

STR HOLDINGS, INC.  
Form 10-Q  
August 10, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**FORM 10-Q**

**(mark one)**

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

**For the Quarterly Period Ended June 30, 2018**

**Or**

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

**For the transition period from            to**

**Commission file number 001-34529**

**STR Holdings, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**27-1023344**

(I.R.S. Employer Identification No.)

**10 Water Street, Enfield, Connecticut**

(Address of principal executive offices)

**06082**

(Zip Code)

**(860) 272-4235**

(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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

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

Large accelerated filer o Accelerated filer o

Non-accelerated filer o Smaller reporting company x  
Emerging growth company o

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

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

At July 31, 2018, there were 20,101,221 shares of Common Stock, par value \$0.01 per share, outstanding.

**INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**STR Holdings, Inc. and Subsidiaries**

**Three and Six Months Ended June 30, 2018**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****STR Holdings, Inc. and Subsidiaries****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)****All amounts in thousands except share and per share amounts**

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$11,710	\$ 13,499
Bank acceptance notes	—	904
Accounts receivable, trade, less allowances for doubtful accounts of \$1,734 and \$1,725 in 2018 and 2017, respectively	1,588	1,199
Inventories, net	1,357	1,110
Prepaid expenses	859	748
Other current assets	738	767
Total current assets	16,252	18,227
Property, plant and equipment, net	7,767	8,728
Assets held for sale (Note 7)	6,155	6,155
Other long-term assets	78	76
Total assets	\$30,252	\$ 33,186
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$1,451	\$ 971
Accrued liabilities (Note 8)	1,349	2,307
Income taxes payable	898	896
Due to factor	397	454
Total current liabilities	4,095	4,628
Deferred tax liabilities	969	698
Total liabilities	5,064	5,326
<b>COMMITMENTS AND CONTINGENCIES (Note 9)</b>		
Stockholders' Equity		
Preferred stock, \$0.01 par value, 20,000,000 shares authorized; no shares issued and outstanding	—	—
	200	195

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Common stock, \$0.01 par value, 200,000,000 shares authorized; 20,039,461 and 20,038,221 issued and outstanding, respectively, in 2018 and 19,919,529 and 19,918,289 issued and outstanding, respectively, in 2017

Treasury stock, 1,240 shares at cost	(57 )	(57 )
Additional paid-in capital	232,315	232,149
Accumulated deficit	(201,827)	(199,072 )
Accumulated other comprehensive loss, net	(5,443 )	(5,355 )
Total stockholders' equity	25,188	27,860
Total liabilities and stockholders' equity	\$30,252	\$ 33,186

See accompanying notes to these condensed consolidated financial statements.

**STR Holdings, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME****(unaudited)****All amounts in thousands except share and per share amounts**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net sales	\$2,515	\$3,057	\$6,261	\$6,770
Cost of sales	3,490	3,695	5,935	7,905
Gross (loss) profit	(975)	(638)	326	(1,135)
Selling, general and administrative expenses	1,380	1,299	3,072	3,280
Research and development expense	190	236	405	550
Provision (recovery) for bad debt expense	67	(215)	6	(380)
Operating loss	(2,612)	(1,958)	(3,157)	(4,585)
Interest income (expense), net	16	(3)	15	(7)
Other income, net	183	1,632	1,203	1,206
Loss on disposal of fixed assets	(383)	(16)	(383)	(13)
Foreign currency transaction loss	(106)	(64)	(162)	(75)
Loss before income tax expense (benefit)	(2,902)	(409)	(2,484)	(3,474)
Income tax expense (benefit)	172	(125)	271	(143)
Net loss	\$(3,074)	\$(284)	\$(2,755)	\$(3,331)
Other comprehensive (loss) income:				
Foreign currency translation (net of tax effect of \$(81), \$205, \$(36) and \$257, respectively)	(542)	501	(88)	631
Other comprehensive (loss) income	(542)	501	(88)	631
Comprehensive (loss) income	\$(3,616)	\$217	\$(2,843)	\$(2,700)
Net loss per share (Note 3):				
Basic	\$(0.16)	\$(0.02)	\$(0.14)	\$(0.18)
Diluted	\$(0.16)	\$(0.02)	\$(0.14)	\$(0.18)
Weighted-average shares outstanding (Note 3):				
Basic	19,669,353	18,913,427	19,607,204	18,839,391
Diluted	19,669,353	18,913,427	19,607,204	18,839,391

See accompanying notes to these condensed consolidated financial statements.

**STR Holdings, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)****All amounts in thousands**

	Six Months Ended June 30,	
	2018	2017
<b>OPERATING ACTIVITIES</b>		
Net loss	\$(2,755 )	\$(3,331 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	383	753
Stock-based compensation expense	161	252
Gain (loss) on disposal of property, plant and equipment	383	13
Provision (recovery) for bad debt expense	6	(380 )
Impairment of assets held for sale	—	267
Proceeds from insurance claim	—	1,475
Provision (recovery) for deferred taxes	271	(302 )
Customer forfeiture of deposit	(940 )	—
Changes in operating assets and liabilities:		
Accounts receivable	(637 )	1,010
Inventories, net	(269 )	(170 )
Other current assets	860	1,624
Accounts payable	244	(274 )
Accrued liabilities	67	233
Income taxes payable	4	2
Other, net	150	(23 )
Total net cash (used in) provided by operating activities	(2,072 )	1,149
<b>INVESTING ACTIVITIES</b>		
Capital investments	(36 )	(410 )
Proceeds from sale of fixed assets	238	—
Total net cash provided by (used in) investing activities	202	(410 )
<b>FINANCING ACTIVITIES</b>		
Factoring arrangement	(46 )	111
Total net cash (used in) provided by financing activities	(46 )	111
Effect of exchange rate changes on cash	127	175
Net change in cash and cash equivalents	(1,789 )	1,025
Cash and cash equivalents, beginning of period	13,499	12,379
Cash and cash equivalents, end of period	\$11,710	\$13,404



See accompanying notes to these condensed consolidated financial statements.

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

## **NOTE 1—BASIS OF PRESENTATION**

The accompanying Condensed Consolidated Financial Statements and the related interim information contained within the notes to the Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and the applicable rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information and quarterly reports on the Form 10-Q. Accordingly, they do not include all of the information and the notes required for complete financial statements. These Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2017, included in STR Holdings, Inc.’s (the “Company”) Annual Report on Form 10-K filed with the SEC on March 16, 2018. The unaudited interim Condensed Consolidated Financial Statements have been prepared on the same basis as the audited consolidated financial statements, and in the opinion of management, reflect all adjustments, consisting of only normal and recurring adjustments, necessary for the fair presentation of the Company’s financial position, results of operations and cash flows for the interim periods presented. The results for the interim periods presented are not necessarily indicative of future results.

The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from management’s estimates.

## **NOTE 2—RECENT ACCOUNTING PRONOUNCEMENTS AND ADOPTION**

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers” (Topic 606). This ASU is intended to clarify the principles for recognizing revenue by removing inconsistencies and weaknesses in revenue requirements; providing a more robust framework for addressing revenue issues; improving comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and providing more useful information to users of financial statements through improved revenue disclosure requirements. The provisions of this ASU are ultimately effective for interim and annual periods beginning after December 15, 2017. The standard shall be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. During 2016, the FASB clarified the

implementation guidance on principal versus agent, identifying performance obligations, licensing, and collectability.

The Company adopted the new revenue recognition standard (“ASC 606”) on January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with ASC 605, *Revenue Recognition*. The application of the standard had no impact on the Company’s consolidated financial statements for any periods prior to 2018. The adoption of ASC 606 represents a change in accounting principle to more closely align revenue recognition with the delivery of the Company’s products, licenses and services. ASC 606 requires an entity to evaluate revenue recognition by identifying a contract with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations in the contract, and recognizing revenue when (or as) the entity satisfies a performance obligation.

Revenue is principally derived from the sale and licensing of highly engineered plastic sheet and film products. The Company receives specific purchase orders for the manufacture, sale and delivery of these products that identify the goods and/or services to be transferred, the price for those goods and other commercial terms of the order. The goods are generally purchased under EXW (or EX-Works) terms, meaning that the customer is responsible for arranging the shipping of the goods and title passes when the goods are picked up from the Company’s dock. Revenue is recognized upon the transfer of title, and there are no price concessions, volume discounts, rebates, refunds, credits, incentives, performance bonuses, royalties or other types of variable consideration.

