RADISYS CORP
Form 10-Q
November 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

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

For the transition period from to
Commission File Number: 0-26844

RADISYS CORPORATION
(Exact name of registrant as specified in its charter)

OREGON	93-0945232
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5435 N.E. Dawson Creek Drive, Hillsboro, OR	97124
(Address of principal executive offices)	(Zip Code)

(503) 615-1100
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically 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 [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or 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	x
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. o

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

Number of shares of common stock outstanding as of November 5, 2018: 39,620,534

RADISYS CORPORATION

FORM 10-Q
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RADISYS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts, unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues:				
Product	$17,907	$20,641	$50,775	$75,680
Service	9,116	8,132	26,851	25,796
Total revenue	27,023	28,773	77,626	101,476
Cost of sales:				
Product	9,743	20,361	30,457	60,450
Service	5,314	5,291	15,229	15,821
Amortization of purchased technology	226	1,926	4,080	5,780
Total cost of sales	15,283	27,578	49,766	82,051
Gross margin	11,740	1,195	27,860	19,425
Research and development	3,467	5,639	10,388	18,113
Selling, general and administrative	6,758	7,849	20,546	25,445
Intangible asset amortization	197	289	593	2,809
Restructuring and other charges, net	1,130	1,344	3,990	2,814
Gain (loss) from operations	188	(13,926)	(7,657)	(29,756)
Change in fair value of Warrant liability	(599)	—	(1,102)	—
Interest expense	(1,411)	(431)	(4,206)	(927)
Other income (expense), net	1,447	(116)	2,700	(543)
Income (loss) before income tax expense	(375)	(14,473)	(10,265)	(31,226)
Income tax expense	1,498	938	2,687	1,747
Net loss	$(1,873)	$(15,411)	$(12,952)	$(32,973)
Net loss per share:				
Basic	$(0.05)	$(0.39)	$(0.33)	$(0.85)
Diluted	$(0.05)	$(0.39)	$(0.33)	$(0.85)
Weighted average shares outstanding:				
Basic	39,616	39,087	39,496	38,922
Diluted	39,616	39,087	39,496	38,922

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

RADISYS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands, unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net loss	$(1,873)	$(15,411)	$(12,952)	$(32,973)
Other comprehensive income (loss):				
Translation adjustments gain (loss)	(1,155)	299	(2,148)	1,309
Net adjustment for fair value of hedge derivatives, net of tax	572	(242)	(61)	189
Other comprehensive income (loss)	(583)	57	(2,209)	1,498
Comprehensive loss	$(2,456)	$(15,354)	$(15,161)	$(31,475)

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

RADISYS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,094	$ 8,124
Restricted cash	4,000	—
Accounts receivable, net	31,130	32,820
Other receivables	1,381	3,421
Inventories, net	2,156	4,265
Other current assets	1,589	3,186
Total current assets	50,350	51,816
Property and equipment, net	3,242	4,728
Intangible assets, net	2,189	6,862
Long-term deferred tax assets, net	780	787
Other assets	1,274	1,836
Total assets	$ 57,835	$ 66,029
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 8,060	$ 18,297
Accrued wages and bonuses	6,117	3,711
Deferred revenue	6,495	4,200
Line of credit	11,989	16,000
Short term debt obligations	9,000	—
Warrant liability	4,960	—
Other accrued liabilities	5,998	10,405
Total current liabilities	52,619	52,613
Long-term liabilities:		
Long term debt obligations, net	5,647	—
Other long-term liabilities	7,119	6,866
Total long-term liabilities	12,766	6,866
Total liabilities	65,385	59,479
Commitments and contingencies (Note 7)		
Shareholders' equity (deficit):		
Common stock — no par value, 100,000 shares authorized; 39,621 and 39,280 shares issued and outstanding at September 30, 2018 and December 31, 2017	343,280	342,219
Accumulated deficit	(349,134)	(336,182)
Accumulated other comprehensive income (loss):		
Cumulative translation adjustments	(1,458)	690
Unrealized loss on hedge instruments	(238)	(177)
Total accumulated other comprehensive income (loss)	(1,696)	513
Total shareholders' equity (deficit)	(7,550)	6,550
Total liabilities and shareholders' equity (deficit)	$ 57,835	$ 66,029

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

5

RADISYS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands, unaudited)

	Nine Months Ended September 30,					
	2018			2017		
Cash flows from operating activities:						
Net loss	$	(12,952	)	$	(32,973	)
Adjustments to reconcile net loss to net cash used in operating activities:						
Depreciation and amortization	6,459			12,396		
Amortization of debt discount and issuance costs	2,465			—		
Inventory valuation allowance and adverse purchase commitment charges (benefits)	(24		)	7,900		
Deferred income taxes and uncertain tax positions	409			527		
Stock-based compensation expense	957			1,816		
Change in fair value of warrant liability	1,102			—		
Other	673			216		
Changes in operating assets and liabilities:						
Accounts receivable	1,695			4,530		
Other receivables	1,902			(44		)
Inventories, net	(457		)	2,732		
Accounts payable	(10,369		)	(26		)
Accrued restructuring	(2,562		)	(529		)
Accrued wages and bonuses	2,033			(3,115		)
Deferred revenue	1,546			(1,157		)
Other	3,026			1,144		
Net cash used in operating activities	(4,097		)	(6,583		)
Cash flows from investing activities:						
Capital expenditures	(530		)	(4,544		)
Net cash used in investing activities	(530		)	(4,544		)

Cash flows from financing activities:						
Borrowings on line of credit	91,968			84,000		
Payments on line of credit	(95,979		)	(94,000		)
Proceeds from borrowings on senior notes	17,000			—		
Payments for debt issuance costs	(2,390		)	—		
Net settlement of restricted shares	(29		)	(204		)
Other financing activities	133			499		
Net cash provided by financing activities	10,703			(9,705		)
Effect of exchange rate changes on cash	(106		)	427		
Net increase (decrease) in cash, cash equivalents, and restricted cash	5,970			(20,405		)
Cash and cash equivalents, beginning of period	8,124			33,087		
Restricted cash and cash equivalents, beginning of period	—			—		
Cash, cash equivalents, and restricted cash, beginning of period	8,124			33,087		
Cash and cash equivalents, end of period	10,094			12,682		
Restricted cash and cash equivalents, end of period	4,000			—		
Cash, cash equivalents, and restricted cash, end of period	$	14,094		$	12,682	
Supplemental disclosure of cash flow information:						
Cash paid during the period for:						
Interest	$	438		$	731	
Income taxes	$	632		$	928	

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

RADISYS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 — Significant Accounting Policies

Radisys Corporation (the "Company" or "Radisys") has adhered to the accounting policies set forth in its Annual Report on Form 10-K for the year ended December 31, 2017 in preparing the accompanying interim condensed consolidated financial statements. The preparation of these statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Additionally, the accompanying financial data as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The financial information included herein reflects all normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for interim periods.

Product and Service Revenue

The Company sells its products and services into two primary end markets: telecommunications infrastructure and medical imaging. Sales into the telecommunications infrastructure market spans both of the Company's operating segments while sales of products into the medical imaging market are associated predominantly with one customer in the Company's Hardware-Solutions segment. The Company sells its products and services directly to service providers, through channel partners where its products are part of a larger integrated solution, and directly to original equipment and design manufacturers.

Product revenue includes the sale of software, integrated systems, stand-alone hardware and post-sale royalties tied to end-user product deployments. The Company's products are sold both on a stand-alone basis and bundled with certain other products and services from time to time. Software and hardware products are generally sold for a one-time fee with incremental sales of related products to the same customer tied to expansion needs.

Service revenue is predominantly comprised of professional services and maintenance and support services. Professional services are generally associated with the development and implementation of customer-specific feature requirements on the Company's products. Maintenance and support services are associated with post-sale product updates, upgrades and enhancements as well as general technical support. The Company's customers generally enter into annual or semi-annual agreements for maintenance and support services.

Refer to Note 12 - Segment Information for further information, including revenue by geography and product type.

Multiple Performance Obligations

The Company's contracts with customers often include commitments to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When hardware, software and services are sold in various combinations, judgment is required to determine whether each performance obligation is considered distinct and accounted for separately, or not distinct and accounted for together with other performance obligations.

In instances where the software elements included within hardware for various products are considered to be functioning together with non-software elements to provide the tangible product's essential functionality, these arrangements are accounted for as a single distinct performance obligation.

Judgment is required to determine the stand-alone selling price (SSP) for each distinct performance obligation. When available, Radisys uses observable inputs to determine SSP. In instances where SSP is not directly observable, such as when the Company does not sell the product or service separately, it determines the SSP based on a cost plus model as market or other observable inputs are seldom present based on the proprietary nature of our products.

The Company typically has more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, the Company may use information such as the size of the customer or level of service provided in determining the SSP.

Revenue Recognition

Revenue is recognized upon transfer of control of products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company enters into contracts that may include various combinations of products and services which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for any taxes collected from customers, which are subsequently remitted to governmental authorities.

Hardware

Hardware revenue is recognized when the Company transfers control to the customer, typically at the time the product is shipped to the customer. The Company accrues the estimated cost of product warranties, based on historical experience at the time the Company recognizes revenue.

Software licenses and royalties

The Company recognizes software license revenue at the time of delivery. The Company defers revenue on arrangements, including specified software upgrades, until the specified upgrade has been delivered. Revenue from customers for prepaid, non-refundable software royalties is recorded when the revenue recognition criteria have been met. Revenue for non-prepaid royalties is recognized at the time the Company is able to estimate the revenue that has been earned in the current period.

Maintenance and support services

Maintenance and support services revenue is recognized as earned on the straight-line basis over the term of the contract.

Professional and other services

Professional services revenue is recognized as services are provided. Other services revenues include hardware repair services and custom software implementation projects, with these services recognized upon delivery to customers.

Revenue from distributors

Revenue associated with distributors is recognized upon shipment. Based on historical activity and contractual rights estimated effects of returns and allowances provided to distributors are considered insignificant. The Company accrues the estimated cost of product warranties, based on historical experience at the time the Company recognizes revenue.

Deferred revenue

Deferred revenue represents amounts received or billed for the following types of transactions:

•Undelivered elements of an arrangement: the Company defers hardware and software arrangements in the event the element is not delivered. For products that are determined not to be distinct in nature, revenue is deferred until all elements that make up the distinct product are delivered.

•Maintenance and support services: the Company has a number of maintenance support agreements with customers for hardware and software maintenance. Generally, these services are billed in advance and recognized over the term of the agreement.

Cost of sales associated with deferred revenue is also deferred. These deferred costs are recognized when the associated revenue is recognized.

Assets Recognized from Costs to Obtain a Contract with a Customer

We apply the practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would be one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities. Costs incurred to obtain a contract in excess of one year are insignificant.

Backlog

Backlog as of September 30, 2018 was $23.2 million. Backlog is defined as purchase orders the Company has received and expects to fulfill over the next 12 months.

Capitalized Software Development Costs

The Company does not capitalize internal software development costs incurred in the production of computer software as the Company does not incur any material costs between the point of technological feasibility and general release of the product to customers in the future. As such software development costs are expensed as research and development ("R&D") costs.

Shipping Costs

Radisys does not consider shipping and handling to be a separate performance obligation but as activities to fulfill the entity's promise to transfer the good. In instances where revenue is recognized prior to incurring shipping costs, Radisys will accrue for those costs in the period revenue is recognized.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs consist primarily of media, display, web, and print advertising, along with trade show costs and product demos and brochures.

Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less at the date of purchase to be cash equivalents.

Restricted Cash

As part of the debt financing completed on January 3, 2018 and amendments completed on June 29, 2018, the Company is required to maintain a restricted cash balance of $4.0 million that will secure both the obligations under the Notes and the ABL Facility.

Accounts Receivable

Trade accounts receivable are stated at invoice amount net of an allowance for doubtful accounts and do not bear interest. An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. Management reviews the allowance for doubtful accounts quarterly for reasonableness and adequacy. If the financial condition of the Company's customers were to deteriorate resulting in an impairment of their ability to make payments, additional provisions for uncollectible accounts receivable may be required. In the event the Company determined that a smaller or larger reserve was appropriate, it would record a credit or a charge in the period in which such determination is made. In addition to specific customer reserves, the Company maintains a non-specific bad debt reserve for all customers. This non-specific bad debt reserve is calculated based on the Company's historical pattern of bad debt write-offs as a percentage of gross accounts receivable for the current rolling eight quarters, which percentage is then applied to the current gross accounts receivable. The Company’s customers are concentrated in the technology industry and the collection of its accounts receivable are directly associated with the operational results of the industry.

