PGT Innovations, Inc.
Form 10-Q
May 02, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 30, 2019

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 001-37971

PGT Innovations, Inc.

1070 Technology Drive

North Venice, FL 34275

Registrant’s telephone number: 941-480-1600

State of Incorporation	IRS Employer Identification No.
Delaware	20-0634715

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting companyEmerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section13(a) of the Exchange Act.

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Common Stock, $0.01 par value, outstanding was 58,347,213 shares, as of April 30, 2019.

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value $0.01 per share	PGTI	New York Stock Exchange, Inc.

PGT INNOVATIONS, INC.

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Form 10-Q for the Three Months Ended March 30, 2019

PART I — FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

PGT INNOVATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended	
	March 30, 2019	March 31, 2018
	(unaudited)	
Net sales	$173,737	$140,253
Cost of sales	112,467	95,480
Gross profit	61,270	44,773
Selling, general and administrative expenses	44,014	28,657
Income from operations	17,256	16,116
Interest expense, net	6,714	4,043
Debt extinguishment costs	—	3,079
Income before income taxes	10,542	8,994
Income tax expense	2,285	1,654
Net income	$8,257	$7,340
Net income per common share:		
Basic	$0.14	$0.15
Diluted	$0.14	$0.14
Weighted average shares outstanding:		
Basic	58,134	49,858
Diluted	59,220	51,998

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

PGT INNOVATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended	
	March 30, 2019	March 31, 2018
	(unaudited)	
Net income	$8,257	$7,340
Other comprehensive income (loss) before tax:		
Change in fair value of derivatives	595	(83)
Reclassification to earnings	915	—
Other comprehensive income (loss) before tax	1,510	(83)
Income tax (expense) benefit related to components of other comprehensive income (loss)	(386)	21
Other comprehensive income (loss), net of tax	1,124	(62)
Comprehensive income	$9,381	$7,278

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

PGT INNOVATIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(unaudited)

	March 30, 2019	December 29, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$44,936	$52,650
Accounts receivable, net	76,035	80,717
Inventories	47,962	44,666
Contract assets, net	9,375	6,757
Prepaid expenses	5,495	2,863
Other current assets	10,317	7,908
Total current assets	194,120	195,561
Property, plant and equipment, net	120,238	115,707
Operating lease right-of-use asset, net	29,568	—
Intangible assets, net	267,803	271,818
Goodwill	277,827	277,827
Other assets, net	1,192	1,240
Total assets	$890,748	$862,153
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$56,963	$68,557
Current portion of long-term debt	87	163
Current portion of operating lease liability	7,016	—
Total current liabilities	64,066	68,720
Long-term debt, less current portion	367,041	366,614
Operating lease liability, less current portion	25,510	—
Deferred income taxes	23,144	22,758
Other liabilities	15,139	18,517
Total liabilities	494,900	476,609
Shareholders' equity:		
Preferred stock; par value $.01 per share; 10,000 shares authorized; none outstanding	—	—
Common stock; par value $.01 per share; 200,000 shares authorized; 61,273 and		

60,729 shares issued and 58,289 and 58,082 shares outstanding at		
March 30, 2019 and December 29, 2018, respectively	613	607
Additional paid-in-capital	410,578	409,661
Accumulated other comprehensive loss	(1,941)	(3,065)
Accumulated deficit	(643)	(8,900)
Shareholders' equity	408,607	398,303
Less: Treasury stock at cost	(12,759)	(12,759)
Total shareholders' equity	395,848	385,544
Total liabilities and shareholders' equity	$890,748	$862,153

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

PGT INNOVATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Three Months Ended March 30, 2019	March 31, 2018
	(unaudited)	
Cash flows from operating activities:		
Net income	$8,257	$7,340
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,497	2,961
Amortization	4,015	1,659
Amortization of right-of-use asset	1,597	-
Provision for allowance for doubtful accounts	68	416
Stock-based compensation	1,198	514
Amortization and write-offs of deferred financing costs and debt discount	427	615
Debt extinguishment costs	—	3,079
Gains on transfers and disposals of assets	(28)	(10)
Change in operating assets and liabilities:		
Accounts receivable	(60)	(7,921)
Inventories	(3,651)	(3,332)
Contract assets, net, prepaid expenses, other current and other assets	(4,678)	(1,034)
Change in operating lease liability	508	-
Accounts payable, accrued and other liabilities	(11,242)	4,591
Net cash provided by operating activities	908	8,878
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,299)	(6,644)
Proceeds from transfers and disposals of assets	28	10
Net cash used in investing activities	(8,271)	(6,634)
Cash flows from financing activities:		
Payments of long-term debt	(76)	(72)
Payments of financing costs	—	(1,687)
Taxes paid relating to shares withheld on employee equity awards	(505)	(637)
Proceeds from exercise of stock options	213	173
Proceeds from issuance of common stock under employee stock purchase plan (ESPP)	17	5
Other	—	(7)
Net cash used in financing activities	(351)	(2,225)