In the specific case of the Equipment Purchase Agreement and a Technology License Agreement (the “Agreements”) signed on January 16, 2018 for an aggregate transaction price of \$6,000, the Company will purchase from a third party specialized equipment (the “Equipment”) for the production of one of the Company’s proprietary encapsulants (the “Encapsulant”), resell the Equipment to the customer, install the Equipment at a facility of the customer and train the

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 2—RECENT ACCOUNTING PRONOUNCEMENTS AND ADOPTION (Continued)**

customer's personnel in the Equipment's use. Under the license agreement, the Company has granted the customer the right to use the formula for the Encapsulant and certain of the Company's production techniques to make or have made the Encapsulant for use in photovoltaic (PV) modules manufactured by the customer. For revenue recognition purposes, the Company defines the following three distinct major performance obligations of the Agreements and the corresponding transaction price allocated to those performance obligations:

- Obligation 1 - \$1,750 - Price Report, Formula and Sample
- Obligation 2 - \$2,000 - Equipment, including delivery & installation (incl. training)
- Obligation 3 - \$2,250 - License (perpetual)

Obligation 1 is considered to be separate and distinct from the other two obligations, in that the information provided under this obligation represents significant standalone value to the customer and the Company's obligation to provide this information is separately identifiable from the other obligations in the agreements. Obligation 2 and Obligation 3 were also clearly identifiable, as defined by the Equipment Purchase Agreement (including delivery and installation by an agreed-upon date) and the license ("License") granted pursuant to the Technology License Agreement (with an effective start date upon the receipt of an acceptance test payment).

The Company is applying a "cost-plus" approach to Obligation 1 and Obligation 2. As the Company had never before sold any type of license, had no established specific license pricing and had no knowledge of pricing for similar licenses, the Company is using the residual approach for Obligation 3. The License is perpetual, distinct and not combined with other goods and services, and is a right to use, rather than to access, functional intellectual property.

The Company also assessed whether it was acting in a principal or agent role in each performance obligation of the Agreements. In all obligations, the Company determined it was acting in the role of principal and therefore revenue is recognized on a gross basis.

As a result, the Company recognized \$1,750 in the quarter ended March 31, 2018 upon the satisfaction of Obligation 1, its delivery of a price report, formula and sample. The total transaction price of the Agreements is expected to be recognized as revenue as follows:

2018	2019(a)	Total
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Revenue expected to be recognized during the year ended December 31    \$1,750    \$4,250    \$6,000

- (a) \$2,000 upon installation of the Equipment and \$2,250 upon acceptance and commencement of the License.

There are no new accounting pronouncements that the Company believes may have a material impact on its consolidated financial statements.

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 3—LOSS PER SHARE**

The calculation of basic and diluted net loss per share for the periods presented is as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Basic and diluted net loss per share				
Numerator:				
Net loss	\$ (3,074 )	\$ (284 )	\$ (2,755 )	\$ (3,331 )
Denominator:				
Weighted-average shares outstanding	19,669,353	18,913,427	19,607,204	18,839,391
Add:				
Dilutive effect of stock options	—	—	—	—
Dilutive effect of restricted common stock	—	—	—	—
Weighted-average shares outstanding with dilution	19,669,353	18,913,427	19,607,204	18,839,391
Net loss per share:				
Basic	\$ (0.16 )	\$ (0.02 )	\$ (0.14 )	\$ (0.18 )
Diluted	\$ (0.16 )	\$ (0.02 )	\$ (0.14 )	\$ (0.18 )

Due to the net loss for the three and six months ended June 30, 2018 and 2017, the computation of dilutive weighted-average common shares outstanding does not include any stock options or any shares of unvested restricted common stock as these potential awards are anti-dilutive.

Because the effect would be anti-dilutive, there were 1,121,332 stock options outstanding that were not included in the computation of diluted weighted-average shares outstanding for each of the three and six months ended June 30, 2018. Similarly, there were 1,121,332 stock options outstanding that were not included in the computation of diluted weighted-average shares outstanding for each of the three and six months ended June 30, 2017.

**NOTE 4—BANK ACCEPTANCE NOTES**

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Customers in China may settle their accounts with bank acceptance notes, which are draft instruments that are guaranteed to be paid at maturity by the issuing bank. Upon receipt of the bank acceptance note, the Company can elect to hold the instrument until maturity and receive full face value, discount it with the bank for a fee, or transfer it at full face value to suppliers who will accept the note as settlement of the Company's accounts payable balance with them.

Bank acceptance notes consist of the following:

	June 30, 2018	December 31, 2017
Balance as of beginning of period	\$904	\$3,360
Received from customers	—	1,985
Converted to cash	(888)	(3,508 )
Paid to suppliers	—	(1,162 )
Foreign exchange impact	(16 )	229
Balance as of end of period	\$—	\$904

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 5—INVENTORIES**

Inventories consist of the following:

	June 30, December 31,	
	2018	2017
Finished goods	\$365	\$ 340
Raw materials	996	829
Reserve	(4 )	(59 )
Inventories, net	\$1,357	\$ 1,110

**NOTE 6—LONG-LIVED ASSETS*****Impairment Testing***

In accordance with ASC 360-Property, Plant and Equipment, the Company assesses the impairment of its long-lived assets whenever changes in events or circumstances indicate that the carrying value of such assets may not be recoverable. During each reporting period, the Company assessed if the following factors were present, which would cause an impairment review: overall negative solar industry conditions; a significant or prolonged decrease in net sales generated under its trademarks; loss of a significant customer or a reduction in demand for customers' products; a significant adverse change in the extent to or manner in which the Company used its trademarks or proprietary technology; such assets becoming obsolete due to new technology or manufacturing processes entering the markets or an adverse change in legal factors; and the market capitalization of the Company's common stock.

At June 30, 2018 and December 31, 2017, the Company recorded valuation allowances against its deferred tax assets. The valuation allowances were recorded since the Company had three consecutive years of taxable losses and determined that its history of actual net losses was evidence that should be given more weight than future projections. The Company determined the recording of valuation allowances against deferred tax assets to be an indicator to test its long-lived assets, which consist solely of property, plant and equipment, for impairment. The Company assessed the specific recoverability of its property, plant and equipment using updated real estate appraisals and other data for its other fixed assets, mainly production equipment. Based upon this analysis, the Company believes its property, plant and equipment carrying value was recoverable and depreciable lives were appropriate as of June 30, 2018. Therefore no impairment was recorded in 2018. If the Company experiences a significant reduction in future sales volume, further average selling price ("ASP") reductions, lower profitability, a cessation of operations at any of its



facilities, or negative changes in U.S. or Spain real estate markets, the Company's property, plant and equipment may be subject to future impairment or accelerated depreciation.

#### **NOTE 7—ASSETS HELD FOR SALE**

In July 2015, the Company announced a restructuring plan that included the closure of its Johor, Malaysia facility effective August 2, 2015. Subsequent to the announcement, the Company engaged advisors and was actively trying to sell its land-use right, building and other fixed assets located at the facility. During 2016, the Company entered into a definitive Purchase and Sale Agreement for the land-use right and the building for a purchase price of RM25,000. Closing of the transaction was subject to customary conditions to closing of transactions of this type, including the approval of the Johor Port Authority ("JPA"). On July 31, 2017, the Company received a notice from the purchaser purporting to terminate the agreement, alleging that the JPA was seeking to impose certain conditions on the approval of the transfer of the facility to the purchaser that it found unacceptable. The Company was not successful in removing those conditions, and the agreement terminated. The Company has re-launched the sale process for its Malaysia facility.

In accordance with ASC 360-Property, Plant and Equipment, the Company assessed the asset group attributed to the sale for impairment. Based upon the Company's assessment of the status of the Malaysia property, plant and equipment, all of the requirements (including the held for sale requirements) set forth in ASC 360-10-45-9 were met and the assets were classified on the Condensed Consolidated Balance Sheet as of June 30, 2018 and December 31, 2017 as assets held for sale. An impairment loss of \$267, related to the foreign currency fluctuation of the Ringgit, was recorded in the Company's Condensed Consolidated Statement of Comprehensive (Loss) Income in other expense, net during the first half of 2017.

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 8—ACCRUED LIABILITIES**

Accrued liabilities consist of the following:

	June 30, December 31,	
	2018	2017
Salaries and wages	\$ 323	\$ 239
Accrued bonus	210	258
Professional fees	285	319
Restructuring severance and benefits (see Note 10)	102	87
Environmental (see Note 9)	57	57
Accrued franchise tax	79	90
Client deposits	179	1,157
Other	114	100
Total accrued liabilities	\$ 1,349	\$ 2,307

**NOTE 9—COMMITMENTS AND CONTINGENCIES**

The Company is a party to claims and litigation in the normal course of its operations. Management believes that the ultimate outcome of these matters will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

***Product Performance***

The Company provides a short-term warranty that it has manufactured its products to the Company's specifications. On limited occasions, the Company incurs costs to service its products in connection with specific product performance matters that do not meet the Company's specifications. Anticipated future costs are recorded as part of cost of sales and accrued liabilities for specific product performance matters when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated.

On isolated occasions, the Company has also offered limited short-term performance warranties relating to its encapsulants not causing module power loss. The Company's encapsulants are validated by long-term performance

testing during product development prior to launch and during customer certification prior to mass production. The Company has operated its solar business since the 1970s and over 20 GW of solar modules incorporating its encapsulants have been installed in the field with no reported module power performance issues caused by the Company's encapsulants and no related warranty claims to date. Based on this fact pattern, the Company has not accrued any warranty liability associated for this potential liability as its occurrence is deemed to be remote. If the Company was to ever receive a warranty claim for such matter, the Company would assess the need for a warranty accrual at that time.