Inventories

Inventories are stated at the lower of cost, determined on the first-in, first-out (FIFO) basis, or net realizable value, net of an inventory valuation allowance. The Company uses a standard cost methodology to determine the cost basis for its inventories. The Company evaluates inventory on a quarterly basis for obsolete or slow-moving items to ascertain if the recorded allowance is reasonable and adequate. Inventory is written down for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future demand and market conditions. The Company's inventory valuation allowances establish a new cost basis for inventory.

Long-Lived Assets

Long-lived assets, such as property and equipment and definite-life intangible assets are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company assesses the impairment of the assets based on the undiscounted future cash flow the assets are expected to generate compared to the carrying value of the assets. If the carrying amount of the assets is determined not to be recoverable, a write-down to fair value is recorded. Management estimates future cash flows using assumptions about expected future operating performance. Management’s estimates of future cash flows may differ from actual cash flow due to, among other things, technological changes, economic conditions or changes to the Company’s business operations.

Intangible assets with estimable useful lives are amortized on a straight-line basis over their respective estimated life and reviewed for impairment when certain triggering events suggest impairment has occurred. The Company did not identify a triggering event during the three and nine months ended September 30, 2018 to suggest an impairment has occurred.

Property and Equipment

Property and equipment is recorded at historical cost and is depreciated or amortized on a straight-line basis according to the table below. In certain circumstances where the Company is aware that an asset’s life differs from the general guidelines set forth in its policy, management adjusts its depreciable life accordingly, to ensure expense is being recognized over the appropriate future periods. Ordinary maintenance and repair expenses are expensed when incurred.

Machinery, equipment, furniture and fixtures	5 years
Software, computer hardware and manufacturing test fixtures	3 years
Engineering demonstration products and samples	1 year
Leasehold improvements	Lesser of the lease term or estimated useful lives

Leases

The Company leases all of its facilities, certain office equipment and vehicles under non-cancelable operating leases that expire at various dates through 2023, along with options that permit renewals for additional periods. Rent escalations are considered in the determination of straight-line rent expense for operating leases. Leasehold improvements made at the inception of or during the lease are amortized over the shorter of the asset life or the lease term.

Derivative Liability

In connection with the issuance of the Notes, on January 3, 2018, the Company issued to an affiliate of Hale Capital and another purchaser Warrants to purchase up to 6,006,667 shares of common stock at an exercise price equal to $1.00 per share (the “Warrants”).

The Warrants contain a cash settlement feature contingent upon the occurrence of certain events defined in the Warrants. As a result of this cash settlement feature, the Warrants are subject to derivative accounting as prescribed under ASC 815. Accordingly, the fair value of the Warrants on the date of issuance was recorded in the Company’s condensed consolidated balance sheets as a liability.

The Warrant liability was recorded in the Company's condensed consolidated balance sheets at its fair value on the date of issuance and is revalued on each subsequent balance sheet date until such instrument is exercised or expires, with any changes in the fair value between reporting periods recorded in the condensed consolidated statements of operations.

The Company estimates the fair value of this liability using a Monte Carlo pricing model that is based on the individual characteristics of the Warrants on the valuation date, which includes assumptions for expected volatility, expected life and risk-free interest rate, as well as the present value of the minimum cash payment component of the instrument. Changes in the assumptions used could have a material impact on the resulting fair value. The primary inputs affecting the value of the Warrant liability are the Company’s stock price and expected future volatility in the Company's stock price. Increases in the fair value of the underlying stock or increases in the volatility of the stock price generally result in a corresponding increase in the fair value of the Warrant liability; conversely, decreases in the fair value of the underlying stock or decreases in the volatility of the stock price generally result in a corresponding decrease in the fair value of the Warrant liability.

Restructuring and Other Charges

The Company has engaged, and may continue to engage, in restructuring and other actions, which require the Company to make significant estimates in several areas including: realizable values of assets made redundant or obsolete; expenses for severance and other employee separation costs; the ability and timing to generate sublease income, as well as the Company's ability to terminate lease obligations at the amounts estimated; and other costs. Should the actual amounts differ from the estimates, the amount of the restructuring and other charges could be materially impacted.

Restructuring and other charges may include costs incurred for employee severance, acquisition or divestiture activities, excess facility costs, certain legal costs, asset related charges and other expenses associated with business integration or restructuring activities. Costs associated with exit or disposal activities are recognized when probable and estimable because the Company has a history of paying severance benefits.

Warranty

The Company provides for the estimated cost of product warranties at the time it recognizes revenue. Products are generally sold with warranty coverage for a period of 12 or 24 months after shipment. On a quarterly basis the Company assesses the reasonableness and adequacy of the warranty liability and adjusts such amounts as necessary. Warranty reserves are included in other accrued liabilities and other long-term liabilities in the accompanying condensed consolidated balance sheets.

Research and Development

R&D costs are expensed as incurred. R&D expenses consist primarily of salary, bonuses and benefits for product development staff, and cost of design and development supplies and equipment, net of reimbursements for non-recurring engineering services.

Income Taxes

Income tax accounting requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities. Valuation allowances are established to reduce deferred tax assets if it is “more likely than not” that all or a portion of the asset will not be realized due to inability to generate sufficient taxable income in the relevant period to utilize the deferred tax asset. Tax law and rate changes are reflected in the period such changes are enacted. The Company recognizes uncertain tax positions after evaluating whether certain tax positions are more likely than not to be sustained by taxing authorities. In addition, the Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense.

Comprehensive Loss

The Company reports accumulated other comprehensive loss in its condensed consolidated balance sheets. Comprehensive loss includes net loss, translation adjustments and unrealized gains (losses) on hedging instruments net of their tax effect. The cumulative translation adjustments consist of unrealized gains (losses) for foreign currency translation.

Stock-Based Compensation

The Company measures stock-based compensation at the grant date, based on the fair value of the award, and recognizes expense on a straight-line basis over the employee's requisite service period. For performance-based restricted stock unit awards ("PRSUs"), the requisite service period is equal to the period of time over which performance objectives underlying the award are expected to be achieved and vested. The number of shares that ultimately vest depends on the achievement of certain performance criteria over the measurement period. For non-market performance-based restricted stock, quarterly, we reevaluate the period during which the performance objective will be met and the number of shares expected to vest. The amount of quarterly expense recorded each period is based on our estimate of the number of awards that will ultimately vest.

The Company estimates the fair value of stock options and purchase rights under our employee stock purchase plans using a Black-Scholes option-pricing model. The Black-Scholes option-pricing model incorporates several highly subjective assumptions including expected volatility, expected term and interest rates.

In reaching our determination of expected volatility, we use the historic volatility of our shares of common stock. We base the expected term of our stock options on historic experience. The expected term for purchase rights under our employee stock plans is based on the 18 month offering period. The risk-free rate is based on the U.S. Treasury constant maturities in effect at the time of grant for the expected term of the option or share.

The calculation includes several assumptions that require management's judgment. The expected term of the option or share is determined based on assumptions about patterns of employee exercises and represents a probability-weighted average time-period from grant until exercise of stock options, subject to information available at time of grant. Determining expected volatility generally begins with calculating historical volatility for a similar long-term period and then considers the ways in which the future is reasonably expected to differ from the past.

The input factors used in the valuation model are based on subjective future expectations combined with management's judgment. If there is a difference between the assumptions used in determining stock-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining stock-based compensation costs. These changes may materially impact the results of operations in the event such changes are made. In addition, if we were to modify any awards, additional charges would be taken.

Net loss per share

Basic loss per share amounts are computed based on the weighted average number of common shares outstanding. Diluted net loss per share incorporates the incremental shares issuable upon the assumed exercise of stock options, Warrants granted in connection with the Note Purchase Agreement (as defined below), and the incremental shares associated with the assumed vesting of restricted stock.

Derivatives

The Company hedges exposure to changes in exchange rates from the U.S. Dollar to the Indian Rupee. These derivatives are recognized on the balance sheet at their fair value. Unrealized gain positions are recorded as other current assets and unrealized loss positions are recorded as other accrued liabilities. Changes in the fair values of the outstanding derivatives that are highly effective are recorded in other comprehensive loss until net income (loss) is affected by the variability of the cash flows of the hedged transaction. Hedge ineffectiveness could result when the amount of the Company’s hedge contracts exceed the Company’s forecasted or actual transactions for which the hedge contracts were designed to hedge. Once a hedge contract matures the associated gain (loss) on the contract will remain in accumulated other comprehensive income (loss) until the underlying hedged transaction affects net income (loss), at which time the gain (loss) will be recorded to the expense line item being hedged, which is primarily cost of sales, research and development and selling, general and administrative. The Company only enters into derivative contracts in order to hedge foreign currency exposure. If the Company entered into a contract for speculative reasons or if the Company's current hedge position becomes ineffective, changes in the fair values of the derivatives would be recognized in earnings in the current period.

Foreign currency translation

Assets and liabilities of international operations using a functional currency other than the U.S. dollar are translated into U.S. dollars at exchange rates. Income and expense accounts are translated into U.S. dollars at the average daily rates of exchange prevailing during the period. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as a separate component in shareholders' equity. Foreign exchange transaction gains and losses are included in other expense, net, in the condensed consolidated statements of operations.

Adoption of New Accounting Policies

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), which requires that restricted cash and cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. ASU 2016-18 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and a retrospective transition method is required. The Company adopted this guidance in the first quarter of 2018 using the retrospective approach. The Company has not historically had restricted cash resulting in no impact to previously reported periods. This new guidance did not impact the Company's financial results but did result in a change in the presentation of restricted cash and restricted cash equivalents within the statement of cash flows.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," that has superseded all existing revenue recognition guidance under U.S. GAAP. The standard's core principle is that a company recognizes revenue when it transfers promised goods or services to a customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning on or after December 15, 2017.

The new guidance, which includes several amendments, replaces most of the prior revenue recognition guidance under U.S. Generally Accepted Accounting Principles. The Company adopted the new guidance as of January 1, 2018 using the modified retrospective method, as applied to all contracts. As a result, the Company has changed its accounting policy for revenue recognition.

Aspects of the new standard that have impacted the Company include a change in the timing of certain usage-based royalties. Historically revenue was not recognized until fixed and determinable; however, the new ASU requires the Company to estimate using either the probability weighted expected amount or the most likely amount and estimate the transaction price to recognize when or as control is transferred to the customer. Additionally, for certain professional services with no VSOE under ASC 605, certain licenses were deferred and recognized with the associated software. Such contracts represent a small subset of the Company's total portfolio. Refer to the Company's policy over revenue recognition above for further detail.

Due to the immaterial nature from the impact on the timing of revenue recognition based on the cumulative effect of adopting this guidance, an adjustment to the balance of retained earnings as of January 1, 2018 was not required. The comparative information for the three and nine months ended September 30, 2017, including disclosures, has not been restated and continues to be reported under the accounting standards in effect for that period.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires lessees to recognize a lease liability and a right-of-use asset on the balance sheet and aligns many of the underlying principles of the new lessor model with those in Accounting Standards Codification Topic 606, Revenue from Contracts with Customers.

ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the requirements of ASU 2016-02 and has not yet determined its impact on the condensed consolidated financial statements.

Note 2 — Fair Value of Financial Instruments

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company measures at fair value certain financial assets and liabilities. GAAP specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1— Quoted prices for identical instruments in active markets;

Level 2— Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3— Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The following tables summarize the fair value measurements as of September 30, 2018 and December 31, 2017 for the Company's financial instruments (in thousands):

	Fair Value Measurements as of September 30, 2018			
Liabilities:	Total	Level 1	Level 2	Level 3
Foreign currency forward contracts	$163	—	$ 163	—
Derivative Warrant Liability	$4,960	—	—	$4,960

	Fair Value Measurements as of December 31, 2017			
Assets:	Total	Level 1	Level 2	Level 3
Foreign currency forward contracts	$508	—	$ 508	$ —

Foreign currency forward contracts are measured at fair value using models based on observable market inputs such as foreign currency exchange rates; therefore, they are classified within Level 2 of the valuation hierarchy.