Net (decrease) increase in cash and cash equivalents	(7,714)	19
Cash and cash equivalents at beginning of period	52,650	34,029
Cash and cash equivalents at end of period	$44,936	$34,048
Non-cash activity:		
Establish right-of-use asset	$31,165	$—
Establish operating lease liability	$(33,594)	$—
Property, plant and equipment additions in accounts payable	$729	$512

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

PGT INNOVATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands)

	Common stock Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Treasury Stock	Total
Balance at December 30, 2017	49,805,338	$ 525	$ 252,275	$ —	$ (64,716)	$ (12,759)	$ 175,325
Cumulative effect of change in accounting principle, net of tax effect of $647	—	—	—	—	1,883	—	1,883
Balance at December 30, 2017 - as adjusted	49,805,338	525	252,275	—	(62,833)	(12,759)	177,208
Vesting of restricted stock	116,475	—	—	—	—	—	—
Grants of restricted stock	—	1	(1)	—	—	—	—
Purchases of treasury stock	(32,439)	—	—	—	—	(637)	(637)
Retirement of treasury stock	—	(1)	(636)	—	—	637	—
Stock-based compensation	—	—	514	—	—	—	514
Exercise of stock options	86,549	1	172	—	—	—	173
Common stock issued under ESPP	373	—	5	—	—	—	5
Net income	—	—	—	—	7,340	—	7,340
Other comprehensive loss	—	—	—	(62)	—	—	(62)
Balance at March 31, 2018	49,976,296	$ 526	$ 252,329	$ (62)	$ (55,493)	$ (12,759)	$ 184,541

	Common stock Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Treasury Stock	Total
Balance at December 29, 2018	58,081,540	$ 607	$ 409,661	$ (3,065)	$ (8,900)	$ (12,759)	$ 385,544
Vesting of restricted stock	133,770	—	—	—	—	—	—
Grants of restricted stock	—	5	(5)	—	—	—	—
Purchases of treasury stock	(34,240)	—	—	—	—	(505)	(505)
Retirement of treasury stock	—	—	(505)	—	—	505	—
Stock-based compensation	—	—	1,198	—	—	—	1,198
Exercise of stock options	106,740	1	212	—	—	—	213
Common stock issued under ESPP	1,061	—	17	—	—	—	17
Net income	—	—	—	—	8,257	—	8,257

Other comprehensive income	—	—	—	1,124	—	—	1,124
Balance at March 30, 2019	58,288,871	$ 613	$ 410,578	$ (1,941)	$ (643)	$ (12,759)	$ 395,848

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

PGT INNOVATIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of PGT Innovations, Inc. and its direct and indirect wholly-owned subsidiaries, including, PGT Industries, Inc., CGI Window and Door Holdings, Inc. ("CGI"), CGI Commercial, Inc. ("CGIC"), WinDoor, Incorporated, Coyote Acquisition Co. and WWS Acquisition LLC (formerly known as GEF WW Parent LLC) (collectively, the "Company"), after elimination of intercompany accounts and transactions.

PGT Innovations, Inc. ("PGTI", "we," or the "Company"), formerly named PGT, Inc., is a leading manufacturer of impact-resistant aluminum and vinyl-framed windows and doors and energy-efficient windows and doors designed to unify indoor/outdoor living spaces and offers a broad range of fully customizable window and door products. Products are sold through an authorized dealer and distributor network. The majority of our sales are to customers in the state of Florida, but we sell products to customers in many states. We also have sales in the Caribbean, Canada, and in South and Central America. With the acquisition of Western Window Systems ('WWS'), we have an increased level of sales in the western United States. See Note 6 for a discussion of this acquisition.