The Company's product performance liability that is recorded in accrued liabilities in the Condensed Consolidated Balance Sheets was \$0 as of each June 30, 2018 and December 31, 2017.

### ***Environmental***

During 2010, the Company performed a Phase II environmental site assessment at its 10 Water Street, Enfield, Connecticut location. During its investigation, the site was found to contain a presence of volatile organic compounds. The Company has been in contact with the Department of Environmental Protection and has engaged a licensed contractor to remediate this circumstance. Based on ASC 450-Contingencies, the Company has accrued the estimated cost to remediate. The Company's environmental liability that is recorded in accrued liabilities in the Condensed Consolidated Balance Sheets was \$57 as of June 30, 2018 and December 31, 2017.

### ***Solaria***

In October 2016, a complaint was filed by Solaria Energia y Medio Ambiente S.A.U. ("Solaria") against the Company and its Spanish subsidiary, Specialized Technology Resources España S.A.U. ("STR Spain"), in the Court of the First Instance No. 8 in Oviedo, Spain, relating to a product quality claim in connection with a non-encapsulant product that STR Spain

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 9—COMMITMENTS AND CONTINGENCIES (Continued)**

purchased from a vendor in 2005 and 2006 and resold to Solaria. The Company stopped selling this product in 2006. Solaria is seeking approximately €3,300, plus interest, in damages.

A trial was held on April 6, 2017 in Oviedo, Spain, and the Company is currently awaiting a ruling from the court. The Company believes that it has product liability insurance coverage for claims of this nature, excluding the original product cost but including defense costs. The Company believes it has meritorious defenses and does not believe a loss is probable or can be reasonably estimated. As such, no accrual relating to this complaint was recorded as of June 30, 2018 and December 31, 2017.

**NOTE 10—COST-REDUCTION ACTIONS**

In March 2017 the Company made the decision to wind down its China manufacturing operations substantially by the end of the second quarter of 2017. The decision was consistent with ongoing efforts to reorganize its encapsulant business to better align with customer geography, to reduce losses related to unprofitable locations and to convert assets to cash for potential redeployment into more profitable endeavors. In connection with the restructuring, the Company does not expect any significant asset impairment charges and recorded \$93 of severance charges and benefits in cost of sales and \$48 of severance charges and benefits in selling, general and administrative expenses during the first six months of 2017 and \$67 of severance charges during the first six months of 2018. The Company sold certain production and testing equipment from the China facility to its tolling partner in India during the third quarter of 2017.

In June 2018, the Company eliminated certain positions at its Spain facility, effective June 18, 2018. The Company recorded \$588 of severance and benefits in cost of sales and \$67 of severance and benefits in selling, general and administrative expenses during the second quarter of 2018.

The restructuring accrual consists of \$102 for severance and benefits as of June 30, 2018. A rollforward of the severance and other exit cost accrual activity is as follows:

	June 30, 2018	June 30, 2017
Balance as of beginning of year	\$ 87	\$269
Additions	722	143
Reductions	(707 )	(177)
Reversals	—	(120)
Balance as of end of period	\$ 102	\$115

**NOTE 11—FAIR VALUE MEASUREMENTS**

The Company measures certain financial assets and liabilities at fair value on a recurring basis in the financial statements. The hierarchy ranks the quality and reliability of inputs, or assumptions, used in the determination of fair value

and requires financial assets and liabilities carried at fair value to be classified and disclosed in one of the following three categories:

- Level 1-quoted prices (unadjusted) in active markets for identical assets and liabilities;
- Level 2-unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability; and
- Level 3-unobservable inputs that are not corroborated by market data.

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 11—FAIR VALUE MEASUREMENTS (Continued)**

The following table provides the fair value measurements of applicable financial assets and liabilities as of June 30, 2018:

	Financial assets and liabilities at fair value as of June 30, 2018		
	Level 1	Level 2	Level 3
Money market funds (1)	\$ 7,605	\$ —	\$ —
Bank acceptance notes (2)	—	—	—
Non-recurring fair value measurements (3)	—	—	6,155
Total	\$ 7,605	\$ —	\$ 6,155

The following table provides the fair value measurements of applicable financial assets and liabilities as of December 31, 2017:

	Financial assets and liabilities at fair value as of December 31, 2017		
	Level 1	Level 2	Level 3
Money market funds (1)	\$ 6,688	\$ —	\$ —
Bank acceptance notes (2)	904	—	—
Non-recurring fair value measurements (3)	—	—	6,155
Total	\$ 7,592	\$ —	\$ 6,155

(1) Included in cash and cash equivalents on the Company's Condensed Consolidated Balance Sheets. The carrying amount of money market funds is a reasonable estimate of fair value due to the short-term maturity.

(2) Refer to Note 4 for further information

(3) Included in assets held for sale on the Company's Condensed Consolidated Balance Sheets. Refer to Note 7 for further information.

**NOTE 12—FACTORING ARRANGEMENT**

In October 2015, the Company's wholly owned Spanish subsidiary, STR Spain, entered into a factoring agreement to sell, with recourse, certain European, U.S. and other foreign company-based receivables to Eurofactor Hispania S.A.U., who was later acquired by Credit Agricole Leasing and Factoring Sucursal en España during the first quarter of 2017. Under the current terms of the factoring agreement, the maximum amount of outstanding advances at any one time is €1,500 (approximately \$1,752 as of June 30, 2018), which is subject to adjustment based on the level of eligible receivables, restrictions on concentrations of receivables and the historical performance of the receivables sold. The annual discount rate is 2% plus EURIBOR for Euro denominated receivables and 2% plus LIBOR for all other currencies. The term of the agreement is for one year, which will be automatically extended unless terminated by either party with 90 days prior written notice. As of June 30, 2018 and December 31, 2017 the Company has recorded \$397 and \$454, respectively, as due to factor on the Condensed Consolidated Balance Sheets.

#### **NOTE 13—INCOME TAXES**

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law in the United States. The legislation contains several key tax provisions including the reduction of the corporate income tax rate to 21% effective January 1, 2018, a one-time transition tax on foreign earnings which have not previously been subject to tax in the United States, as well as a variety of other changes, including limitation of the tax deductibility of interest expense, limitations for the deduction for net operating losses, new taxes on certain foreign-sourced earnings, and modification or repeal of many business deductions and credits.

The SEC staff issued SAB 118 which allows companies to record provisional amounts during a one-year measurement period. At December 31, 2017, the Company has not completed its accounting for the tax effects of the

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 13—INCOME TAXES (Continued)**

enactment of the TCJA; however, the Company estimated what it believes to be the effects of the TCJA on its existing deferred tax balances and the one-time transition tax, and recorded a provisional estimate for these tax effects.

During the three and six months ended June 30, 2018, the Company did not record any measurement period adjustments to the provisional estimates recorded at December 31, 2017. Final accounting for these impacts is expected in the third quarter of 2018 subsequent to the Company's completion of the 2017 tax return.

The TCJA subjects a U.S. shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries for which an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. Given the complexity of the GILTI provisions, the Company is still evaluating the effects of the GILTI provisions and has not yet determined its accounting policy. As of June 30, 2018, the Company does not anticipate a GILTI inclusion for the taxable year. The Company will continue to assess forthcoming guidance and accounting

interpretations on the effects of the TCJA and expects to complete its analysis within the measurement period in accordance with the SEC guidance.

During the three and six months ended June 30, 2018, the Company recorded an income tax expense of \$172 and \$271 resulting in an effective tax rate of (5.9%) and (10.9%), respectively. This effective tax rate for the three months ended June 30, 2018 differs from the U.S. statutory tax rate primarily due to the effect of taxes on foreign earnings.

There was no provision or benefit for federal, foreign or state income taxes for the three and six months ended June 30, 2017 other than income tax benefit of \$125 and \$143, respectively, resulting from an intra-period tax allocation between operations and other comprehensive income.

**NOTE 14—STOCKHOLDERS' EQUITY**

Changes in stockholders' equity for the six months ended June 30, 2018 are as follows:



	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
	Issued	Amount	Acquired	Amount				
Balance at December 31, 2017	19,532,573	\$ 195	1,240	\$ (57 )	\$ 232,149	\$ (5,355 )	\$ (199,072 )	\$ 27,860
Stock-based compensation	505,648	5	—	—	166	—	—	171
Net loss	—	—	—	—	—	—	(2,755 )	(2,755 )
Foreign currency translation, net of tax	—	—	—	—	—	(88 )	—	(88 )
Balance at June 30, 2018	20,038,221	\$ 200	1,240	\$ (57 )	\$ 232,315	\$ (5,443 )	\$ (201,827 )	\$ 25,188

### *Common Stock*

The Company's Board of Directors has authorized 200,000,000 shares of common stock, \$0.01 par value. At June 30, 2018, there were 20,039,461 shares issued and 20,038,221 shares outstanding of common stock. Each share of common

stock is entitled to one vote per share.

