee,” “Compensation Committee Interlocks and Insider Participation,” “Compensation Committee Report” and “Executive Compensation” contained in the Company's Proxy Statement in connection with its Annual Meeting of Shareholders to be held on May 15, 2018.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item 12 (other than the information required by Item 201(d) of Regulation S-K which is set forth below) is incorporated by reference to the information under the heading “Security Ownership of Certain Beneficial Owners and Management” contained in the Company's Proxy Statement in connection with its Annual Meeting of Shareholders to be held on May 15, 2018.

In May 2010, we adopted an Amended Directors’ Restricted Share Plan and an Amended and Restated Long-Term Incentive Plan, as amended. In May 2013, we adopted an Amended Directors’ Restricted Shares Plan and an Amended and Restated Long-Term Incentive Plan, as amended, to increase the number of shares available for issuance under the plans. In May 2016, we adopted the 2016 Long-Term Incentive Plan. Our shareholders approved each plan. Equity compensation plan information as of December 31, 2017 is as follows:

	Number of securities remaining available for future issuance under equity compensation plans (A)
Equity compensation plans approved by shareholders	1,474,595
Equity compensation plans not approved by shareholders	-

(A) Excludes 1,188,985 share units issued to key employees pursuant to the Company’s Amended and Restated Long-Term Incentive Plan, as amended and 35,504 restricted Common Shares issued and outstanding to directors under the Amended Directors’ Restricted Share Plan as of December 31, 2017.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item 13 is incorporated by reference to the information under the subsections “Transactions with Related Persons” and “Director Independence” contained in the Company's Proxy Statement in connection with its Annual Meeting of Shareholders to be held on May 15, 2018.

Item 14. Principal Accounting Fees and Services.

The information required by this Item 14 is incorporated by reference to the information under the subsections “Service Fees Paid to Independent Registered Accounting Firm” and “Pre-Approval Policy” contained in the Company's Proxy Statement in connection with its Annual Meeting of Shareholders to be held on May 15, 2018.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as part of this Form 10-K.

Page in Form 10-K

(1) Consolidated Financial Statements:

(2) Financial Statement Schedule:

(3) Exhibits:

80

Exhibit Number	Exhibit
2.1	Share Sale and Purchase Agreement, dated as of January 31, 2017, by and among Stoneridge B.V., Stoneridge, Inc., Wide-Angle Management B.V., Exploitatiemaatschappij Berghaaf B.V., and Henrie G. van Beusekom (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on February 1, 2017).
3.1	Second Amended and Restated Articles of Incorporation of the Company (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999).
3.2	Amended and Restated Code of Regulations of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007).
4.1	Common Share Certificate (incorporated by reference to Exhibit 4.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.1	Form of Directors' Restricted Shares Plan Grant Agreement under the Directors' Restricted Shares Plan, filed herewith*.
10.2	Agreement for the Purchase and Sale of Quotas of Capital of PST Electronica Ltda.("PST") between Stoneridge, Inc. and Adriana Campos De Cerqueira Leite and Marcos Feretti and PST, guarantor, dated May 16, 2017 (incorporated by reference to the Company's Current Report on Form 8-K filed on May 17, 2017).
10.3	Stoneridge, Inc. Deferred Compensation Plan (incorporated by reference in 10.1 to the Company's Current Report on Form 8-K filed on June 2, 2017).*
10.4	Annual Incentive Plan (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on May 12, 2016)*.
10.5	Stoneridge, Inc. Long-Term Cash Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009)*.
10.6	Amended and Restated Officers' and Key Employees' Severance Plan of Stoneridge, Inc., filed herewith*.
10.7	Stoneridge, Inc. Amended and Restated Long-Term Incentive Plan – Form of Restricted Shares Grant Agreement (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010)*.
10.8	Form of Phantom Share Grant Agreement under the Stoneridge, Inc. Long-Term Cash Incentive Plan (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010)*.