In connection with the issuance of the Notes, on January 3, 2018, the Company issued to an affiliate of Hale Capital and another purchaser Warrants to purchase up to 6,006,667 shares of common stock at an exercise price equal to $1.00 per share (the “Warrants”). The exercise price of the Warrants and the number of shares of common stock to be purchased upon exercise of the Warrants is subject to adjustment upon certain events, including certain price-based anti-dilution adjustments in the event of future issuances of equity securities. The term of the Warrants is seven years from January 3, 2018. The Warrants contain a cash settlement feature contingent upon the occurrence of certain events defined in the Warrants. As a result of this cash settlement feature, the Warrants are subject to derivative accounting as prescribed under ASC 815. Accordingly, the fair value of the Warrants on the date of issuance was recorded in the Company’s condensed consolidated balance sheets as a liability.

The Warrant liability was recorded in the Company's condensed consolidated balance sheets at its fair value on the date of issuance and is revalued on each subsequent balance sheet date until such instrument is exercised or expires, with any changes in the fair value between reporting periods recorded in the condensed consolidated statements of operations. During the three and nine months ended September 30, 2018, the Company recorded a non-cash loss from the change in fair value of the Warrant liability of 0.6 million and $1.1 million. The increase in fair value during the three and nine months ended September 30, 2018, was driven by the stock premium offered as part of the planned merger as discussed in Note 14 - Definitive Agreement. The Warrants include a repurchase election whereby, in the event of a change of control, the holders thereof may elect to require the Company to repurchase the Warrants at a purchase price equal to the greater of $5.0 million in the aggregate or the aggregate merger consideration payable for the shares underlying the Warrants net of the aggregate exercise price of $1.00 per share. On June 29, 2018, the Company entered into the merger agreement discussed in Note 14 - Definitive Agreement. Based on the $1.72 per share merger consideration, if the merger closes, the Warrants will be repurchased for $5.0 million in the aggregate.

The Company estimates the fair value of this liability using a Monte Carlo pricing model that is based on the individual characteristics of the Warrants on the valuation date, which includes assumptions for expected volatility, expected life and risk-free interest rate, as well as the present value of the minimum cash payment component of the instrument. In performing the fair-value analysis for the Warrant liability the Company engages the support of a third party valuation consultant.

Since the Warrant liability is recorded at fair value and is remeasured on each balance sheet date, if the Company’s stock price experiences an increase or decline, it could increase or decrease the Warrant liability with the change recorded as a corresponding income or expense. Any such change could have a material impact on the Company’s results of operations. The Company classified the Warrant liability as Level 3 due to the lack of relevant observable market data over fair value inputs such as the probability-weighting of the various scenarios in the arrangement. The following table represents a rollforward of the fair value of the Level 3 instrument (in thousands):

Balance at January 3, 2018 (inception)	$3,858
Change in fair value	1,102
Balance at September 30, 2018	$4,960

Note 3 — Accounts Receivable and Other Receivables

Accounts receivable consists of sales to the Company's customers which are generally based on standard terms and conditions. Accounts receivable balances consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Accounts receivable, gross	$ 31,274	$ 32,970
Less: allowance for doubtful accounts	(144)	(150)
Accounts receivable, net	$ 31,130	$ 32,820

As of September 30, 2018 and December 31, 2017, the balance in other receivables was $1.4 million and $3.4 million. Other receivables consisted primarily of non-trade receivables including inventory sold to the Company's contract manufacturing partners or other integration partners (on which the Company does not recognize revenue) and net receivables for value-added taxes.

Note 4 — Inventories

Inventories consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	$ 13,688	$ 23,269
Finished goods	2,134	4,012
	15,822	27,281
Less: inventory valuation allowance	(13,666)	(23,016)
Inventories, net	$ 2,156	$ 4,265

Consigned inventory is held at third-party locations, which include the Company's contract manufacturing partners and customers. The Company retains title to the inventory until purchased by the third-party.

The Company’s consignment inventory with its contract manufacturer consists of inventory transferred from the Company’s prior contract manufacturer as well as inventory that has been purchased by the contract manufacturer as a result of the Company's forecasted demand. The Company is contractually obligated to purchase inventory that has been purchased by its contract manufacturer as a result of the Company's forecasted demand when the inventory ages beyond 180 days and has no forecasted demand. All of the Company's consigned inventory was held by its contract manufacturing partners as of September 30, 2018 and December 31, 2017. The Company records a liability for adverse purchase commitments of inventory owned by its contract manufacturing partners. See Note 7 - Commitments and Contingencies for additional information regarding the Company's adverse purchase commitment liability.

The Company recorded the following charges associated with the valuation of inventory and the adverse purchase commitment liabilities (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Inventory, net	$250	$5,763	$2,538	$6,249
Adverse purchase commitments(A)	100	1,278	(2,562)	1,651
Net charges	$350	$7,041	$(24)	$7,900

(A) When the Company takes possession of inventory reserved for under the adverse purchase liability (Note 7 — Commitments and Contingencies), the associated liability is transferred from other accrued liabilities to the excess and obsolete inventory valuation allowance.

Note 5 — Restructuring and Other Charges

The following table summarizes the Company's restructuring and other charges as presented in the condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Employee-related restructuring expenses	$23	$1,061	$801	$2,318
Integration-related, legal and other non-recurring expenses	1,107	226	2,999	439
Facility reductions	—	57	190	57
Restructuring and other charges, net	$1,130	$1,344	$3,990	$2,814

Restructuring and other charges may include costs from events such as costs incurred for employee severance, acquisition or divestiture activities, excess facility costs, certain legal costs, asset related charges and other expenses associated with business restructuring activities.

For the three months ended September 30, 2018, the Company recorded the following restructuring charges:

- $1.1 million in integration-related, legal and other non-recurring expenses related to the Company's contract manufacturing transfer and non-recurring costs associated with legal, banking, accounting and tax advice associated with the planned merger.

For the three months ended September 30, 2017, the Company recorded the following restructuring charges:

- $1.1 million net expense relating to the severance for 57 employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with the Company's go-forward strategy. An additional $1.0 million of expense will be recognized over a portion of the notified employees’ respective service terms that span up to the next three quarters subsequent September 30, 2017;
- $0.2 million in non-recurring legal expenses; and
- $0.1 million in facility reductions.

For the nine months ended September 30, 2018, the Company recorded the following restructuring charges:

- $3.0 million in integration-related, legal and other non-recurring expenses related to the contract manufacturing transfer and non-recurring costs associated with legal, banking, accounting and tax advice associated with the planned merger;
- $0.8 million expense relating to employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with our go-forward strategy; and

- $0.2 million in facility reductions in the United States.

For the nine months ended September 30, 2017, the Company recorded the following restructuring charges:

- $2.3 million net expense relating to the severance for 87 employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with the Company's go-forward strategy;
- $0.4 million in non-recurring legal expenses associated with closing a strategic agreement with a MediaEngine channel partner; and
- $0.1 million in facility reductions.

Accrued restructuring, which is included in other accrued liabilities in the accompanying condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017, consisted of the following (in thousands):

	Severance, payroll taxes and other employee benefits	Facility reductions	Total
Balance accrued as of December 31, 2017	$ 2,774	$ —	$2,774
Additions	985	190	1,175
Reversals	(192)	—	(192)
Expenditures and payments	(3,473)	(73)	(3,546)
Balance accrued as of September 30, 2018	$ 94	$ 117	$211

The Company evaluates the adequacy of the accrued restructuring charges on a quarterly basis. Reversals are recorded in the period in which the Company determines that expected restructuring obligations are less than the amounts accrued.

Note 6 — Debt and Credit Agreements

Silicon Valley Bank Credit Agreement

On January 3, 2018, concurrently with the Company’s entry into the Note Purchase Agreement and the ABL Credit Agreement described below, the Company repaid in full and terminated the Credit Agreement, dated September 19, 2016, between the Company, as borrower, Silicon Valley Bank, as administrative agent, and the other lenders party thereto, which provided for a three-year revolving credit facility with a $30.0 million revolving loan commitment. As part of the termination of the Silicon Valley Bank Credit Agreement the Company expensed $0.2 million of unamortized debt issuance costs in the period ended March 31, 2018.

ABL Credit Agreement

On January 3, 2018, the Company entered into a Loan and Security Agreement (the “ABL Credit Agreement”) between Marquette Business Credit, LLC, as lender (the “Lender”), and the Company, as borrower. The ABL Credit Agreement provides for a revolving credit facility that provides financing of up to $20.0 million, with a $1.5 million sub-limit for letters of credit (the “ABL Facility”). Borrowings under the ABL Facility are subject to a borrowing base, which is a formula based upon certain eligible domestic accounts receivables, plus the lesser of (x) certain eligible foreign accounts receivables and (y) $20.0 million and minus certain established reserves and the amount of certain other funds held in blocked accounts. The ABL Credit Agreement matures on January 3, 2021. On June 29, 2018, the Company entered into a Temporary Amendment to Loan and Security Agreement (the “First ABL Amendment”). The amendments set forth in the First ABL Amendment remain in effect until the earliest to occur of (i) the occurrence of an event of default under the ABL Credit Agreement, (ii) the termination of the Merger Agreement, (c) the making of any principal payment with respect to the Notes under the Note Purchase Agreement (each as defined below) or (d) October 31, 2018. The Company entered into a Second Temporary Amendment to Loan and Security Agreement (the “Second ABL Amendment”), which, among other things, expires December 31, 2018, compared to the October 31, 2018 expiration date of the First ABL Amendment. For additional information on the Second ABL Amendment, see Note 15 - Subsequent Events. The following takes into account the terms per the agreement as amended on June 29, 2018.

Outstanding borrowings under the ABL Facility bear interest at a rate per annum equal to the sum of the applicable base rate, which is the higher of (i) the prime rate then in effect and (ii) LIBOR plus 2.00%, plus, in each case, 1.00% and is payable monthly in arrears. During the continuance of a default or event of default, borrowings under the ABL Facility will bear interest at a rate 2.00% above the otherwise applicable interest rate. Under the ABL Credit Agreement, the Company is required to pay a commitment fee of 0.375% per annum based on the average unused portion of the revolving loan commitment and certain other fees in connection with the origination of the ABL Facility and the issuance of letters of credit. In connection with the early termination of the ABL Facility, the Company will also be required to pay (x) a fee equal to 2.00% of the total revolving loan commitment if termination occurs on or prior to January 3, 2019 and (y) 1.00% of the total revolving loan commitment if termination occurs after January 3, 2019 and on or prior to January 3, 2020. There is no early termination fee if the ABL Facility is terminated after January 3, 2020.
The ABL Credit Agreement contains representations and warranties, covenants, indemnities and conditions, in each case, that the Company believes are customary for transactions of this type. Pursuant to the terms of the ABL Credit Agreement, the Company is required to meet certain financial and other restrictive covenants, including maintaining a minimum Fixed Charge Coverage Ratio (as defined in the ABL Credit Agreement) (the Fixed Charge Coverage Ratio requirement has been temporarily suspended pursuant to the First ABL Amendment) and not exceeding maximum capital expenditures in any fiscal year (each as defined in the ABL Credit Agreement), not exceeding certain thresholds for Cash Loss After Debt Service (as defined in the ABL Credit Agreement). Additionally, the Company is also prohibited from taking certain actions without consent of the Lender, including, without limitation, incurring additional indebtedness, entering into certain mergers or other business combination transactions, disposing of or permitting liens or other encumbrances on the Company’s assets and making restricted payments, including cash dividends on shares of the Company’s common stock, in each case, except as expressly permitted under the ABL Credit Agreement. The ABL Credit Agreement contains events of default that the Company believes are customary for transactions of this type. If a default occurs and is not cured within the applicable cure period or is not waived, any outstanding obligations under the ABL Credit Agreement may be accelerated.

The ABL Facility is guaranteed on a senior secured basis by the Guarantors (as defined below). The Company’s and the Guarantors’ obligations under the ABL Facility and any guarantee of the ABL Facility (and certain related obligations) are secured by first-priority liens on the Collateral (as defined below). The Company’s and the Guarantors’ obligations under the ABL Facility and any guarantee of the ABL Facility (and certain related obligations) have first-priority in the waterfall set forth in the Intercreditor Agreement (as defined below) in respect of the liens on the Collateral constituting, among other things, accounts receivable, inventory and cash of the Borrower and the Guarantors (collectively, the “ABL Priority Collateral”). The Company’s and the Guarantors’ obligations under the ABL Facility and any guarantee of the ABL facility (and certain related obligations) have second-priority in the waterfall set forth in the Intercreditor Agreement in respect of the liens on the Term Priority Collateral (as defined below). As described below, the Company must also maintain minimum cash balances in a restricted deposit account of $4.0 million, which will secure both the obligations under the Notes and the ABL Facility.