### **NOTE 15—STOCK-BASED COMPENSATION**

On November 6, 2009, the Company's Board of Directors approved the Company's 2009 Equity Incentive Plan (the "2009 Plan"), which became effective on the same day. Effective May 14, 2013, the 2009 Plan was amended to increase the number of shares subject to the 2009 Plan. As a result, a total of 4,133,133 shares of common stock were reserved for issuance under the 2009 Plan. The 2009 Plan is administered by the Board of Directors or any committee designated by the Board of Directors, which has the authority to designate participants and determine the number and type of awards to be granted, the time at which awards are exercisable, the method of payment and any other terms or conditions of the awards. The 2009 Plan provides for the grant of stock options, including incentive stock options and nonqualified stock options (collectively, "options"), stock appreciation rights, shares of restricted stock, or "restricted stock," rights to dividend equivalents and other stock-based awards (collectively, the "awards"). The Board of Directors or the committee will, with regard to each award,

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 15—STOCK-BASED COMPENSATION (Continued)**

determine the terms and conditions of the award, including the number of shares subject to the award, the vesting terms of the award, and the purchase price for the award. Awards may be made in assumption of or in substitution for outstanding awards previously granted by the Company or its affiliates, or a company acquired by the Company or with which it combines. Options outstanding generally vest over a three or four-year period and expire ten years from the date of grant. There were 431,131 shares available for grant under the 2009 Plan as of June 30, 2018.

The following table summarizes the options activity under the Company's 2009 Plan for the six months ended June 30, 2018:

	Options Outstanding				Aggregate Intrinsic Value <sup>(1)</sup>
	Number of Shares	Weighted-Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Weighted- Average Grant-Date Fair Value	
Balance at December 31, 2017	1,121,332	\$ 1.52	—	\$ 0.99	\$(1,402 )
Options granted	—	\$ —	—	\$ —	\$ —
Exercised	—	\$ —	—	\$ —	\$ —
Canceled/forfeited	—	\$ —	—	\$ —	\$ —
Balance at June 30, 2018	1,121,332	\$ 1.52	6.61	\$ 0.99	\$(1,402 )
Vested and exercisable as of June 30, 2018	1,121,332	\$ 1.52	6.61	\$ 0.99	\$(1,402 )
Vested and exercisable as of June 30, 2018 and expected to vest thereafter	1,121,332	\$ 1.52	6.61	\$ 0.99	\$(1,402 )

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of \$0.27 of the Company's common stock on June 30, 2018.

As of June 30, 2018, there was \$0 of unrecognized compensation cost related to outstanding stock option awards. The Company did not receive any proceeds related to the exercise of stock options for the six months ended June 30, 2018.

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The following table summarizes the restricted common stock activity of the Company for the six months ended June 30, 2018:

	Unvested Restricted Shares	Weighted- Average Grant-Date Fair Value
Unvested at December 31, 2017	385,716	\$ —
Granted	119,932	\$ —
Vested	(505,648)	\$ 0.28
Unvested at June 30, 2018	—	\$ —
Expected to vest after June 30, 2018	—	\$ —

Stock-based compensation expense was included in the following Condensed Consolidated Statements of Comprehensive Loss categories for operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Selling, general and administrative expense	\$ 88	\$ 132	\$ 161	\$ 252
Total stock-based compensation expense	\$ 88	\$ 132	\$ 161	\$ 252

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 16—GEOGRAPHICAL INFORMATION**

ASC 280-10-50 Disclosure about Segments of an Enterprise and Related Information establishes standards for the manner in which companies report information about operating segments, products, geographic areas and major customers. The method of determining what information to report is based on the way that management organizes the operating segment within the enterprise for making operating decisions and assessing financial performance. The Company focuses on the manufacturing, sale and licensing of highly engineered plastic sheet and film products to customers throughout the world. The Company procures raw materials from multiple similar vendors and expects similar long-term economic characteristics for its products.

**Operations by Geographic Area**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net Sales				
Spain	\$ 1,906	\$ 2,042	\$ 3,382	\$ 3,754
China	—	983	30	2,974
India	478	—	904	—
United States	131	32	1,945	42
Total Net Sales	\$ 2,515	\$ 3,057	\$ 6,261	\$ 6,770

**Long-Lived Assets by Geographic Area**

	June 30, December 31,	
	2018	2017
Long-Lived Assets		
United States	\$ 1,237	\$ 1,311
Spain	6,454	7,141
China	76	276
Total Long-Lived Assets	\$ 7,767	\$ 8,728

Foreign sales are based on the country in which the sales originated. Net sales to four of the Company's major customers that exceeded 10% of the Company's consolidated net sales for the three months ended June 30, 2018 were \$1,401. Net sales to two of the Company's major customers that exceeded 10% of the Company's consolidated net sales

for the six months ended June 30, 2018 were \$1,444. Net sales to one of the Company's major customers that exceeded 10% of the Company's consolidated net sales for the three and six months ended June 30, 2018 were \$683 and \$1,330, respectively. Accounts receivable from two customers amounted to \$1,072 and \$70 as of June 30, 2018 and December 31, 2017, respectively.

#### **NOTE 17—RELATED PARTY TRANSACTION**

##### Huhui Supply Agreement

The Company's Chinese subsidiary, Specialized Technology Resources Solar (Suzhou) Co. Ltd. ("STR China") entered into a supply agreement (the "Huhui Supply Agreement") dated as of December 31, 2014 with Zhangjiagang Huhui Segpv Co. Ltd ("Huhui"), a solar module manufacturer and an affiliate of Zhenfa. Pursuant to the Huhui Supply Agreement, STR China agreed to supply Huhui with the Company's encapsulant products and Huhui agreed (i) to purchase

not less than 535 MW worth of encapsulants (the "Minimum Amount") during each contract year, (ii) to pay the Company a deposit equal to 10% of the Minimum Amount, and (iii) not to purchase encapsulant products from other encapsulant manufacturers. The initial term of the Huhui Supply Agreement was for one year; however, such initial term was extended due to failure by Huhui to purchase the Minimum Amount at the end of the first year anniversary of the effective date of the Huhui Supply Agreement. The Huhui Supply Agreement further provided that Huhui's obligations were contingent (unless otherwise provided in the agreement) upon (i) the delivery by STR China of an initial shipment of products in accordance with the specifications and (ii) the qualification of the products by Huhui during a sample production run of not less than 30 days. As of December 31, 2017, Huhui had not commenced the sample production run. The Huhui Supply Agreement automatically renewed for additional one year terms if either party failed to notify the other party at least 90 days prior to the

STR Holdings, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

All amounts in thousands except share amounts, per share amounts or unless otherwise noted

**NOTE 17—RELATED PARTY TRANSACTION (Continued)**

end of the then current term that it was electing to terminate the agreement. The Company believes that the terms and conditions set forth in the Huhui Agreement at that time were fair and reasonable to the Company. The Company received

\$1,148 as a deposit from Huhui during the year ended December 31, 2015, which was included in accrued liabilities on the Condensed Consolidated Balance Sheets.

Huhui did not complete its 30 day production run as contemplated under the Supply Agreement and on March 27, 2018, following the approval of the Company's Special Committee of Continuing Directors, STR China entered into an agreement to terminate the Supply Agreement (the "Termination Agreement"). Pursuant to the Termination Agreement,

Huhui agreed that STR China would retain the Deposit, and each of Huhui and STR China agreed to release the other from any liability or further obligations under the Supply Agreement. The Company recognized the full amount of the deposit as other income on the Condensed Consolidated Statement of Comprehensive Income (Loss).

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

The following discussion and analysis of the financial condition and results of our operations should be read together with our Condensed Consolidated Financial Statements and the related Notes to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements, based on current expectations and related to future events and our future financial performance, that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those set forth under Item 1A,—Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended by Form 10-K/A filed with the SEC on April 28, 2018.