Exhibit Number	Exhibit
10.9	Amended and Restated Long-Term Incentive Plan, as amended (incorporated by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed with the SEC on August 5, 2013 (No. 333-172002)*.
10.10	Amended Directors' Restricted Share Plan (incorporated by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-8 filed with the SEC on August 5, 2013 (No. 333-172002))*.
10.11	First Amendment to the Stoneridge, Inc. Amended and Restated Long-Term Incentive Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on May 8, 2013)*.
10.12	Form of Performance Share Grant Agreement under the Stoneridge, Inc. Long-Term Incentive Plan, filed herewith*.
10.13	Form of Share Units Grant Agreement under the Stoneridge, Inc. 2016 Long-Term Incentive Plan, filed herewith*.
10.14	Stoneridge, Inc. 2016 Long-Term Incentive Plan (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on May 12, 2016)*.
10.15	First Amendment to the Stoneridge, Inc. Amended Directors' Restricted Shares Plan (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on May 8, 2013)*.
10.16	Amended and Restated Change in Control Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 21, 2011)*.
10.17	Employment Agreement, dated March 16, 2015, between the Company and Jonathan B. DeGaynor (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 19, 2015)*.
10.18	Indemnification Agreement between the Company and Jonathan B. DeGaynor (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on March 19, 2015).
10.19	Third Amended and Restated Credit Agreement by and among Stoneridge, Inc. and certain of its subsidiaries as borrowers and its lenders, dated September 12, 2014 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 15, 2014).
10.20	Amendment No. 1 to Third Amended and Restated Credit Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 31, 2015).
10.21	Amendment No. 2 to Third Amended and Restated Credit Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 24, 2016).
10.22	

	Amendment No. 3 to Third Amended and Restated Credit Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 17, 2016).
10.23	Consent and Amendment No. 4 to Third Amended and Restated Credit Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 1, 2017).

82

Exhibit Number	Exhibit
14.1	Code of Ethics for Senior Financial Officers (incorporated by reference to Exhibit 14.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
21.1	Principal Subsidiaries and Affiliates of the Company, filed herewith.
23.1	Consent of Independent Registered Public Accounting Firm, filed herewith.
31.1	Chief Executive Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
31.2	Chief Financial Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.1	Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
32.2	Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Labels Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
	* - Reflects management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(b) of this Annual Report on Form 10-K.

(b) The exhibits listed are filed as part of or incorporated by reference into this report.

(c) Additional Financial Statement Schedules.

None.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) 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.

STONERIDGE, INC.

Date: March 6, 2018 /s/ ROBERT R. KRAKOWIAK
Robert R. Krakowiak
Chief Financial Officer and Treasurer
(Principal Financial Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 6, 2018 /s/ JONATHAN B. DEGAYNOR
Jonathan B. DeGaynor

President, Chief Executive Officer and Director

(Principal Executive Officer)

Date: March 6, 2018 /s/ ROBERT R. KRAKOWIAK
Robert R. Krakowiak
Chief Financial Officer and Treasurer
(Principal Financial Officer)

Date: March 6, 2018 /s/ ROBERT J. HARTMAN JR.
Robert J. Hartman Jr.
Chief Accounting Officer
(Principal Accounting Officer)

Date: March 6, 2018 /s/ WILLIAM M. LASKY
William M. Lasky

Chairman of the Board of Directors

Date: March 6, 2018 /s/ JEFFREY P. DRAIME
Jeffrey P. Draime

Director

Date: March 6, 2018 /s/ DOUGLAS C. JACOBS
Douglas C. Jacobs

Director

Date: March 6, 2018 /s/ IRA C. KAPLAN
Ira C. Kaplan

Director

Date: March 6, 2018 /s/ KIM KORTH
Kim Korth

Director

Date: March 6, 2018 /s/ GEORGE S. MAYES, JR.
George S. Mayes, Jr.

Director

Date: March 6, 2018 /s/ PAUL J. SCHLATHER
Paul J. Schlather

Director