The Company paid approximately $0.3 million in debt issuance fees which were capitalized and will be expensed on a straight-line basis as interest expense over the term of the ABL Credit Agreement.
As of September 30, 2018, the Company had an outstanding balance of $12.0 million under the ABL Credit Agreement. As of December 31, 2017, the Company had an outstanding balance of $16.0 million under the Silicon Valley Bank Credit Agreement. At September 30, 2018, the Company had $3.4 million of total borrowing availability remaining under the ABL Credit Agreement. At September 30, 2018, the Company was in compliance with all covenants under the ABL Credit Agreement.

Hale Capital Note Purchase Agreement

On January 3, 2018, the Company also entered into a Note Purchase Agreement (the “Note Purchase Agreement”) among the Company, as borrower, the Guarantors (as defined below) from time to time party thereto, the purchasers from time to time party thereto (collectively, the “Purchasers”) and HCP-FVG, LLC, an affiliate of Hale Capital Partners LP, as collateral agent and as a Purchaser ("Hale Capital"). Pursuant to the Note Purchase Agreement, the Company issued and sold to the Purchasers senior secured promissory notes in an aggregate original principal amount of $17.0 million (the "Notes"). On June 29, 2018, the Company entered into a First Amendment to Note Purchase Agreement (the “NPA First Amendment”). In the event that (i) the Merger Agreement is terminated or the closing of the Merger is not consummated and the effective time of the Merger has not occurred prior to the Outside Date (as defined in the Merger Agreement), (ii) the Merger Agreement has been amended without consent of the Purchasers or there has been a decline in the merger consideration offered or (iii) Radisys has failed to make certain exit fee payments to the Purchasers as required by the NPA First Amendment, the amendments set forth in the NPA First Amendment shall cease to be of force or effect and the Note Purchase Agreement shall revert to the terms originally set forth therein prior to the NPA First Amendment. The following takes into account the terms per the agreement as amended on June 29, 2018.

The Notes bear interest at a rate equal to the greater of 4.50% or the prime rate plus 5.75% (currently 11.00% per year), payable monthly in arrears. For any interest payment date occurring on or prior to February 28, 2019, the monthly interest payment will be paid in the form of additional Notes (unless an event of default has occurred and is continuing, in which case all interest shall be paid in cash). Thereafter, the interest will be payable monthly in cash in arrears. Interest on the Notes will be computed on the basis of a 360-day year comprising twelve 30-day months. During the continuance of a default or event of default, the Notes will bear interest at a rate 5.00% above the otherwise applicable interest rate.

The maturity date of the Notes is January 3, 2021 (the “Term Maturity Date”). The Company is required to redeem the Notes in principal installments of (i) $4.5 million payable on February 28, 2019 and (ii) $1.50 million payable on the last day of each fiscal quarter beginning with the fiscal quarter ending March 31, 2019 and continuing through the last full fiscal quarter prior to the Term Maturity Date. In addition, the Company will be required to redeem all of the Notes upon a change of control; the NPA First Amendment provides that the execution of the Merger Agreement will not constitute a change of control under the Note Purchase Agreement or otherwise violate relevant covenants and conditions set forth in the Note Purchase Agreement. The Company will be required to make certain mandatory redemptions of the Notes with (x) the net proceeds of any voluntary or involuntary sale or disposition of assets (including casualty losses and condemnation awards, subject to certain exceptions) and (y) 33% of the net proceeds from the issuance or sale of any equity (unless an event of default exists under the Note Purchase Agreement, in which case it will be 100% of the net proceeds), subject to certain exceptions and limitations. The Company may also redeem the Notes in whole or in part at any time.

All redemptions of the Notes (whether mandatory, optional or as result of the acceleration of the Notes) are subject to a prepayment fee as follows: (i) if a prepayment is on or before January 3, 2020, 5% of the principal prepaid; and (ii) if prepayment is on or after January 4, 2020 and on or before January 2, 2021, 3% of the principal prepaid.

The Note Purchase Agreement contains representations and warranties, covenants, indemnities and conditions, in each case, that the Company believes are customary for transactions of this type. Under the Note Purchase Agreement, the Company is required to meet certain financial and other restrictive covenants, including maintaining a minimum Coverage Ratio and Total Liquidity (each as defined in the Note Purchase Agreement), maintaining the amount of negative cumulative cash flow from operations below an agreed threshold, maintaining certain minimum levels of revenue and not exceeding a maximum long-term deferred revenue threshold. Additionally, the Company and its subsidiaries are also prohibited from taking certain actions without consent of the Purchasers, including, without limitation, incurring additional indebtedness, entering into certain mergers or other business combination transactions, disposing of or permitting liens or other encumbrances on their assets, making restricted payments, including cash dividends on shares of the Company's common stock, and other investments and making capital expenditures in excess of certain thresholds, in each case, except as otherwise expressly permitted under the Note Purchase Agreement. The Note Purchase Agreement contains events of default that the Company believes are customary for transactions of this type. If a default occurs and is not cured within the applicable cure period or is not waived, any outstanding obligations under the Note Purchase Agreement may be accelerated.

The Notes are guaranteed on a senior secured basis by the Company’s U.S. subsidiary, Radisys International LLC (“Radisys International”). Each of its future material domestic subsidiaries will also be required to guarantee the Notes on a senior secured basis (collectively with Radisys International, the “Guarantors”). The Company’s and the Guarantors’ obligations under the Notes and any guarantee of the Notes (and certain related obligations) are secured by substantially all of the Company’s and the Guarantors’ tangible and intangible assets, subject to specified exceptions (the “Collateral”). The Company’s and the Guarantors’ obligations under the Notes and any guarantee of the Notes (and certain related obligations) have first-priority in the waterfall set forth in an intercreditor agreement entered into in connection with the Notes and the ABL Facility (the “Intercreditor Agreement”) in respect of the liens on the Collateral other than the ABL Priority Collateral (the “Term Priority Collateral”). The Company’s and the Guarantors’ obligations under the Notes and any guarantee of the Notes (and certain related obligations) have second-priority in the waterfall set forth in the Intercreditor Agreement in respect of the liens on the ABL Priority Collateral. The Company must also maintain at least $4.0 million in cash in a restricted deposit account at UMB Bank, n.a. or at a restricted deposit account designated by Hale Capital. The amount in the restricted account will secure both the obligations under the

Notes and the ABL Facility.
The Company incurred approximately $2.1 million in debt issuance fees which are shown as a direct deduction from the Notes payable balance. The debt issuance costs are being amortized to interest expense using the effective interest method over the term of the Note Purchase Agreement. At September 30, 2018, the Company was in compliance with all covenants under the Note Purchase Agreement.

The components of the Company’s Note Purchase Agreement for the nine months ended September 30, 2018 are as follows:

	December 31, 2017	Additions/Borrowings	Repayment /Amortization	September 30, 2018
	(In thousands)			
Notes	$ —	$ 17,000	$ —	$ 17,000
Add: Interest converted to Notes	—	1,388	—	1,388
Less: Deferred issuance costs	—	(2,077)	751	(1,326)
Less: Issuance costs associated with Warrants	—	(3,858)	1,443	(2,415)
Total Debt, net of deferred issuance costs	—	12,453	2,194	14,647
Short term debt obligations	—			9,000
Long term debt obligations, net	$—			$ 5,647

The carrying value of the Notes and credit facility approximates fair value due to the recent execution of the agreements and variability of the interest rates being tied to indexes.

Warrants

In connection with the issuance of the Notes, on January 3, 2018, the Company issued to an affiliate of Hale Capital and another purchaser warrants to purchase up to 6,006,667 shares of common stock at an exercise price equal to $1.00 per share on January 3, 2018 (the “Warrants”). The exercise price of the Warrants and the number of shares of common stock to be purchased upon exercise of the Warrants is subject to adjustment upon certain events, including certain price-based anti-dilution adjustments in the event of future issuances of equity securities. The term of the Warrants is seven years from January 3, 2018. The Company relied on the exemption from registration contained in Section 4(2) of the Securities Act of 1933, as amended (the “Securities Act”) in connection with the issuance of the Warrants. On March 30, 2018, the Company filed a Registration Statement on Form S-3 to register the shares of common stock underlying the Warrants for resale under the Securities Act. The Registration Statement became effective on April 30, 2018.

The Warrants contain a cash settlement feature contingent upon the occurrence of certain events, defined in the Warrants. As a result of this cash settlement feature, the Warrants are subject to derivative accounting as prescribed under ASC 815. Accordingly, the fair value of the Warrants on the date of the issuance was recorded in the Company's condensed consolidated balance sheets as a liability and is revalued on each subsequent balance sheet date until such instruments are exercised or expire, with any changes in the fair value between reporting periods recorded as other income or expense.

Note 7 — Commitments and Contingencies

Adverse Purchase Commitments

The Company is contractually obligated to reimburse its contract manufacturer for the cost of excess inventory used in the manufacture of the Company's products if there is no alternative use. This liability, referred to as adverse purchase commitments, is presented in other accrued liabilities in the accompanying condensed consolidated balance sheets. Estimates for adverse purchase commitments are derived from reports received on a quarterly basis from the Company's contract manufacturer. Increases to this liability are charged to cost of sales. If and when the Company takes possession of inventory reserved for in this liability, the liability is transferred from other accrued liabilities to the excess and obsolete inventory valuation allowance (Note 4 —Inventories).

The adverse purchase commitment liability is included in other accrued liabilities in the accompanying condensed consolidated balance sheets and was $0.7 million and $3.3 million as of September 30, 2018 and December 31, 2017.

Guarantees and Indemnification Obligations

As permitted under Oregon law, the Company has agreements whereby it indemnifies its officers, directors and certain finance employees for certain events or occurrences while an officer, director or employee is or was serving in such capacity at the request of the Company. The term of the indemnification period is for the officer's, director's or employee's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a Director and Officer insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts paid. To date, the Company has not incurred any costs associated with these indemnification agreements and, as a result, management believes the estimated fair value of these indemnification agreements is minimal. Accordingly, the Company has not recorded any liabilities for these agreements as of September 30, 2018.

The Company enters into standard indemnification agreements in its ordinary course of business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally the Company's business partners or customers, in connection with patent, copyright or other intellectual property infringement claims by any third party with respect to the Company's current products, as well as claims relating to property damage or personal injury resulting from the performance of services by us or the Company's subcontractors. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is generally limited. Historically, the Company's costs to defend lawsuits or settle claims relating to such indemnity agreements have been minimal.

Accrued Warranty

The Company provides for the estimated cost of product warranties at the time it recognizes revenue. Products are generally sold with warranty coverage for a period of 12 or 24 months after shipment. Parts and labor are covered under the terms of the warranty agreement. The workmanship of the Company’s products produced by the contract manufacturer is covered under warranties provided by the contract manufacturer for 12 to 24 months. The warranty provision is based on historical experience by product family. The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its components suppliers; however ongoing failure rates, material usage and service delivery costs incurred in correcting product failure, as well as specific product class failures out of the Company’s baseline experience, affect the estimated warranty obligation. If actual product failure rates, material usage or service delivery costs differ from estimates, revisions to the estimated warranty liability would be required.

The following is a summary of the change in the Company's accrued warranty reserve (in thousands):

	September 30, 2018	December 31, 2017
Warranty liability balance, beginning of the period	$ 1,124	$ 1,821
Product warranty accruals (reversals)	238	305
Utilization of accrual	(331)	(1,002)
Warranty liability balance, end of the period	$ 1,031	$ 1,124

At September 30, 2018 and December 31, 2017, $0.6 million and $0.9 million of the warranty liability balance was included in other accrued liabilities and $0.4 million and $0.2 million was included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

Liquidity Outlook

During the third quarter of 2018 the Company generated positive operating cash flows of $4.8 million. However, over the previous several quarters, the Company has experienced significant operating losses and consumed significant cash from operations resulting from a material decline in DCEngine product line. Given the uncertainty of future business from the DCEngine product line, the Company began taking action in the fourth quarter of 2017 to significantly reduce its overhead and operating expenses moving forward aimed at enabling the Company to return to profitability and free cash flow generation. These actions also included closing the new financing arrangements disclosed in Note 6- Debt and Credit Agreements, which positioned the Company to implement its expense reduction actions and settle committed inventory purchases through the first half of 2018.