### **Forward-Looking Statements**

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to inherent risks and uncertainties. These forward-looking statements present our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business and are based on assumptions that we have made in light of our industry experience and perceptions of historical trends, current conditions, expected future developments and other factors management believes are appropriate under the circumstances. However, these forward-looking statements are not guarantees of future performance or financial or operating results. Forward-looking statements include, but are not limited to, the statements regarding the following: (1) incurring substantial losses for the foreseeable future and our inability to achieve or sustain profitability in the future; (2) the potential impact of pursuing strategic alternatives, including dissolution and liquidation of our Company, winding up our operations in China, restructuring our business to align with our customers' geography; (3) our reliance on a single product line and any contemplated pursuits of new market sectors; (4) our securing net sales to new customers, growing net sales to existing key customers and increasing our market share; (5) customer concentration in our business and our relationships with and dependence on key customers; (6) the outsourcing arrangements and reliance on third parties for the manufacture of a portion of our encapsulants; (7) technological changes in the solar energy industry or our failure to develop and introduce or integrate new technologies could render our encapsulants uncompetitive or obsolete; (8) competition; (9) excess capacity in the solar supply chain; (10) demand for solar energy in general and solar modules in particular; (11) our operations and assets in China and India being subject to significant political and economic uncertainties; (12) limited legal recourse under the laws of China and India if disputes arise; (13) our ability to adequately protect our intellectual property, particularly during the outsource manufacturing of our products; (14) our lack of credit facility and our inability to obtain credit; (15) a significant reduction or elimination of government subsidies and economic incentives or a change in government policies that promote the use of solar energy; (16) volatility in commodity costs; (17) our customers' financial profile causing additional credit risk on our accounts receivable; (18) our dependence on a limited number of third-party suppliers for raw materials for our encapsulants and other significant materials used in our process; (19) potential product performance matters and product liability; (20) our substantial international operations and shift of business focus to India; (21) the impact of changes in foreign currency exchange rates on financial results, and the geographic distribution of revenues; (22) losses of financial incentives from government bodies in certain foreign jurisdictions; (23) the ability to successfully complete our investment in Spain on a timely basis or within

budget, if at all, or that we will be able to achieve our anticipated revenue, earnings or payback from this new investment; (24) that we will be able to timely collect the full amount of the insurance proceeds that we anticipate to support this project, or that we will be able to obtain the loan we have applied for from the regional government on favorable terms if at all and (25) the other risks and uncertainties described under “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in subsequent periodic reports on Form 10-K, 10-Q and 8-K. You are urged to carefully review and consider the disclosure found in our filings, which are available on <http://www.sec.gov> or <http://www.strsolar.com>. Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove to be incorrect, actual results may vary materially from those projected in these forward-looking statements. We undertake no obligation to publicly update any forward-looking statement contained in this Quarterly Report, whether as a result of new information, future developments or otherwise, except as may be required by law.

## Overview

STR Holdings, Inc. and its subsidiaries (“we”, “us”, “our” or the “Company”) commenced operations in 1944 as a plastics and industrial materials research and development company. Based upon our expertise in polymer science, we evolved into a global provider of encapsulants to the solar industry. Encapsulant is a critical component used to protect and hold solar modules together.

We were the first to develop ethylene-vinyl acetate (“EVA”) based encapsulants for use in commercial solar module manufacturing. Our initial development effort was conducted while under contract to the predecessor of the U.S. Department of Energy in the 1970s. Since that time, we have expanded our solar encapsulant business, by investing in research and development and global production capacity.



### ***Recent Developments***

***Wind-down of China Manufacturing Operations.*** Our business unit in China (“STR China”) incurred a loss of approximately \$5.8 million during 2016, including a bad debt expense of \$1.5 million. In October 2016, a fire destroyed one of our two China-based production lines and caused substantial damage to our building and some of our ancillary equipment. In light of continued poor financial results of STR China, as well as the effects of the fire, we conducted an orderly wind down of our China manufacturing operations to reduce operating losses related to this business unit. By the close of 2017, we effectively completed the wind down process, with only a small administrative team remaining in an office under a short-term lease.

***India Tolling Plan.*** A review of our production in China revealed that our sales volume was shifting to customers in India. Moreover, our customers in India generally were more reliable in terms of payment and pricing than our customers in China. In conjunction with our wind down of manufacturing operations in China, we have entered into an agreement with a tolling partner in India. We sold our undamaged production line from STR China to this tolling partner and it is now in commercial operation making STR-formulated encapsulant products. By using a tolling partner, our goal is to continue to serve and grow our customer base in India without having to make a significant direct capital investment. We have not worked with our tolling partner in India prior to 2017 and we cannot ensure that the tolling partner will provide us with the support we anticipate or that we can otherwise successfully manage our collaboration with our tolling partner. If problems develop in our relationship with our India tolling partner, or if such party fails to perform as expected, it could lead to product defects, manufacturing and shipping delays, significant cost increases, changes in our strategies, and even failure of our initiatives, each of which may have a material adverse effect on our business, financial condition, and results of operations. We cannot assure that the India tolling plan will continue to be successful or that it is sustainable in the long term. We recently sold an additional production line to our tolling partner to enable the tolling partner to further increase its manufacturing capacity in India.

We continue to reorganize our encapsulant business to better align with customer geography, to reduce the cash burn related to unprofitable locations, to convert assets to cash for potential redeployment into more profitable endeavors and possible business opportunities in potentially more profitable parts of the solar supply-chain, and to evaluate other strategic alternatives.

***High-End Food Packaging.*** In the fourth quarter of 2017, we initiated a significant investment through our wholly-owned subsidiary in Spain to enter the high-end food packaging business. This investment, which leverages our plastics expertise, includes the purchase of new, state-of-the-art plastics processing equipment and related building improvements along with the addition of experienced staff to pursue manufacturing and sales of high-end food packaging products. As anticipated, we have received and applied certain conditional insurance proceeds to this project (see “Manufacturing Facility Fire” below), helping to offset our net capital investment. These insurance proceeds are available to the Company only if we invest in new plastics manufacturing equipment. We have been advised by our insurer that our investment qualifies for reimbursement under the terms of our policy and, accordingly, they paid

our U.S. entity the amount of \$0.8 million in October 2017, to cover the cost of the deposit for the primary capital equipment. We expect them to reimburse our U.S. entity for approximately an additional \$1.8 million during 2018 as we continue to make qualifying capital investment under the packaging project. We have also applied for loans of up to €2.0 million from the regional government of Asturias, Spain to further support the project. Subject to the timely purchase and installation of equipment, we expect to begin production by 2019. The food packaging business is highly competitive having market participants with substantially more resources and experience than us. We will be a new entrant in this market and we cannot assure you that we will be successful in this new endeavor. In particular, we cannot assure that we will be able to successfully complete our investment in this new business on a timely basis or within budget, if at all, or that we will be able to achieve our anticipated revenue or earnings from this new investment. Nor can we assure that we will be able to timely collect the full amount of the insurance proceeds that we anticipate to support this project, or that we will be able to obtain the loan(s) we have applied for from the regional government on favorable terms if at all.

***Alternative Transactions.*** In the event that we are not successful in restructuring our plastics manufacturing business, in entering into the high-end food packaging business, or in completing other strategic transactions, we also intend to consider alternatives, including without limitation, the acquisition of another business, the divestiture of all or certain of our assets, joint ventures and other transactions outside the ordinary course of business.

If we are unsuccessful in executing on our strategic plans to ultimately achieve profitability by reorganizing our plastics manufacturing business and entering the high-end packaging business, we may also decide to wind down or cease any or all of our operations.

In addition, any wind-down or dissolution may be a lengthy and complex process, yield unexpected results and delay any potential distributions to our stockholders. Such process may also require the further expenditure of our resources, such as legal, accounting and other professional fees and expenses and other related charges, which would decrease the amount of assets available for distribution to our stockholders.

***Manufacturing Facility Fire.*** During the fourth quarter of 2016, we recorded a \$0.9 million loss on disposal of fixed assets attributable to our Manufacturing Facility Fire. During 2017, STR China received interim payments totaling RMB12.7 million (approximately \$1.9 million as of June 30, 2018) from our local China insurance carrier related to the existing fire insurance claim. During 2017, we also received \$0.8 million in the U.S. under the master property insurance plan related to the same claim. These payments do not represent a final settlement, and we continue to work with our agents and the carrier to finalize the claim.

***Equipment Purchase Agreement and Technology License Agreement.*** On January 16, 2018, we entered into an equipment purchase agreement and a technology license agreement (together, the “Agreements”) with a manufacturer of solar photovoltaic (PV) modules (the “Purchaser”).

Under the equipment purchase agreement, the Company will purchase from a third party specialized equipment (the “Equipment”) for the production of one of the Company’s proprietary encapsulants (the “Encapsulant”), resell the Equipment to the Purchaser, install the Equipment at a facility of the Purchaser and train Purchaser personnel in the Equipment’s use. Under the technology license agreement, the Company has granted the Purchaser the right to use the formula for the Encapsulant and certain of the Company’s production techniques to make or have made the Encapsulant for use in PV modules manufactured by the Purchaser. The license granted to the Purchaser pursuant to the technology license agreement is exclusive with respect to specified types of PV modules manufactured by the Purchaser, and nonexclusive as to all other types of PV modules. The Purchaser may also sublicense its rights under the technology license agreement to licensees of its PV module manufacturing processes.

Under the Agreements, the Purchaser will pay the Company an aggregate of \$6.0 million. Billing and payment under the Agreements follows a schedule involving certain milestones relating to the qualification of the Encapsulant and installation, acceptance and operation of the Equipment. The Company received the initial payment of \$1.8 million during the first quarter of 2018, with the balance to follow during the remainder of 2018 and 2019 as milestones occur. For revenue recognition purposes under ASC 606, \$1.8 million was recorded as revenue during the first quarter of 2018 as initial performance obligations were satisfied, and the Company expects that the balance of the \$6.0 million aggregate amount will be recognized as revenue when the remaining performance obligations are fulfilled. See

Note 2 to the Consolidated Financial Statements.