We were incorporated in the state of Delaware on December 16, 2003, as JLL Window Holdings, Inc., with primary operations in North Venice, Florida. On February 15, 2006, our Company was renamed PGT, Inc. On December 14, 2016, we announced that we changed our name to PGT Innovations, Inc. and, effective on December 28, 2016, the listing of our common stock was transferred to the New York Stock Exchange (NYSE) from the NASDAQ Global Market (NASDAQ), and began trading on the NYSE under its existing ticker symbol of "PGTI". We have four manufacturing operations in Florida, with one in North Venice, two in the greater Miami area, and one in Orlando and one in Arizona. Additionally, we have two glass tempering and laminating plants and one insulation glass plant, all located in North Venice.

All references to PGTI or our Company apply to the consolidated financial statements of PGT Innovations, Inc. unless otherwise noted.

These condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all the information and footnotes required by United States Generally Accepted Accounting Principles ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the interim period is not necessarily indicative of the results that may be expected for the remainder of the current year or for any future periods. Each of the Company's fiscal quarters ended March 30, 2019, and March 31, 2018, consisted of 13 weeks.

The condensed consolidated balance sheet as of December 29, 2018, is derived from the audited consolidated financial statements, but does not include all disclosures required by GAAP. The condensed consolidated balance sheet as of December 29, 2018, and the unaudited condensed consolidated financial statements as of and for the period ended March 30, 2019, should be read in conjunction with the more detailed audited consolidated financial statements for the year ended December 29, 2018, included in the Company's most recent Annual Report on Form 10-K. Except for the adoption of the guidance relating to leases discussed below, the accounting policies used in the preparation of these unaudited condensed consolidated financial statements are consistent with the accounting policies described in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

In the three months ended March 30, 2019, we concluded that we have two reportable segments: the Southeast segment, and the Western segment. The Southeast reporting segment, which is also an operating segment, is composed of our sales in Florida, the core market of our Legacy business, as well as Alabama, Georgia, Louisiana, Mississippi, North Carolina, South Carolina and the Caribbean. The Western reporting segment, also an operating segment, is composed of sales in the rest of the United States, along with Canada and Mexico. While both of our operating segments have products, distribution methods and customers of a similar nature, we determined to not aggregate them due to the differences in their geographic markets. Therefore, our operating segments are our reportable segments. See Note 16 for segment disclosures.

Recently Adopted Accounting Pronouncements

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. ASU 2016-02 was subsequently amended by ASU 2018-01, “Land Easement Practical Expedient for Transition to Topic 842”; ASU 2018-10, “Codification Improvements to Topic 842, Leases”; and ASU 2018-11, “Targeted Improvements”. The new standard requires a lessee to recognize a right-of-use asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The new standard was effective for us on December 30, 2018 (the first day of our 2019 fiscal year), with early adoption permitted. We adopted the new standard on this date, using the required modified retrospective transition approach, applying the new standard to all leases existing on the effective date. Consequently, financial information was not updated, and the disclosures required under the new standard are and will not be provided for dates and periods prior to December 30, 2018. As of the date of adoption, all of our leases were operating leases, and we have no financing leases as of March 30, 2019.

The new standard provided a number of optional practical expedients in transition. We elected the ‘package of practical expedients’, which permitted us not to reassess under the new standard our prior conclusions about lease identification, lease classification and direct costs, and implemented internal controls and additional lease accounting and tracking procedures to enable the preparation of financial information on adoption. We did not elect the use-of-hindsight practical expedient, or the practical expedient pertaining to land easements as it was not applicable to us.

The new standard also provides practical expedients for an entity’s ongoing accounting. We elected the short-term lease recognition exemption for all leases that qualified, primarily for certain vehicle and office equipment leases that are month-to-month leases. This means, for those leases, we did not recognize right-of-use assets or lease liabilities. We also elected the practical expedient to not separate lease and non-lease components for all classes of underlying assets.

This standard had a material effect on our consolidated balance sheet relating to the recognition of an operating lease right-of-use asset and operating lease liability on our balance sheet for our real estate operating leases and to providing new disclosures about our leasing activities. On adoption, we recognized an operating lease right-of-use asset of $31.2 million, and an operating lease liability of $33.6 million, based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. Calculation of the present value of the remaining minimum rental payments required the use of judgment relating to the selection of the discount rate applied to future lease payments. We used a weighted-average interest rate of 6.2%, which was based on a current trade rate for our 2018 Senior Notes due 2026. See Note 10 for additional information relating to our leases.