A sustained return to profitability and free cash flow generation is based on certain assumptions and projections, including growth from our Software-Systems business. If the Company is unable to attain certain levels of revenue growth, or meet its cost reduction targets, the Company may be out of compliance with covenants associated with the new financing arrangements which may have a material adverse effect on its liquidity.

At September 30, 2018, the Company's cash and cash equivalents including restricted cash amounted $14.1 million. The Company believes its current cash and cash equivalents, cash expected to be generated from operations and available borrowings under the ABL Credit Agreement will satisfy the Company's short and long-term expected working capital needs, capital expenditures, stock repurchases, and other liquidity requirements associated with its present business operations. If the Company is unable to comply with various covenants under the ABL Credit Agreement and the Note Purchase Agreement due to the timing of orders and shipments from the Company's Software-Systems customers, delays in payment of accounts receivable or other adverse business conditions that impact its operating plans, without an amendment or waiver, the Company's liquidity outlook could be materially and adversely affected. Pursuant to the Merger Agreement, aggregate borrowings under the ABL Credit Agreement and any additional indebtedness the Company incurs may not exceed $14 million at any time. The Company continues to pursue a number of actions to improve its cash position including (i) minimizing capital expenditures, (ii) effectively managing working capital, (iii) seeking amendments or waivers from lenders and (iv) improving cash flows from operations. These efforts continue in earnest.

Note 8 — Basic and Diluted Net Loss per Share

A reconciliation of the numerator and the denominator used to calculate basic and diluted net loss per share is as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Numerator				
Net loss	$(1,873)	$(15,411)	$(12,952)	$(32,973)
Denominator — Basic				
Weighted average shares used to calculate net loss per share, basic	39,616	39,087	39,496	38,922
Denominator — Diluted				
Weighted average shares used to calculate net loss per share, basic	39,616	39,087	39,496	38,922
Effect of dilutive restricted stock units [(A)]	—	—	—	—
Effect of dilutive stock options [(A)]	—	—	—	—
Weighted average shares used to calculate net loss per share, diluted	39,616	39,087	39,496	38,922
Net loss per share				
Basic	$(0.05)	$(0.39)	$(0.33)	$(0.85)
Diluted	$(0.05)	$(0.39)	$(0.33)	$(0.85)

22

(A) For the three and nine months ended September 30, 2018 and 2017, the following equity awards, by type, were excluded from the calculation, as their effect would have been anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	5,059	3,527	5,059	3,527
Restricted stock units	211	639	211	639
Performance-based restricted stock units (B)	335	999	335	999
Warrants	6,067	—	6,067	
Total equity award shares excluded	11,672	5,165	11,672	5,165

(B) Performance-based restricted stock units are presented based on attainment of 100% of the performance goals being met.

Note 9 — Income Taxes

The Company's effective tax rate for the three and nine months ended September 30, 2018 differs from the statutory rate due to a full valuation allowance provided against its United States net deferred tax assets, and taxes on foreign income that differ from the U.S. tax rate.

The Company utilizes the asset and liability method of accounting for income taxes. The Company records deferred tax assets to the extent it believes these assets will more likely than not be realized. In making such determination, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Based upon the Company's review of all positive and negative evidence, including its three year U.S. cumulative pre-tax book loss and taxable loss, it concluded that a full and a partial valuation allowance should continue to be recorded against its U.S. and Canadian net deferred tax assets at September 30, 2018. In certain other foreign jurisdictions, where the Company does not have cumulative losses or other negative evidence, the Company had net deferred tax assets of $0.8 million and $0.8 million at September 30, 2018 and December 31, 2017. In the future, if the Company determines that it is more likely than not that it will realize its U.S. and Canadian net deferred tax assets, it will reverse the applicable portion of the valuation allowance and recognize an income tax benefit in the period in which such determination is made.

The ending balance for the unrecognized tax benefits for uncertain tax positions was approximately $4.8 million at September 30, 2018. The related interest and penalties were $1.1 million and $0.2 million. The uncertain tax positions, including interest and penalties, that are reasonably possible to decrease in the next twelve months are approximately $0.3 million.

The Company is currently under tax examination in India and Canada. The periods under examination in India and Canada are the Company's financial years 2005, 2006, 2009, and 2011 for India and 2007 through 2014 for Canada. The examinations are in various stages of appellate proceedings and all material uncertain tax positions associated with the examinations have been taken into account in the ending balance of the unrecognized tax benefits at September 30, 2018.

In December 2017, the Tax Cuts and Jobs Act (the "2017 Tax Act") introduced significant changes to U.S. income tax law. Effective 2018, the Tax Act reduced the U.S. statutory tax rate from 35% to 21% and created new taxes on certain foreign-sourced earnings.

Due to the timing of the enactment and the complexity involved in applying the provisions of the 2017 Tax Act, the Company made reasonable estimates of the effects and recorded provisional amounts in its financial statements as of December 31, 2017. As the Company collects and prepares necessary data and interprets the 2017 Tax Act and any additional guidance issued by the U.S. Treasury Department, the Internal Revenue Service (IRS), and other standard-setting bodies, the Company may make adjustments to the provisional amounts. Those adjustments may materially affect the Company’s provision for income taxes and effective tax rate in the period in which the adjustments are made. The accounting for the tax effects of the 2017 Tax Act will be completed later in 2018.

Note 10 — Stock-based Compensation

The following table summarizes awards granted under the Radisys Corporation 2007 Stock Plan (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	—	30	2,775	30
Restricted stock units	21	20	21	677
Performance-based restricted stock awards (A)	—	20	—	690
Total	21	70	2,796	1,397

(A) On March 10, 2017, the Compensation Committee approved grants of PRSUs to certain employees. The awards will vest only on satisfaction of certain performance criteria during two separate annual performance periods and a portion of the award earned will vest upon satisfaction of a time-based service component. 50% of the awards can be earned by meeting strategic revenue targets in fiscal year 2017 and 50% can be earned by meeting strategic revenue targets in fiscal year 2018. One-half of any PRSUs earned during each performance period will vest upon meeting the performance criteria, and the remaining half will be subject to a further time-based service component and will vest one year after meeting the targets. By meeting the relevant performance criteria set forth in the award agreement, employees can earn 0%, 75%, 100% or 125% of the award during each performance period. If an employee earns less than 100% of the award for the 2017 performance period, the employee is eligible to earn the remaining portion of the award in fiscal year 2018 if cumulative 2017 and 2018 strategic revenue targets are met in the two year period. Shares are presented based on attainment of 0% of the performance goals being met. At attainment of 125%, the amount of shares eligible to be earned is 418,334.

Management assessed it is not probable that the 2017 and 2018 PRSU award will be achieved. No expense associated with these awards was recognized in the three and nine months ended September 30, 2018.

The awards associated with strategic revenue targets in 2016 were earned and settled in shares in the nine month period ended September 30, 2017.

Stock-based compensation was recognized and allocated as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of sales	$12	$(3)	$70	$134
Research and development	35	22	155	365
Selling, general and administrative	203	105	732	1,317
Total	$250	$124	$957	$1,816

Note 11 — Hedging

The Company's business activities expose it to a variety of market risks, including the effects of changes in foreign currency exchange rates. The Company manages these risks through the use of forward exchange contracts, designated as foreign-currency cash flow hedges, in an attempt to reduce the potentially adverse effects of foreign currency exchange rate fluctuations that occur in the normal course of business. As such, the Company's hedging activities are employed solely for risk management purposes. All hedging transactions are conducted with, in the opinion of management, financially stable and reputable financial institutions. As of September 30, 2018 and December 31, 2017, the only hedge instruments executed by the Company are associated with its exposure to fluctuations in the Indian Rupee, which result from obligations such as payroll and rent paid in this currency.

These derivatives are recognized on the balance sheet at their fair value. Unrealized gain positions are recorded as other current assets and unrealized loss positions are recorded as other current liabilities. Changes in the fair values of the outstanding derivatives that are highly effective are recorded in other comprehensive income until net income (loss) is affected by the variability of the cash flows of the hedged transaction. Typically, hedge ineffectiveness could result when the amount of the Company’s hedge contracts exceed the Company’s forecasted or actual transactions for which the hedge contracts were designed to hedge. Once a hedge contract matures, the associated gain (loss) on the contract will remain in other comprehensive income (loss) until the underlying hedged transaction affects net income (loss), at which time the gain (loss) will be reclassified out of accumulated other comprehensive income (loss) and recorded to the expense line item being hedged. The Company only enters into derivative contracts in order to hedge foreign currency exposure, and these contracts do not exceed two years from inception. If the Company entered into a contract for speculative reasons or if the Company’s current hedge position becomes ineffective, changes in the fair values of the derivatives would be recognized in earnings in the current period.

The Company assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives are expected to remain highly effective in future periods. For the three and nine months ended September 30, 2018 and 2017, the Company had no hedge ineffectiveness.

During the three and nine months ended September 30, 2018 the Company did not enter into any new foreign currency forward contracts. During the three and nine months ended September 30, 2017 the Company entered into 6 and 18 new foreign currency forward contracts, with total contractual values of $3.6 million and $10.5 million.

A summary of the aggregate contractual or notional amounts, balance sheet location and estimated fair values of derivative financial instruments designated as cash flow hedges at September 30, 2018 is as follows (in thousands):

Type of Cash Flow Hedge	Contractual/ Notional Amount	Condensed Consolidated Balance Sheets Classification	Estimated Fair Value Asset	(Liability)
Foreign currency forward exchange contracts	$ 2,007	Other accrued liabilities	$ —	$ (163)

A summary of the aggregate contractual or notional amounts, balance sheet location and estimated fair values of derivative financial instruments designated as cash flow hedges at December 31, 2017 is as follows (in thousands):

Type of Cash Flow Hedge	Contractual/ Notional Amount	Condensed Consolidated Balance Sheets Classification	Estimated Fair Value Asset	(Liability)
Foreign currency forward exchange contracts	$ 13,018	Other current assets	$ 508	$ —

The following table summarizes the effect of derivative instruments on the condensed consolidated financial statements as a loss (gain) as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of sales	$165	$(48)	$140	$(98)
Research and development	122	(67)	87	(137)
Selling, general and administrative	57	(22)	46	(45)

Total	$344	$(137)	$273	$(280)

The following is a summary of changes to comprehensive income (loss) associated with the Company's hedging activities (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Beginning balance of unrealized loss on forward exchange contracts	$(810)	$(96)	$(177)	$(527)
Other comprehensive income (loss) before reclassifications	228	(105)	(334)	469
Amounts reclassified from other comprehensive income (loss)	344	(137)	273	(280)
Other comprehensive income (loss)	572	(242)	(61)	189
Ending balance of unrealized loss on forward exchange contracts	$(238)	$(338)	$(238)	$(338)

Over the next twelve months, the Company expects to reclassify into earnings a loss of approximately $0.2 million currently recorded as accumulated other comprehensive loss, as a result of the maturity of currently held forward exchange contracts.

The bank counterparties in these contracts expose the Company to credit-related losses in the event of their nonperformance. However, to mitigate that risk, the Company only contracts with counterparties who meet its minimum requirements regarding counterparty credit worthiness. In addition, the Company monitors credit ratings, credit spreads and potential downgrades prior to entering into any new hedging contracts.

Note 12 — Segment Information

The Company is comprised of two operating segments: Software-Systems and Hardware Solutions. The Company's Chief Executive Officer, or chief operating decision maker, regularly reviews discrete financial information for purposes of allocating resources and assessing the performance of each segment:

- Software-Systems. Software-Systems is comprised of three product lines: FlowEngine, MediaEngine and MobilityEngine, each of which delivers software-centric solutions to service providers on a direct and indirect basis.

- Hardware Solutions. Hardware Solutions includes the Company's embedded product portfolio and DCEngine products lines.

Cost of sales, research and development and selling, general and administrative expenses are allocated to Software-Systems and Hardware Solutions. Expenses, reversals, gains and losses not allocated to Software-Systems or Hardware Solutions include amortization of acquired intangible assets, stock-based compensation, restructuring and other charges, and other one-time non-recurring events. These items are allocated to corporate and other.