The Company does not expect the Agreements to impact or otherwise displace any of its existing business in the solar encapsulant market.

### **2014 Transaction with Zhenfa**

In 2014, we entered into certain definitive agreements with Zhenfa Energy Group Co., Ltd., a Chinese limited liability company (“Zhenfa”), and its indirect wholly owned subsidiary, Zhen Fa New Energy (U.S.) Co., Ltd., a Nevada corporation (“Zhenfa U.S.”).

#### ***Purchase Agreement***

On August 11, 2014, we entered into a Stock Purchase Agreement (the “Purchase Agreement”) with Zhenfa U.S., pursuant to which Zhenfa U.S. acquired approximately 51% of our then outstanding shares of common stock on December 15, 2014 (the “Closing Date”).

#### ***Sales Service Agreement***

In connection with the execution of the Purchase Agreement, Specialized Technology Resources, Inc., our wholly owned subsidiary, entered into a sales service agreement (the "Sales Service Agreement") with Zhenfa, whereby Zhenfa agreed, among other things, to assist us in a number of endeavors, including, without limitation, marketing and selling our products in China, acquiring local raw materials, hiring and training personnel in China, and complying with Chinese law. The Sales Service Agreement became effective on the date of Closing, for an initial term of two years, and automatically renews for one year periods unless terminated earlier. The Sales Service Agreement may also be terminated by either party at such time as Zhenfa and its affiliates own less than 10% of our outstanding common stock.

As we have substantially discontinued operations in China, Zhenfa is not currently providing us with any material services under this agreement. Any activities with Zhenfa under the Sales Service Agreement are subject to the oversight of our Special Committee of Continuing Directors.

## CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our interim Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses, and related disclosures of contingent assets and liabilities. We continually evaluate our estimates, including those related to bad debts, valuation of inventory, long-lived assets, product performance matters, income taxes, stock-based compensation and deferred tax assets and liabilities. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. The accounting policies we believe to be most critical to understand our financial results and condition and that require complex and subjective management judgments are discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies” in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2018, as amended by Form 10-K/A filed with the SEC on April 28, 2018.

There have been no changes in our critical accounting policies during the quarter ended June 30, 2018.

## RESULTS OF OPERATIONS

### Condensed Consolidated Results of Operations

The following tables set forth our condensed consolidated results of operations for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net sales	\$2,515	\$3,057	\$6,261	\$6,770

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Cost of sales	3,490	3,695	5,935	7,905
Gross (loss) profit	(975 )	(638 )	326	(1,135)
Selling, general and administrative expenses	1,380	1,299	3,072	3,280
Research and development expense	190	236	405	550
Provision (recovery) for bad debt expense	67	(215 )	6	(380 )
Operating loss	(2,612 )	(1,958 )	(3,157)	(4,585)
Interest income (expense), net	16	(3 )	15	(7 )
Other income, net (Note 8)	183	1,632	1,203	1,206
Loss on disposal of fixed assets	(383 )	(16 )	(383 )	(13 )
Foreign currency transaction loss	(106 )	(64 )	(162 )	(75 )
Loss before income tax expense (benefit)	(2,902 )	(409 )	(2,484)	(3,474)
Income tax expense (benefit)	172	(125 )	271	(143 )
Net loss	\$(3,074 )	\$(284 )	\$(2,755)	\$(3,331)

*Net Sales*

	Three Months Ended June 30,				Change	Six Months Ended June 30,				Change		
	2018		2017			2018		2017				
	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	%	Amount	% of Total Net Sales	Amount	%		
Net sales	\$2,515	100.0%	\$3,057	100.0%	\$(542)	(17.7)%	\$6,261	100.0%	\$6,770	100.0%	\$(509)	(7.5)%

The decrease in net sales for the three months ended June 30, 2018 compared to the corresponding period in 2017 was driven by an approximate 30% decrease in sales volume partially offset by a 16% increase in our average selling price (“ASP”).

The volume decline was primarily driven by a 21% decrease in Spain and a 100% decrease in China, partially offset by sales to customers in India through our tolling partner.

The decrease in net sales for the six months ended June 30, 2018 compared to the corresponding period in 2017 was driven by a \$2.3 million reduction in encapsulant sales partially offset by recognition of \$1.8 million related to completed performance obligations under the equipment purchase agreement and the technology license agreement. The decrease in encapsulant sales was primarily attributable to an approximate 45% decrease in sales volume that was partially offset by an approximate 21% increase in our ASP, relating to our discontinuance of our lower priced sales in China.

The volume decline was primarily driven by a 25% volume decrease in Spain and a 99% volume decrease in China, partially offset by sales to customers in India through our tolling partner. The increase in ASP was primarily attributable to our elimination of our lower priced and unprofitable sales in China.

On a sequential basis, net sales decreased by \$1.2 million, or 32.9%, compared to the three months ended March 31, 2018. This decrease was primarily driven by recognition of \$1.8 million related to completed performance obligations under the equipment purchase agreement and the technology license agreement during the first quarter, partially offset by a 24% increase in encapsulant sales volume and a 1% increase in ASP.

### *Cost of Sales*

	Three Months Ended June 30,				Six Months Ended June 30,				Change		
	2018		2017		2018		2017				
	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	%	Amount	% of Total Net Sales	Amount	%	
Cost of sales	\$3,490	138.8%	\$3,695	120.9%	\$(205)	(5.5)%	\$5,935	94.8%	\$7,905	116.8%	\$(1,970) (24.9)%

The decrease in our cost of sales for the three months ended June 30, 2018 compared to the corresponding period in 2017 was primarily driven by the 30% decrease in encapsulant sales volume partially offset by an approximate 15% increase in raw material cost per unit. The higher raw material cost per unit was primarily driven by a 6% increase in resin costs, as well as a 4% decrease in paperless sales mix. Direct labor increased by \$0.3 million mainly due to \$0.3 million of restructuring charges partially offset by the sales volume decrease. Overhead costs decreased by less than \$0.1 million primarily due to continued cost-reduction actions.

The decrease in our cost of sales for the six months ended June 30, 2018 compared to the corresponding period in 2017 was primarily driven by the 45% decrease in encapsulant sales volume partially offset by an approximate 14% increase in raw material cost per unit. The higher raw material cost per unit was primarily driven by a 10% increase in resin costs, as well as a 5% decrease in paperless sales mix. Direct labor increased by \$0.2 million mainly due to \$0.3 million of restructuring charges partially offset by the sales volume decrease. Overhead costs decreased by \$0.3 million primarily due to continued cost-reduction actions.

**Gross (Loss) Profit**

	Three Months Ended June 30,				Six Months Ended June 30,				Change			
	2018		2017		2018		2017					
	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	%		
Gross (loss) profit	\$ (975)	(38.8)%	\$ (638)	(20.9)%	\$ (337)	(52.8)%	\$ 326	5.2%	\$ (1,135)	(16.8)%	\$ 1,461	128.7%

Gross loss, as a percentage of net sales, declined for the three months ended June 30, 2018 compared to the corresponding period in 2017 mainly as a result of \$0.6 million of restructuring charges related to eliminating certain positions at our Spain location, as well as a decrease in sales volume combined with an increase in raw material prices.

Gross profit (loss) as a percentage of net sales improved for the six months ended June 30, 2018 compared to the corresponding period in 2017 mainly as a result of recognition of \$1.8 million related to completed performance obligations under the equipment purchase agreement and the technology license agreement. This was partially offset by \$0.6 million of restructuring charges related to eliminating certain positions at our Spain facility, as well as a decrease in sales volume combined with an increase in raw material prices.



***Selling, General and Administrative Expenses (“SG&A”)***

	Three Months Ended June 30,			Six Months Ended June 30,			Change	
	2018	2017	Change	2018	2017	Change		
	Amount	Amount	Amount	Amount	Amount	Amount	Amount	Amount
	% of Total Net Sales	% of Total Net Sales	%	% of Total Net Sales	% of Total Net Sales	%	%	%
SG&A	\$1,380	\$1,299	\$81	\$3,072	\$3,280	\$(208)	6.2%	(6.3)%

SG&A increased by \$0.1 million for the three months ended June 30, 2018 compared to 2017. This increase was primarily driven by a \$0.3 million increase in restructuring expense partially offset by a \$0.1 million decrease in professional fees.

SG&A decreased by \$0.2 million for the six months ended June 30, 2018 compared to 2017. This decrease was primarily driven by \$0.2 million in lower labor and benefits and a \$0.1 million reduction in non-cash stock compensation expense partially offset by \$0.2 million in increased restructuring expense.