Leases Accounting Policy

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use assets, current portion of operating lease liability, and operating lease liability, less current portion on our consolidated balance sheets. Should we engage in any finance leases in the future, finance leases would be included in property and equipment, other current liabilities, and other liabilities on our consolidated balance sheets.

Operating lease right-of-use assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. The operating lease right-of-use asset also includes any lease payments made and excludes lease incentives and initial direct costs incurred. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

Recently Issued Accounting Pronouncements

Fair Value Measurement Disclosures

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820) - Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement”. The new guidance modifies disclosure requirements related to fair value measurement. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The standard also allows for early adoption of any removed or modified disclosures upon issuance of this ASU while delaying adoption of the additional disclosures until their effective date. The Company does not believe that the adoption of this guidance will have a significant impact on its fair value disclosures.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires entities to measure all expected credit losses for most financial assets held at the reporting date based on an expected loss model which includes historical experience, current conditions, and reasonable and supportable forecasts. Entities will now use forward-looking information to better form their credit loss estimates. ASU 2016-13 also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity’s portfolio. Subsequently, in November 2018, the FASB issued ASU 2018-19, “Codification Improvements to Topic 326, Financial Instruments-Credit Losses”. ASU 2018-19 clarifies the codification and corrects unintended application of the guidance. ASU’s 2016-13 and 2018-19 are effective for us for our fiscal year beginning after December 15, 2019. We are currently assessing the impact that adopting these new standards updates will have on our consolidated financial statements.

In the ordinary course of business, we extend credit to qualified dealers and distributors, generally on a non-collateralized basis. The Company maintains an allowance for doubtful accounts which is based on management’s assessments of the amount which may become uncollectible in the future and is determined through consideration of our write-off history, specific identification of uncollectible accounts based in part on the customer’s past due balance (based on contractual terms), and consideration of prevailing economic and industry conditions. Uncollectible accounts are written off after repeated attempts to collect from the customer have been unsuccessful. As of March 30, 2019, and December 29, 2018, the allowance for doubtful accounts was $2.9 million and $2.8 million, respectively.

NOTE 2. REVENUE RECOGNITION AND CONTRACTS WITH CUSTOMERS

Revenue Recognition Accounting Policy

The Company is a manufacturer of fully-customized windows and doors, and manufactures products based on design specifications, measurements, colors, finishes, framing materials, glass-types, and other options selected by the customer at the point in time an order is received from the customer. The Company has an enforceable right to payment at the time an order is received and accepted at the agreed-upon sales prices contained in our agreements with our customers for all manufacturing efforts expended by the Company on behalf of its customers. Due to the customized build-to-order nature of the Company's products, the Company's assessment is that substantially all of its finished goods and certain unused glass components have no alternative use, and that control of these products and components passes to the customer over time during the manufacturing of the products in an order, or upon our receipt of certain pre-cut glass components from our supplier attributed to specific customer orders. Based on these factors, the Company recognizes the substantial portion of revenue over time during the manufacturing process once customization begins, and for certain unused glass components on hand, at the end of a reporting period. Revenue on work-in-process at the end of a reporting period is recognized in proportion to costs incurred to total estimated cost of the product being manufactured. Revenue recognized at a point in time is immaterial.

Disaggregation of Revenue from Contracts with Customers

As discussed in note 1, in the first quarter of 2019, we determined that we have two reportable segments: our Southeast business unit and our Western business unit. See note 16 for more information. Net sales of the Western business unit for the three months ended March 31, 2018 are not presented as they were immaterial. The following tables provides information about our net sales by product category and by channel for the three months ended March 30, 2019, by segment, and for the three months ended March 31, 2018 (dollars in millions):

	Three Months Ended March 30, 2019		
	Segments		
	Southeast	Western	Total
Product category:			
Impact-resistant window and door products	$120.7	$ 0.8	$121.5
Non-impact window and door products	19.1	33.1	52.2
Total net sales	$139.8	$ 33.9	$173.7
Channel:			
New construction	$56.2	$ 32.1	$88.3
Repair and remodel	83.6	1.8	85.4
Total net sales	$139.8	$ 33.9	$173.7