The Company recorded the following revenues, gross margin and income (loss) from operations by operating segment for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Revenue				
Software-Systems	$14,073	$11,306	$38,884	$32,943
Hardware Solutions	12,950	17,467	38,742	68,533
Total revenues	$27,023	$28,773	$77,626	$101,476

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Gross margin				
Software-Systems	$8,390	$5,420	$22,699	$17,128
Hardware Solutions	3,387	(2,302)	8,737	8,211
Corporate and other	(37)	(1,923)	(3,576)	(5,914)
Total gross margin	$11,740	$1,195	$27,860	$19,425

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Income (loss) from operations				
Software-Systems	$39	$(2,358)	$(2,159)	$(7,574)
Hardware Solutions	1,751	(7,885)	3,547	(8,963)
Corporate and other	(1,602)	(3,683)	(9,045)	(13,219)
Total income (loss) from operations	$188	$(13,926)	$(7,657)	$(29,756)

Assets are not allocated to segments for internal reporting presentations. A portion of depreciation is allocated to the respective segment. It is impracticable for the Company to separately identify fixed assets by segment whose depreciation is included in the measure of segment profit or loss.

Revenues by geographic area were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States	$12,582	$11,223	$31,570	$49,151
Other North America	93	269	386	703
Asia Pacific ("APAC")	2,822	5,703	12,267	17,819
Netherlands	8,257	7,849	20,370	21,450
Other EMEA	3,269	3,729	13,033	12,353
Europe, the Middle East and Africa (“EMEA”)	11,526	11,578	33,403	33,803
Foreign Countries	14,441	17,550	46,056	52,325
Total	$27,023	$28,773	$77,626	$101,476

Long-lived assets by geographic area are as follows (in thousands):

	September 30, 2018	December 31, 2017
Property and equipment, net		
United States	$ 2,055	$ 2,974
Other North America	3	33
China	39	163
India	1,145	1,558
Total APAC	1,184	1,721
Foreign Countries	1,187	1,754
Total property and equipment, net	$ 3,242	$ 4,728
Intangible assets, net		
United States	$ 2,189	$ 6,862
Total intangible assets, net	$ 2,189	$ 6,862

The following customers accounted for more than 10% of the Company's total revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Customer A	32.6%	30.3%	34.6%	23.1%
Customer C	N/A	17.7%	N/A	12.8%
Customer D	N/A	N/A	N/A	25.5%

The following customers accounted for more than 10% of accounts receivable:

	September 30, 2018	December 31, 2017
Customer A	27.5 %	19.1 %
Customer B	N/A	18.7 %
Customer C	N/A	14.5 %

28

Note 14 - Definitive Agreement

On June 29, 2018, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Reliance Industries Limited, a company organized and existing under the laws of India ("Reliance"), and Integrated Cloud Orchestration (ICO), Inc., an Oregon corporation and a wholly owned subsidiary of Reliance ("Merger Sub"). The Merger Agreement provides that, among other things and upon the terms and subject to the conditions of the Merger Agreement, (i) Merger Sub will be merged with and into Radisys (the "Merger"), with Radisys surviving and continuing as the surviving corporation in the Merger and a wholly owned subsidiary of Reliance, and, (ii) at the effective time of the Merger, each outstanding share of common stock of Radisys, no par value ("Common Stock"), (other than Common Stock owned by Reliance, Merger Sub or any wholly-owned subsidiary of Reliance or Radisys or held in the treasury of Radisys, all of which shall be canceled without any consideration being exchanged therefor) will be converted into the right to receive an amount equal to $1.72 per share in cash (the "Merger Consideration"). The closing of the Merger is subject to customary closing conditions, including (i) the adoption of the Merger Agreement by the holders of not less than a majority of the outstanding shares of Common Stock, which was approved on September 5, 2018, (ii) the receipt of specified required regulatory approvals, and the suitable form of approval by the Committee on Foreign Investment in the United States, (iii) the absence of any law or order enjoining or prohibiting the Merger or making it illegal, (iv) the accuracy of the representations and warranties contained in the Merger Agreement (generally subject to a "material adverse effect" qualification) and (v) compliance with covenants in the Merger Agreement in all material respects. The closing of the Merger is not subject to a financing condition. The Merger is expected to close in the fourth quarter of 2018.

Note 15. Subsequent Event

Radisys entered into the Second ABL Amendment, effective October 31, 2018, which amends the ABL Credit Agreement. The Second ABL Amendment temporarily suspends the requirement that Radisys maintain a minimum Fixed Charge Coverage Ratio (as defined in the ABL Credit Agreement) and continues required thresholds relating to Cash Loss After Debt Service (as defined in the ABL Credit Agreement) by Radisys through December 31, 2018. The Second ABL Amendment also temporarily reduces the minimum balance that must be maintained in blocked accounts.

The amendments set forth in the Second ABL Amendment shall remain in effect until the earliest to occur of: (a) the occurrence of an event of default under the ABL Credit Agreement; (b) the termination of the Merger Agreement; (c) the making of any principal payment with respect to the Notes under the Note Purchase Agreement; or (d) December 31, 2018.

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

You should read the following discussion and analysis in conjunction with our condensed consolidated financial statements and the related notes included in this Quarterly Report on Form 10-Q and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Unless required by context, or as otherwise indicated, "we," "us," "our" and similar terms, as well as references to the "Company" and "Radisys" refer to Radisys Corporation and include all of our consolidated subsidiaries.

Overview

Radisys Corporation (NASDAQ: RSYS), a global leader in open telecom solutions, enables service providers to drive disruption with new open architecture business models. Radisys' innovative disaggregated and virtualized enabling technology solutions leverage open reference architectures and standards, combined with open software and hardware to power business transformation for the telecom industry, while its world-class services organization delivers systems integration expertise necessary to solve communications and content providers' complex deployment challenges. We operate in two primary segments, Software-Systems and Hardware Solutions.

- Software-Systems products and services are targeted at delivering differentiated solutions for service providers to enable their deployment of next generation networks and technologies. This segment is comprised of technologies aimed at enabling service providers to more rapidly adopt new technologies while driving down the costs of their network infrastructure.

- Hardware Solutions leverages our hardware design expertise, coupled with our manufacturing, supply chain, integration and service capabilities, to enable differentiation from our competition. While the Software-Systems business will be our core strategic focus moving forward, we continue to support existing customers that value the products we deliver within our Hardware Solutions segment.

Third Quarter 2018 Summary

As disclosed in our 2017 annual report, changes to our strategy in late 2017 specifically tied to our hardware-centric DCEngine product line led to material year-on-year revenue declines through the first half of 2018. These strategy changes led us to drive material cost-reduction actions across our business, which actions were largely completed by the end of the first quarter of 2018. In the third quarter of 2018, we experienced an increasing share of our revenues from our higher margin Software-Systems business given growth from both existing and new customers which was offset by continued declines in our Hardware Solutions revenue.

The following is a summary-level comparison of the three months ended September 30, 2018 and 2017:

- Revenues decreased $1.8 million to $27.0 million for the three months ended September 30, 2018 from $28.8 million for the three months ended September 30, 2017. Hardware Solutions revenue decreased $4.5 million, due to expected declines in revenue from our legacy hardware business. Software-Systems revenue increased $2.8 million as compared to the prior year driven by strong sales of software supporting initial 5G development, expanding voice-over-LTE and conferencing deployments, and increased professional services business from both existing and new customers.

- Gross margin increased 3,930 basis points to 43.4% for the three months ended September 30, 2018 from 4.1% for the three months ended September 30, 2017. Gross margins for the three months ended September 30, 2017 were adversely impacted by a $7.0 million inventory charge associated with a strategic decision to eliminate non-core legacy hardware product lines. Further gross margin expansion was realized in the quarter ended September 30, 2018 given the increasing mix of our Software-Systems business.

- R&D expense decreased by $2.2 million to $3.5 million for the three months ended September 30, 2018 from $5.6 million in 2017 and was the result of reductions in headcount, stock compensation, and other product development expenses associated with our aforementioned cost-reduction initiatives.

- Selling, general and administrative (SG&A) expense decreased $1.1 million to $6.8 million for the three months ended September 30, 2018 from $7.8 million for the three months ended September 30, 2017. This was the result of reduction in headcount, stock compensation, and other expenses associated with our aforementioned cost-reduction initiatives.

30

- Cash and cash equivalents, including restricted cash, on September 30, 2018 increased $6.0 million to $14.1 million from $8.1 million at December 31, 2017. The increase was the result of net increases in our borrowings of $10.6 million offset by $4.1 million in cash consumption from operations predominantly associated with our cost reduction initiatives and payment for inventory purchase commitments not sold to our customers.

Comparison of the Three and Nine Months Ended September 30, 2018 and 2017

Results of Operations

The following table sets forth certain operating data as a percentage of revenues for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Revenues:				
Product	66.3 %	71.7 %	65.4 %	74.6 %
Service	33.7	28.3	34.6	25.4
Total revenues	100.0	100.0	100.0	100.0
Cost of sales:				
Product	36.1	70.8	39.2	59.6
Service	19.7	18.4	19.6	15.6
Amortization of purchased technology	0.8	6.7	5.3	5.7
Total cost of sales	56.6	95.9	64.1	80.9
Gross margin	43.4	4.1	35.9	19.1
Research and development	12.8	19.6	13.4	17.8
Selling, general, and administrative	25.0	27.3	26.5	25.1
Intangible asset amortization	0.7	1.0	0.7	2.8
Restructuring and other charges, net	4.2	4.7	5.1	2.8
Income /(loss) from operations	0.7	(48.5)	(9.8)	(29.4)
Change in fair value of Warrant liability	(2.2)	—	(1.4)	—
Interest expense	(5.2)	(1.5)	(5.4)	(0.9)
Other income (expense), net	5.4	(0.4)	3.6	(0.5)
Loss before income tax expense	(1.3)	(50.4)	(13.0)	(30.8)
Income tax expense	5.5	3.3	3.7	1.7
Net loss	(6.8)%	(53.7)%	(16.7)%	(32.5)%

Revenues

The following table sets forth operating segment revenues for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Change	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	Change
Revenue						
Software-Systems	$14,073	$11,306	24.5 %	$38,884	$32,943	18.0 %

Hardware Solutions	12,950	17,467	(25.9)	38,742	68,533	(43.5)
Total revenues	$27,023	$28,773	(6.1)%	$77,626	$101,476	(23.5)%

31

Software-Systems. Revenues in our Software-Systems segment increased $2.8 million and $5.9 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. This was driven by strong sales of software supporting initial 5G development, expanding voice-over-LTE and software-based conferencing deployments, and increased professional services revenues.

Hardware Solutions. Revenues in our Hardware Solutions segment decreased $4.5 million and $29.8 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. This decrease is due to a decline in revenues from our legacy hardware product lines including a decline in sales to a tier-one U.S. service provider for their data center buildout.

Revenue by Geography

The following tables outline overall revenue dollars and the percentage of revenues, by geographic region, for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
North America	$12,675	$11,492	10.3 %	$31,956	$49,854	(35.9)%
Asia Pacific	2,822	5,703	(50.5)	12,267	17,819	(31.2)
Europe, the Middle East and Africa ("EMEA")	11,526	11,578	(0.4)	33,403	33,803	(1.2)
Total	$27,023	$28,773	(6.1)%	$77,626	$101,476	(23.5)%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
North America	46.9 %	39.9 %	41.2 %	49.1 %
Asia Pacific	10.4	19.8	15.8	17.6
EMEA	42.7	40.3	43.0	33.3
Total	100.0%	100.0%	100.0%	100.0%

North America. Revenues from North America increased $1.2 million and decreased $17.9 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. The increase for the three months ended September 30, 2018 is driven by increased sales of our software-based conferencing products. The decrease for the nine months ended September 30, 2018 was due to a decline in revenues due to the timing of shipments as well as a decline in sales from a tier-one U.S. service provider for their data center buildout.

Asia Pacific. Revenues from Asia Pacific decreased $2.9 million and $5.6 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. This was the result of declines in revenue from a large telecommunication integrator.

EMEA. Revenues from EMEA decreased $0.1 million and $0.4 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. Revenues in the region were consistent period over period as shipments from our largest customer remained stable.

We currently expect continued fluctuations in the revenue contribution from each geographic region. Additionally, we expect non-U.S. revenues to remain a significant portion of our revenues.