***Research and Development Expense (“R&D”)***

	Three Months Ended June 30,			Six Months Ended June 30,			Change	
	2018	2017	Change	2018	2017	Change		
	Amount	Amount	Amount	Amount	Amount	Amount	Amount	Amount
	% of Total Net Sales	% of Total Net Sales	%	% of Total Net Sales	% of Total Net Sales	%	%	%
R&D	\$190	\$236	\$(46)	\$405	\$550	\$(145)	7.6%	(26.4)%

Research and development expense decreased by less than \$0.1 million and \$0.1 million for the three and six months ended June 30, 2018, respectively, compared to 2017, as we continued to economize these activities.

***Provision (Recovery) for Bad Debt Expense***

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	Three Months Ended June 30,					Six Months Ended June 30,						
	2018	2017	Change		2018	2017	Change					
	Amount	Amount	Amount	%	Amount	Amount	Amount	%				
			% of Total Net Sales	% of Total Net Sales			% of Total Net Sales	% of Total Net Sales				
Provision (recovery) for bad debt expense	\$67	2.7%	\$ (215)	(7.0)%	\$282	131.2%	\$6	0.1%	\$ (380)	(5.6)%	\$386	101.6%

The provision for bad debt expense recorded during the three and six months ended June 30, 2018 and June 30, 2017 primarily related the aging of accounts receivable under our policy, primarily in the U.S. The provision was partially offset by receiving cash for previously aged accounts receivable that were reserved for under our policy, primarily in China.

**Other Income (Expense), net**

	Three Months Ended June 30,					Six Months Ended June 30,						
	2018	2017	Change		2018	2017	Change					
	Amount	Amount	Amount	%	Amount	Amount	Amount	%				
			% of Total Net Sales	% of Total Net Sales			% of Total Net Sales	% of Total Net Sales				
Other income (expense), net	\$183	7.3%	\$1,632	53.4%	\$ (1,449)	(88.8)%	\$1,203	19.2%	\$1,206	17.8%	\$ (3)	(0.2)%

On March 27, 2018, following the approval of the Company's Special Committee of Continuing Directors, STR China entered into an agreement to terminate the Huhui Supply Agreement (the "Termination Agreement"). Pursuant to the Termination Agreement, Huhui agreed that STR China would retain the deposit, and each of Huhui and STR China agreed to release the other from any liability or further obligations under the Supply Agreement. As a result of the Termination Agreement, we recorded other income of \$1.0 million during the first quarter of 2018.

During the three months ended June 30, 2017, our China subsidiary received interim payments of \$1.5 million from our local China insurance carrier related to the existing fire insurance claim. These payments do not represent a final settlement, and we continue to work with our agents and the carrier to finalize the claim.

In July 2015, we announced a restructuring plan that included the closure of our Malaysia facility, effective August 2, 2015. During 2016, we entered into a definitive Purchase and Sale Agreement for the land-use right and the building for a purchase price of RM25.0 million (approximately \$6.2 million as of June 30, 2018). As a result of the pending sale (which was subject to the approval of the JPA), a gain on assets held for sale of \$0.2 million and a loss on assets held for sale of \$0.3 million, related to the foreign currency fluctuation of the Malaysian Ringgit, was recorded during the three and six months ended June 30, 2017, respectively. As noted above, this agreement terminated prior to the consummation of the sale. The Company has re-launched the sale process for its Malaysia facility.

**Foreign Currency Transaction (Loss) Gain**

	Three Months Ended June 30,			Change	Six Months Ended June 30,			Change				
	2018	2017	2017		2018	2017	2017					
	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	% of Total Net Sales				
Foreign currency transaction (loss) gain	\$(106)	(4.2)%	\$(64)	(2.1)%	\$(42)	(65.6)%	\$(162)	(2.6)%	\$(75)	(1.1)%	\$(87)	(116.0)%

The foreign currency transaction impact was a loss of \$0.1 million for each of the three months ended June 30, 2018 and June 30, 2017 period. Both amounts are primarily the result of volatility in the Euro spot exchange rate versus the U.S. Dollar.

The foreign currency transaction loss for the six months ended June 30, 2018 was \$0.2 million compared to a loss of \$0.1 million for the six months ended June 30, 2017.

Our primary foreign currency exposures are intercompany loans, U.S. dollar cash balances in foreign locations and some U.S. dollar denominated accounts receivable at our Spain and China facilities.

**Income Tax Expense (Benefit)**

	Three Months Ended June 30,					Six Months Ended June 30,						
	2018	2017		Change		2018	2017		Change			
	Amount	% of Total Net Sales	Amount	% of Total Net Sales	Amount	%	Amount	% of Total Net Sales	Amount	%		
Income tax expense (benefit)	\$172	6.8%	\$(125)	(4.1)%	\$297	237.6%	\$271	4.3%	\$(143)	(2.1)%	\$414	289.5%

During the three and six months ended June 30, 2018, we recorded an income tax expense of \$0.2 million and \$0.3 million, resulting in an effective tax rate of (5.9%) and (10.9%), respectively. This effective tax rate for the three months ended June 30, 2018 differs from the U.S. statutory tax rate primarily due to the effect of taxes on foreign earnings.

During the three months ended June 30, 2018, the Company did not record any measurement period adjustments to the provisional estimates recorded at December 31, 2017 relating to the Tax Cuts and Jobs Act. Final accounting for these impacts is expected in the third quarter of 2018 subsequent to the Company's completion of the 2017 tax return.

During the three and six months ended June 30, 2017, we recorded an income tax benefit of \$0.1 million and \$0.1 million, respectively, resulting in an effective tax rate of 30.6% and 4.1%, respectively. The income tax benefit was primarily related to the allocation of tax expense between operations and other comprehensive income when applying the exception to the ASC 740 intra-period allocation rule. The projected annual effective tax rate, excluding the intraperiod allocation, is 0.0% as compared to the U.S. federal statutory rate of 35.0%. The annual effective tax rate is principally driven by changes in valuation allowances.

**Cost-Reduction Actions**

On March 7, 2017 we made the decision to wind down our China manufacturing operations substantially by the end of the second quarter of 2017. The decision was consistent with ongoing efforts to reorganize our encapsulant business to better align with customer geography, to reduce losses related to unprofitable locations and to convert assets to cash for potential redeployment into more profitable endeavors. In connection with the restructuring, we do not expect any significant asset impairment charges and recorded \$0.1 million of severance charges during the first six months of 2017 and the first six months of 2018. The Company sold certain production and testing equipment from the China facility to its tolling partner in India during the third quarter of 2017.

In June 2018, we eliminated certain positions at our Spain facility effective June 18, 2018. We recorded \$0.6 million of severance and benefits in cost of sales and \$0.1 million of severance and benefits in selling, general and administrative expenses during the second quarter of 2018.

A roll-forward of the severance and other exit cost accrual activity was as follows:

	June 30, 2018	June 30, 2017
Balance as of beginning of year	\$ 0.1	\$0.3
Additions	0.7	0.1
Reductions	(0.7 )	(0.2)
Reversals	—	(0.1)
Balance as of end of period	\$ 0.1	\$0.1

The restructuring accrual consisted of \$0.1 million and \$0.1 million for severance and benefits as of June 30, 2018 and 2017, respectively.

### **Financial Condition, Liquidity and Capital Resources**

We have funded our operations primarily through our earnings and existing cash balance. As of June 30, 2018, our principal source of liquidity was \$11.7 million of cash. Our principal needs for liquidity have been, and for the foreseeable future we expect will continue to be, for working capital and capital investments. We are also seeking to sell our Johor, Malaysia facility, as discussed herein. With respect to China, evolving currency control regulations may limit our access to the \$0.4 million of cash located in China as of June 30, 2018 for use outside the country. Although we believe that our timely available cash will be sufficient to meet our liquidity needs, including capital investments, through at least the next 12 months, if we are unable to collect our accounts receivable or fail to receive payment in a timely fashion, our financial condition and results of operations will be negatively affected.

Our wholly owned Spanish subsidiary, Specialized Technology Resources España S.A.U. (“STR Spain”), has a factoring agreement to sell, with recourse, certain European, U.S. and other foreign company-based receivables to Eurofactor Hispania S.A.U., who was later acquired by Credit Agricole Leasing & Factoring Sucursal en España during the first quarter of 2017. Under the current terms of the factoring agreement, the maximum amount of outstanding advances at any one time is €1.5 million (approximately \$1.8 million as of June 30, 2018), which is subject to adjustment based on the level of eligible receivables, restrictions on concentrations of receivables and the historical performance of the receivables sold. The annual discount rate is 2% plus EURIBOR for Euro-denominated receivables

and 2% plus LIBOR for all other currencies. The agreement renews annually unless terminated by either party with 90 days prior written notice. As of June 30, 2018, €1.2 million (\$1.4 million as of June 30, 2018) was available under the factoring agreement based upon receivables outstanding.