	Three Months Ended March 31, 2018
Product category:	
Impact-resistant window and door products	$ 120.5

Non-impact window and door products	19.8
Total net sales	$ 140.3
Channel:	
New construction	$ 51.6
Repair and remodel	88.7
Total net sales	$ 140.3

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Contract Balances

Contract assets represent sales recognized in excess of billings related to finished goods not yet shipped and certain unused glass components not yet placed into the production process for which revenue is recognized over time as noted above. Contract liabilities relate to customer deposits at the end of reporting periods. At March 30, 2019, and December 29, 2018, those contract liabilities totaled $8.6 million and $8.3 million, respectively, of which $7.4 million and $7.8 million, respectively, and are classified within accrued liabilities, and $1.2 million and $0.5 million, respectively, are classified within contract assets, net, in the accompanying condensed consolidated balance sheets at March 30, 2019, and December 29, 2018.

Because of the short-term nature of our performance obligations, as discussed below, substantially all of our performance obligations are satisfied within the quarter following the end of a reporting period. As such, substantially all of the contract liabilities at December 29, 2018 were satisfied in the three-month period ended March 30, 2019. Contract assets at December 29, 2018 were transferred to accounts receivable in the three-month period ended March 30, 2019. Contract liabilities at March 30, 2019 represents cash received during the three-month period ended March 30, 2019, excluding amounts recognized as revenue during that period. Contract assets at March 30, 2019 represents revenue recognized during the three-month period ended March 30, 2019, excluding amounts transferred to accounts receivable during that period.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is defined as the unit of account. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue as the performance obligation is satisfied. Our contracts with our customers generally represent an approved purchase order, which is typically accounted for as a single performance obligation. In situations when our contract includes distinct goods that are substantially the same and have the same pattern of transfer to the customer over time, they are recognized as a series of distinct goods. We allocate the contract's transaction price to each distinct product based on the estimated relative standalone selling price of each distinct good. Observable standalone sales are used to determine the standalone selling price.

Performance obligations are satisfied over time, generally for our custom products, and as of a point in time for our standard products. Performance obligations are supported by contracts with customers, and we have elected not to disclose our unsatisfied performance obligations as of March 30, 2019 under the short-term contract exemption as we expect such performance obligations will be satisfied within the quarter following the end of a reporting period.

Policies Regarding Shipping and Handling Costs and Commissions on Contract Assets

The Company has made a policy election to continue to recognize shipping and handling costs as a fulfillment activity. Treating shipping and handling as a fulfillment activity requires estimated shipping and handling costs for undelivered products and certain glass components on which we have recognized revenue and created a contract asset, to be accrued to match this cost with the recognized revenue. This policy is unchanged from the Company's policy for recognizing shipping and handling costs prior to the adoption of the new revenue guidance.

The Company utilizes the practical expedient which permits expensing of costs to obtain a contract when the expected amortization period is one year or less, which typically results in expensing commissions paid to employees. We expense sales commissions paid to employees as sales are recognized, including sales from the creation of contract assets, as the expected amortization period is less than one year.

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NOTE 3. WARRANTY

Most of our manufactured products are sold with warranties. Warranty periods, which vary by product components, generally range from 1 to 10 years; however, the warranty period for a limited number of specifically identified components in certain applications is a lifetime. The majority of the products sold have warranties on components which range from 1 to 3 years. The amount charged to expense for warranties is based on management's assessment of the cost per service call and the number of service calls expected to be incurred to satisfy warranty obligations on the current net sales.

During the three months ended March 30, 2019, we recorded warranty expense at a rate of approximately 1.6% of sales, which decreased from the rate in the first quarter of 2018 of 1.7% of sales.

The following table summarizes: current period charges, adjustments to previous estimates, if necessary, as well as settlements, which represent actual costs incurred during the period for the three months ended March 30, 2019, and March 31, 2018. The reserve is determined through specific identification and assessing Company history. Expected future obligations are discounted to a current value using a risk-free rate for obligations with similar maturities.

Accrued Warranty	Beginning of Period	Charged to Expense	Adjustments	Settlements	End of Period
(in thousands)					
Three months ended March 30, 2019	$ 6,149	$ 2,820	$ 28	$ (3,016)	$5,981
Three months ended March 31, 2018					