Gross Margin

The following table sets forth operating segment gross margins for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Gross margin						
Software-Systems	$8,390	$5,420	54.8 %	$22,699	$17,128	32.5 %
Hardware Solutions	3,387	(2,302)	(247.1)	8,737	8,211	6.4
Corporate and other	(37)	(1,923)	(98.1)	(3,576)	(5,914)	(39.5)
Total gross margin	$11,740	$1,195	882.4 %	$27,860	$19,425	43.4 %

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Gross margin						
Software-Systems	59.6%	47.9 %	24.4 %	58.4%	52.0%	12.3 %
Hardware Solutions	26.2	(13.2)	298.5	22.6	12.0	88.3
Corporate and other	—	—	—	—	—	—
Total gross margin	43.4%	4.2 %	933.3%	35.9%	19.1%	88.0 %

Software-Systems. Gross margin increased 1170 basis points to 59.6% from 47.9% for the three months ended September 30, 2018 and 640 basis points to 58.4% from 52.0% for the nine months ended September 30, 2018 from the comparable periods in 2017. This was the result of favorable mix of software sales across the segment relative to comparable periods in 2017.

Hardware Solutions. Gross margin increased 3940 basis points to 26.2% from (13.2)% for the three months ended September 30, 2018 and increased 1060 basis points to 22.6% from 12.0% for the nine months ended September 30, 2018 from the comparable periods in 2017. This was the result of an inventory charge taken during the nine months ended September 30, 2017 due to a strategic decision to eliminate non-core legacy hardware product lines.

Corporate and other. Gross margin increased $1.9 million and $2.3 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017 as a result of reduced amortization and restructuring charges. Items in Corporate and other cost of sales include intangible asset amortization, stock compensation, and restructuring and other expenses which are not allocated to our operating segments.

Operating Expenses

The following table summarizes our operating expenses for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Research and development	$3,467	$5,639	(38.5)%	$10,388	$18,113	(42.6)%
Selling, general and administrative	6,758	7,849	(13.9)	20,546	25,445	(19.3)
Intangible asset amortization	197	289	(31.8)	593	2,809	(78.9)

Restructuring and other charges, net	1,130	1,344	(15.9)	3,990	2,814	41.8
Total	$11,552	$15,121	(23.6)%	$35,517	$49,181	(27.8)%

33

Research and Development

R&D expenses consist primarily of personnel costs, product development costs, and related equipment expenses. R&D expenses decreased $2.2 million and $7.7 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. The decrease for the three and nine months ended September 30, 2018 was the result of a decrease in headcount, stock compensation, and other employee related expenses. Headcount decreased to 164 at September 30, 2018 from 274 at September 30, 2017.

Selling, General, and Administrative

SG&A expenses consist primarily of salary, commissions, bonuses and benefits for sales, marketing and administrative personnel, as well as professional service providers and the costs of other general corporate activities. SG&A expenses decreased $1.1 million and $4.9 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. The decrease in the three and nine months ended September 30, 2018 was primarily due to a decrease in headcount, stock compensation, and other employee related expenses. Headcount decreased to 109 at September 30, 2018 from 139 at September 30, 2017.

Intangible Asset Amortization

Intangible asset amortization for the three and nine months ended September 30, 2018 decreased $0.1 million and $2.2 million from the comparable periods in 2017 due to several assets reaching the end of their useful lives. During the quarter ended September 30, 2018, we analyzed our long-lived assets for impairment and concluded that there was none.

Restructuring and Other Charges, Net

Restructuring and other charges may include costs from events such as costs incurred for employee severance, acquisition or divestiture activities, excess facility costs, certain legal costs, asset related charges and other expenses associated with business restructuring activities.

Restructuring and other charges, net decreased $0.2 million and increased $1.2 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017.

For the three months ended September 30, 2018, the Company recorded the following restructuring charges:

- $1.1 million in integration-related, legal and other non-recurring expenses related to the Company's contract manufacturing transfer and non-recurring costs associated with legal, banking, accounting and tax advice associated with the planned merger.

For the three months ended September 30, 2017, the Company recorded the following restructuring charges:

- $1.1 million net expense relating to the severance for 57 employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with the Company's go-forward strategy. An additional $1.0 million of expense will be recognized over a portion of the notified employees’ respective service terms that span up to the next three quarters subsequent September 30, 2017;
- $0.2 million in non-recurring legal expenses; and
- $0.1 million in facility reductions.

For the nine months ended September 30, 2018, the Company recorded the following restructuring charges:

- $3.0 million in integration-related, legal and other non-recurring expenses related to the contract manufacturing transfer and non-recurring costs associated with legal, banking, accounting and tax advice associated with the planned merger;
- $0.8 million expense relating to employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with our go-forward strategy; and
- $0.2 million in facility reductions in the United States.

For the nine months ended September 30, 2017, the Company recorded the following restructuring charges:

- $2.3 million net expense relating to the severance for 87 employees primarily in Asia and North America in connection with a reduction in legacy Hardware Solutions engineering and support staff as well as rationalization across various other functional organizations to better align with the Company's go-forward strategy;
- $0.4 million in non-recurring legal expenses associated with closing a strategic agreement with a MediaEngine channel partner; and
- $0.1 million in facility reductions.

Stock-based Compensation Expense

Included within cost of sales, R&D and SG&A are stock-based compensation expenses that consist of the amortization of unvested stock options, performance-based awards, restricted stock units ("RSUs") and employee stock purchase plan ("ESPP") expense. We incurred and recognized stock-based compensation expense as follows (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Cost of sales	$12	$(3)	(500.0)%	$70	$134	(47.8)%
Research and development	35	22	59.1	155	365	(57.5)
Selling, general and administrative	203	105	93.3	732	1,317	(44.4)
Total	$250	$124	101.6 %	$957	$1,816	(47.3)%

Stock-based compensation expense increased by $0.1 million and decreased $0.9 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017, primarily the result of stock options granted in 2018 offset by PRSU and RSU expense declining $0.6 million for the nine months ended September 30, 2018 from the comparable period in 2017 as no additional RSU or PRSU awards were granted in 2018. In the three and nine months ended September 30, 2018, no stock compensation expense was recognized for the PRSUs described in Note 10- Stock-based Compensation.

Income (Loss) from Operations

The following table summarizes our income (loss) from operations (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Income (loss) from operations						
Software-Systems	$39	$(2,358)	(101.7)%	$(2,159)	$(7,574)	(71.5)%
Hardware Solutions	1,751	(7,885)	(122.2)	3,547	(8,963)	(139.6)
Corporate and other	(1,602)	(3,683)	(56.5)	(9,045)	(13,219)	(31.6)
Total income (loss) from operations	$188	$(13,926)	(101.3)%	$(7,657)	$(29,756)	(74.3)%

Software-Systems. Income (loss) from operations improved by $2.4 million and $5.4 million to break-even and a loss of $2.2 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. This was the result of previously described strength in sales of software across our product lines and increasing professional services revenues coupled with declines in operating expenses in both R&D and SG&A primarily driven by a reduction in headcount.

Hardware Solutions. Income (loss) from operations improved by $9.6 million and $12.5 million to income of $1.8 million and $3.5 million for the three and nine months ended September 30, 2018 from the comparable periods in 2017. This was the result of previously described inventory charges taken in 2017 as well as declines in operating expenses in both R&D and SG&A primarily driven by a reduction in headcount offset by reduced revenues from the comparable periods in 2017.

Corporate and other. Corporate and other loss from operations includes amortization of intangible assets, stock compensation, restructuring and other expenses. Loss from operations improved as increased legal costs associated with the merger were offset by a reduction in amortizable intangible assets.

Non-Operating Expenses

The following table summarizes our non-operating expenses (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Change in fair value of Warrant liability	$(599)	$—	— %	$(1,102)	$—	— %
Interest expense	(1,411)	(431)	227.4	(4,206)	(927)	353.7
Interest income	—	78	—	10	167	(94.0)
Other income (expense), net	1,447	(194)	(845.9)	2,690	(710)	(478.9)
Total	$(563)	$(547)	2.9 %	$(2,608)	$(1,470)	77.4 %

Change in Fair Value of Warrant Liability

During the three and nine months ended September 30, 2018, we recorded a non-cash loss from the change in fair value of the Warrant liability of $0.6 million and $1.1 million. The increase in fair value for the three and nine months ended September 30, 2018 was driven by the stock premium offered as part of the planned merger as discussed in Note 14 - Definitive Agreement.

Interest Expense

Interest expense includes interest incurred on our Note Purchase Agreement, revolving line of credit, and associated debt issuance cost and Warrant amortization. The increase in interest expense for the three and nine months ended September 30, 2018 from the comparable periods in 2017 was the result of the Note Purchase Agreement entered on January 3, 2018 resulting in incremental interest expense. Cash paid for interest for the three and nine months ended September 30, 2018 was $0.1 million and $0.4 million. Non-cash interest expense for the three and nine months ended September 30, 2018 was $1.3 million and $3.8 million comprised of accrued interest, associated debt issuance cost, and Warrant amortization.

Other Expense

For the three and nine months ended September 30, 2018, other income improved $1.6 million and $3.2 million from the comparable periods in 2017. The increase was due to currency movements from the US dollar strengthening against the Indian Rupee and Chinese Yuan.

Income Tax Provision

The following table summarizes our income tax provision (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Income tax expense	$1,498	$938	59.7 %	$2,687	$1,747	53.8 %

We recorded tax expense of $1.5 million and $2.7 million for the three and nine months ended September 30, 2018. Our effective tax rates for the three months ended September 30, 2018 and 2017 were 399.5% and 6.5%, respectively. The effective tax rate fluctuation was due to reaching near breakeven gross profit for the three months ended September 30, 2018 and the geographic mix of income amongst different jurisdictions.

Liquidity and Capital Resources

The following table summarizes selected financial information as of the dates indicated (in thousands):

	September 30, 2018	December 31, 2017	September 30, 2017
Cash and cash equivalents, including restricted cash	$ 14,094	$ 8,124	$ 12,682
Working capital	(2,269)	(797)	11,660
Accounts receivable, net	31,130	32,820	33,854
Inventories, net	2,156	4,265	11,055
Accounts payable	8,060	18,297	20,565
Line of credit	11,989	16,000	15,000
Short term debt obligations	9,000	—	—

Cash Flows

As of September 30, 2018, the amount of cash held by our foreign subsidiaries was $1.0 million. We do not permanently reinvest funds in certain of our foreign entities, and we expect to repatriate cash from these foreign entities on an ongoing basis in future periods. Repatriation of funds from these foreign entities is not expected to result in significant cash tax payments due to the utilization of previously generated operating losses of our U.S. entity.

Cash and cash equivalents including restricted cash increased by $6.0 million to $14.1 million as of September 30, 2018 from $8.1 million as of December 31, 2017. Activities impacting cash and cash equivalents including restricted cash were as follows (in thousands):

	Nine Months Ended September 30, 2018	2017
Operating Activities		
Net loss	$(12,952)	$(32,973)
Non-cash adjustments	12,041	23,168
Changes in operating assets and liabilities	(3,186)	3,222
Cash used in operating activities	(4,097)	(6,583)
Cash used in investing activities	(530)	(4,544)
Cash provided by financing activities	10,703	(9,705)
Effects of exchange rate changes	(106)	427
Net increase (decrease) in cash and cash equivalents	$5,970	$(20,405)

Cash used in operating activities during the nine months ended September 30, 2018 was $4.1 million. For the nine months ended September 30, 2018, primary impacts to changes in our working capital consisted of the following:

- Accounts payable decreased $10.4 million due to the payment of previously reserved Hardware Solutions inventory purchase commitments for which we do not have future customer demand and coupled with the timing of payments to suppliers and vendors;
- Accrued restructuring decreased $2.6 million from severance payments made during 2018 associated with restructuring activities commenced in late 2017;
- Accrued wages and bonuses increased $2.0 million due to the timing of payroll payments and incentive compensation accrued during 2018;
- Other receivables decreased $1.9 million due to lower receivables from vendors due to reduced hardware sales and the timing of payments;

- Accounts receivable decreased $1.7 million due to a decrease in sales during 2018 compared to previous periods; and
- Deferred revenue increased $1.5 million due to timing of orders and revenue recognition.

Cash used in investing activities during the nine months ended September 30, 2018 of $0.5 million was associated with ongoing capital expenditures.

Cash generated by financing activities during the nine months ended September 30, 2018 was $10.7 million due to net cash receipts of $15.0 million from borrowings under the Notes Purchase Agreement offset by net repayments of $4.0 million on our line of credit. We expect to continue to borrow additional funds against our line of credit to meet short term intra-quarter needs on an ongoing basis; however, we expect to repay any such borrowings within the quarter as we navigate the timing of customer payments and payables to our suppliers.