In connection with our continued efforts to return our encapsulant business to profitability, on July 24, 2015, our Board approved a restructuring of our encapsulant business that included the shut-down of our Malaysia manufacturing facility, effective August 2, 2015. We are seeking to sell our Johor, Malaysia facility having already sold most of its production and ancillary equipment. In connection with the shut-down and potential sale of the Malaysia facility, we incurred approximately \$1.3 million of associated non-recurring costs during the second half of 2015. In 2016, in connection with the potential sale of the Malaysia facility (specifically, the land-use right and building), an analysis of the asset group was performed and an impairment of assets held for sale of \$1.7 million was recorded. As previously noted, we entered into an agreement to sell our rights to the facility for RM25.0 million (approximately \$6.2 million as of June 30, 2018), however that agreement terminated during 2017 prior to consummation of the transaction. We have since re-launched the sale process for our Malaysia facility.

In the fourth quarter of 2017, the Company initiated a significant investment through STR Spain to enter the high-end food packaging business. This ongoing investment, which leverages our plastics expertise, includes the purchase of new, state-of-the-art plastics processing equipment and related building improvements along with the addition of experienced staff to pursue manufacturing and sales of high-end food packaging products. We have received and applied certain conditional insurance proceeds to this project, helping to offset our net capital investment. These insurance proceeds are available to the Company only if we invest in new plastics manufacturing equipment. We have been advised by our insurer that our investment qualifies for reimbursement under the terms of our policy and, accordingly, they have paid our U.S. entity the amount of \$0.8 million in October 2017, to cover the cost of the deposit for the primary capital equipment. We expect them to reimburse our U.S. entity for an additional approximately \$1.8 million during 2018 as we continue to make qualifying capital investment under the packaging project. We have also applied for loans of up to \$2.4 million from the regional government of Asturias, Spain to further support the project. Subject to the timely purchase and installation of equipment, we expect to begin production by 2019. The food packaging business is highly competitive having market participants with substantially more resources and experience than us. We will be a new entrant in this market and we cannot assure that we will be successful in this new endeavor. In particular, we cannot assure that we will be able to successfully complete our investment in this new business on a timely basis or within budget, if at all, or that we will be able to achieve our anticipated revenue or earnings from this new investment. Nor can we assure that we will be able to timely collect the full amount of the insurance proceeds that we anticipate to support this project, or that we will be able to obtain the loan(s) we have applied for from the regional government on favorable terms if at all.

We remain open to exploring possible business opportunities, alternate geographic markets, as well as other strategic alternatives. We cannot assure that we will be able to successfully pursue any such potential opportunities. If we are successful in pursuing any such opportunities, we may be required to expend significant funds, incur debt or other obligations or issue additional securities, any of which could significantly dilute our current stockholders and may negatively affect our operating results and financial condition. We cannot assure that any such strategic opportunities or related transactions, or any financing in connection therewith, would be available on favorable terms, if at all, or that we will realize any anticipated benefits from any such transactions that we complete. In the event that we are not successful in restructuring our encapsulant business or pursuing opportunities in the downstream solar market or other strategic transactions, we also intend to consider alternatives, including, without limitation, the acquisition of another business, the divestiture of all or certain of our assets, joint ventures and other transactions outside the ordinary course of business.

If we are not able to fund our working capital needs, we will have to slow our projected growth, which may further impede or delay our attempt to return to sustainable profitability. We expect to fund our cash requirements with our existing cash, leveraging our European factoring facility and other potential working capital financing arrangements.

Our cash and cash equivalents balance is located in the following geographies (dollars in thousands):

	June 30, 2018
United States	\$ 10,002
Spain	1,039
Malaysia	206
China	359
Hong Kong	103
India	1
Consolidated	\$ 11,710

As noted above, due to, among other things, the difficulty repatriating cash to the U.S., we may have limited access to the \$0.4 million of cash located in China for use outside the country.

We do not permanently re-invest our Malaysia subsidiary's earnings. Based upon the Malaysia subsidiary's liabilities to us, we expect the undistributed earnings of our Malaysia subsidiary will be repatriated to the U.S. in a tax-free manner. We do not permanently re-invest our Spain earnings, so this cash balance is available for dividend repatriation (less any applicable withholding taxes). We have not elected to permanently re-invest our Hong Kong and China earnings and plan to utilize our cash located in Hong Kong and China to fund working capital requirements and wind down costs. Our goal is to achieve and maintain self-sufficiency in each of our manufacturing locations to meet local cash requirements. We cannot assure that we will continue to fund the manufacturing operations in any location, if such operations would require investment of additional cash from other jurisdictions.

***Cash Flows***

*Cash Flow from Operating Activities*

Net cash used in operating activities was \$2.0 million for the six months ended June 30, 2018 compared to net cash provided by operating activities of \$1.1 million for the six months ended June 30, 2017. Net loss plus and minus non-cash adjustments declined by approximately \$1.2 million for the six months ended June 30, 2018 compared to the same period in 2017. This decline was driven primarily by the receipt of the \$1.5 million partial payment related to the insurance claim from the Manufacturing Facility Fire during 2017.



*Cash Flow from Investing Activities*

Net cash provided by investing activities was \$0.2 million and net cash used in investing activities was \$0.4 million for the six months ended June 30, 2018, respectively. We expect remaining 2018 consolidated capital expenditures to be approximately \$4.0 million related to the high-end food packaging equipment.

*Cash Flow from Financing Activities*

Net cash used in financing activities was less than \$0.1 million and net cash provided by financing activities was \$0.1 million for the six months ended June 30, 2018 and 2017, respectively, primarily due to funds received by our Spanish subsidiary related to the factoring agreement.

**Off-Balance Sheet Arrangements**

We have no significant off-balance sheet financing arrangements.

**Effects of Inflation**

Inflation generally affects us by increasing costs of raw materials, labor and equipment. During the first six months of 2018, we were not materially affected by inflation.

**Recently Issued Accounting Standards**

There are no new accounting pronouncements that we believe may have an impact on our consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are not required to provide this Item 3 because we are a smaller reporting company.

#### **Item 4. Controls and Procedures**

##### **Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports to the Securities Exchange Act of 1934, as amended (“Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chairman, President and Chief Executive Officer and our Vice President, Chief Financial Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of June 30, 2018, we carried out an evaluation, under the supervision and with the participation of our management, including our Chairman, President and Chief Executive Officer and our Vice President, Chief Financial Officer and Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon that evaluation, our Chairman, President and Chief Executive Officer and our Vice President, Chief Financial Officer and Chief Accounting Officer concluded that our disclosure controls and procedures are effective.

##### **Changes in Internal Control Over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the second fiscal quarter of our fiscal year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time, we are and have been a party to litigation that arises in the ordinary course of our business.

In October 2016, a complaint was filed by Solaria Energia y Medio Ambiente S.A. (“Solaria”) against the Company and its Spanish subsidiary, STR Spain, in the Court of the First Instance No. 8 in Oviedo, Spain, relating to a product quality claim in connection with a non-encapsulant product that STR Spain purchased from a vendor in 2005 and 2006 and resold to Solaria. The Company stopped selling this product in 2006. Solaria is seeking approximately €3.3 million (approximately \$3.9 million as of June 30, 2018), plus interest, in damages. A trial was held on April 6, 2017, in Oviedo, Asturias, Spain. The Company is currently awaiting a ruling from the court.

In 2016, the Company filed suit against CEEG (Nanjing) Renewable Energy Co., Ltd. (“NRE”), the parent company of our former customer CSUN in Nanjing Jiangning District People’s Court, China. In a hearing held on August 10, 2016, the court found NRE delinquent in making payment against bona fide invoices dating back to April of 2015 and ordered NRE to pay the Company the amount of RMB8.0 million for encapsulant sold to CSUN, RMB0.1 million for court fees, RMB0.3 million for interest and RMB0.4 million for attorney fees. Following the subsequent failure of NRE to pay according to the order of the Nanjing Jiangning District People’s Court, the Company initiated enforcement proceedings in the enforcement department of Nanjing Jiangning District People’s Court and ultimately agreed to accept installment payments managed through the court, the first of which came due on February 28, 2018 and remains unpaid. The Company has since filed an application for the resumption of enforcement, for which the court has acknowledged receipt. The court has informed the Company that it will schedule another hearing to take further actions against NRE and its Chairman, Mr. Lu Tingxiu, to compel NRE to pay the Company according to the court order currently in force.

### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “*Item 1A. Risk Factors*” in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended by Form 10-K/A filed with the SEC on April 28, 2018, which could materially affect our business, financial position and results of operations. There have been no material changes to the risk factors as disclosed in Part I, “*Item 1A. Risk Factors*” in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended by Form 10-K/A filed with the SEC on April 28, 2018.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

- 10.1\*† Amended and Restated 2009 Equity Incentive Plan
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH\* XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed herewith.

† Management contract or compensatory plan or arrangement.

**SIGNATURE**

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

STR HOLDINGS, INC.  
(Registrant)

Date: August 10, 2018 /s/ Thomas D. Vitro

Name: Thomas D. Vitro

Title: *Vice President, Chief Financial Officer and Chief Accounting Officer*  
(Duly Authorized Officer and Principal Financial Officer)