Note Purchase Agreement

On January 3, 2018, we entered into a Note Purchase Agreement with a principal amount of $17.0 million. Net cash receipt from borrowing on the agreement after issuance costs and excluding accrued interest was $15.0 million. At September 30, 2018, we were in compliance with all covenants under our Note Purchase Agreement. See Note 6 - Debt and Credit Agreements for additional information regarding our Note Purchase Agreement.

Line of Credit

As of September 30, 2018, we had an outstanding balance of $12.0 million under the ABL Credit Agreement. At December 31, 2017, we had an outstanding balance of $16.0 million under our previous revolving credit facility with Silicon Valley Bank, which we repaid in full and terminated concurrently with our entry into the Note Purchase Agreement and the ABL Credit Agreement on January 3, 2018. At September 30, 2018, we had $3.4 million of total borrowing availability under our revolving credit facility. At September 30, 2018, we were in compliance with all covenants under our revolving credit facility. See Note 6 - Debt and Credit Agreements for additional information regarding our revolving credit facilities.

Contractual Obligations

Our contractual obligations as of December 31, 2017 are summarized in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Contractual Obligations, of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. For the nine months ended September 30, 2018, there have been no material changes in our contractual obligations outside of the Note Purchase Agreement and changes to the line of credit discussed in Note 6 - Debt and Credit Agreements. As of September 30, 2018, we have agreements regarding foreign currency forward contracts with total contractual values of $2.0 million that mature through 2018.

In addition to the above, we have approximately $4.8 million in liabilities associated with unrecognized tax benefits. We are not able to reasonably estimate when we would make any cash payments required to settle these liabilities, but do not believe the ultimate settlement of our obligations will materially affect our liquidity.

Off-Balance Sheet Arrangements

We do not engage in any activity involving special purpose entities or off-balance sheet financing.

Liquidity Outlook

During the third quarter of 2018 we generated positive operating cash flows of $4.8 million. However, over the previous several quarters, we have experienced significant operating losses and consumed significant cash from operations resulting from a material decline in our DCEngine product line. Given the uncertainty of future business from the DCEngine product line, we began taking action in the fourth quarter of 2017 to significantly reduce its overhead and operating expenses moving forward aimed at enabling us to return to profitability and free cash flow generation. These actions also included closing the new financing arrangements disclosed in Note 6- Debt and Credit Agreements, which positioned us to implement our expense reduction actions and settle committed inventory purchases through the first half of 2018.

A sustained return to profitability and free cash flow generation is based on certain assumptions and projections, including growth from our Software-Systems business. If we are unable to attain certain levels of revenue growth, or meet our cost reduction targets, we may be out of compliance with covenants associated with the new financing arrangements which may have a material adverse effect on our liquidity.

At September 30, 2018, our cash and cash equivalents including restricted cash amounted to $14.1 million. We believe our current cash and cash equivalents, cash expected to be generated from operations and available borrowings under the ABL Credit Agreement will satisfy our short and long-term expected working capital needs, capital expenditures, stock repurchases, and other liquidity requirements associated with our present business operations. If we are unable to comply with various covenants under the ABL Credit Agreement and the Note Purchase Agreement due to the timing of orders and shipments from our Software-Systems customers, delays in payment of accounts receivable or other adverse business conditions that impact our operating plans, without an amendment or waiver, our liquidity outlook could be materially and adversely affected. Pursuant to the Merger Agreement, aggregate borrowings under the ABL Credit Agreement and any additional indebtedness we incur may not exceed $14 million at any time. We continue to pursue a number of actions to improve our cash position including (i) minimizing capital expenditures, (ii) effectively managing working capital, (iii) seeking amendments or waivers from lenders and (iv) improving cash flows from operations. These efforts continue in earnest.

Definitive Agreement

On June 29, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Reliance Industries Limited, a company organized and existing under the laws of India (“Reliance”), and Integrated Cloud Orchestration (ICO), Inc., an Oregon corporation and a wholly owned subsidiary of Reliance (“Merger Sub”). The Merger Agreement provides that, among other things and upon the terms and subject to the conditions of the Merger Agreement, (i) Merger Sub will be merged with and into Radisys (the “Merger”), with Radisys surviving and continuing as the surviving corporation in the Merger and a wholly owned subsidiary of Reliance, and (ii) at the effective time of the Merger, each outstanding share of common stock of Radisys, no par value (“Common Stock”), (other than Common Stock owned by Reliance, Merger Sub or any wholly-owned subsidiary of Reliance or Radisys or held in the treasury of Radisys, all of which shall be canceled without any consideration being exchanged therefor) will be converted into the right to receive an amount equal to $1.72 per share in cash (the “Merger Consideration”). The closing of the Merger is subject to customary closing conditions, including (i) the adoption of the Merger Agreement by the holders of not less than a majority of the outstanding shares of Common Stock, which was received on September 5, 2018, (ii) the receipt of specified required regulatory approvals, and the suitable form of approval by the Committee on Foreign Investment in the United States, (iii) the absence of any law or order enjoining or prohibiting the Merger or making it illegal, (iv) the accuracy of the representations and warranties contained in the Merger Agreement (generally subject to a “material adverse effect” qualification) and (v) compliance with covenants in the Merger Agreement in all material respects. The closing of the Merger is not subject to a financing condition. The Merger is expected to close in the fourth quarter of 2018.

Adoption of New Accounting Policies

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (“ASU 2016-18”), which requires that restricted cash and cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. ASU 2016-18 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and a retrospective transition method is required. We adopted this guidance in the first quarter of 2018 using the retrospective approach. We have not historically had restricted cash resulting in no impact to previously reported periods. This new guidance did not impact our financial results but did result in a change in the presentation of restricted cash and restricted cash equivalents within the statement of cash flows.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," that has superseded all existing revenue recognition guidance under U.S. GAAP. The standard's core principle is that a company recognizes revenue when it transfers promised goods or services to a customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning on or after December 15, 2017.

The new guidance, which includes several amendments, replaces most of the prior revenue recognition guidance under U.S. Generally Accepted Accounting Principles. We adopted the new guidance as of January 1, 2018 using the modified retrospective method, as applied to all contracts. As a result, we have changed our accounting policy for revenue recognition.

Aspects of the new standard that have impacted us include a change in the timing of certain usage-based royalties. Historically revenue was not recognized until fixed and determinable; however, the new ASU requires us to estimate using either the probability weighted expected amount or the most likely amount and estimate the transaction price to recognize when or as control is transferred to the customer. Additionally, for certain professional services with no VSOE under ASC 605, certain licenses were deferred and recognized with the associated software. Such contracts represent a small subset of our total portfolio.

Due to the immaterial nature from the impact on the timing of revenue recognition based on the cumulative effect of adopting this guidance, an adjustment to the balance of retained earnings as of January 1, 2018 was not required. The comparative information for the three months ended September 30, 2018, including disclosures, has not been restated and continues to be reported under the accounting standards in effect for that period. Refer to our policy over revenue recognition under Critical Accounting Polices and Estimates for further detail.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires lessees to recognize a lease liability and a right-of-use asset on the balance sheet and aligns many of the underlying principles of the new lessor model with those in Accounting Standards Codification Topic 606, Revenue from Contracts with Customers. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the requirements of ASU 2016-02 and have not yet determined its impact on the condensed consolidated financial statements.

Critical Accounting Policies and Estimates

Management’s discussion and analysis of our financial condition and results of operations is based upon the condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires management to make estimates and judgments that may affect the reported amounts of assets, liabilities, and revenues and expenses. On an on-going basis, management evaluates its estimates. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes the following critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

Product and Service Revenue

We sell our products and services into two primary end markets: telecommunications infrastructure and medical imaging. Sales into the telecommunications infrastructure market spans both of our operating segments while sales of products into the medical imaging market are associated predominantly with one customer in our Hardware-Solutions segment. We sell products and services directly to service providers, through channel partners where our products are part of a larger integrated solution, and directly to original equipment and design manufacturers.

Product revenue includes the sale of software, integrated systems, stand-alone hardware and post-sale royalties tied to end-user product deployments. Our products are sold both on a stand-alone basis and bundled with certain other products and services from time to time. Software and hardware products are generally sold for a one-time fee with incremental sales of related products to the same customer tied to expansion needs.

Service revenue is predominantly comprised of professional services and maintenance and support services. Professional services are generally associated with the development and implementation of customer-specific feature requirements on our products. Maintenance and support services are associated with post-sale product updates, upgrades and enhancements as well as general technical support. Our customers generally enter into annual or semi-annual agreements for maintenance and support services.

Multiple Performance Obligations

Our contracts with customers often include commitments to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When hardware, software and services are sold in various combinations, judgment is required to determine whether each performance obligation is considered distinct and accounted for separately, or not distinct and accounted for together with other performance obligations.

In instances where the software elements included within hardware for various products are considered to be functioning together with non-software performance obligations to provide the tangible product's essential functionality, these arrangements are accounted for as a single distinct performance obligation.

Judgment is required to determine the stand-alone selling price (SSP) for each distinct performance obligation. When available, we use observable inputs to determine SSP. In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP based on a cost-plus model, as market or other observable inputs are seldom present based on the proprietary nature of our products.

We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer or level of service provided in determining the SSP.

Revenue Recognition

Revenue is recognized upon transfer of control of products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that may include various combinations of products and services which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for any taxes collected from customers, which are subsequently remitted to governmental authorities.

Hardware

Hardware revenue is recognized when we transfer control to the customer, typically at the time the product is shipped to the customer. We accrue the estimated cost of product warranties, based on historical experience at the time we recognize revenue.

Software licenses and royalties

We recognize software license revenue at the time of delivery. We defer revenue on arrangements, including specified software upgrades, until the specified upgrade has been delivered. Revenue from customers for prepaid, non-refundable software royalties is recorded when the revenue recognition criteria have been met. Revenue for non-prepaid royalties is recognized at the time we are able to estimate the revenue that has been earned in the current period.

Maintenance and support services

Maintenance and support services revenue is recognized as earned on the straight-line basis over the term of the contract.

Professional and other services

Professional services revenue is recognized as services are provided. Other services revenues include hardware repair services and custom software implementation projects, with these services recognized upon delivery to customers.

Allowance for Doubtful Accounts

We have a relatively small set of multinational customers that typically make up the majority of our accounts receivable balance. Our allowance for doubtful accounts is determined using a combination of factors to ensure that our trade receivables balances are not overstated. We record reserves for individual accounts when we become aware of a customer's inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, our estimates of the recoverability of receivables would be further adjusted. If one of our large customers or a number of our smaller customers files for bankruptcy or otherwise is unable to pay the amounts due to us, the current allowance for doubtful accounts may not be adequate.

We maintain a non-specific bad debt reserve for all customers. This non-specific bad debt reserve is calculated based on our historical pattern of bad debt write offs as a percentage gross accounts receivable for the current rolling eight quarters.

Inventory Valuation

We record an inventory valuation allowance for estimated obsolete or unmarketable inventories as the difference between the cost of inventories and the estimated net realizable value based upon assumptions about future demand and market conditions. Our inventory valuation allowances establish a new cost basis for inventory. Factors influencing the provision include: changes in demand; rapid technological changes; product life cycle and development plans; component cost trends; product pricing; regulatory requirements affecting components; and physical deterioration. If actual market conditions are less favorable than those projected by management, additional provisions for inventory reserves may be required. Our estimate for the allowance is based on the assumption that our customers comply with their current contractual obligations. We provide long-life support to our customers and therefore we have material levels of customer-specific inventory. If our customers experience a financial hardship or if we experience unplanned cancellations of customer contracts, the current provision for the inventory reserves may be inadequate. Additionally, we may incur additional expenses associated with any non-cancelable purchase obligations to our suppliers if they provide customer-specific components.

Long-Lived Assets

Long-lived assets, such as property and equipment and definite-life intangible assets are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. We assess impairment of the assets based on the undiscounted future cash flow the assets are expected to generate compared to the carrying value of the assets. If the carrying amount of the assets is determined not to be recoverable, a write-down to fair value is recorded. Management estimates future cash flows using assumptions about expected future operating performance. Management's estimates of future cash flows may differ from actual cash flow due to, among other things, technological changes, economic conditions or changes to our business operations.

Intangible assets with estimable useful lives are amortized on a straight-line basis over their respective estimated life and reviewed for impairment when certain triggering events suggest impairment has occurred. We did not identify a triggering event during the three months ended September 30, 2018 to suggest an impairment has occurred.

Accrued Restructuring

Because we have a history of paying severance benefits, expenses associated with exit or disposal activities are recognized when probable and estimable.

We have engaged, and may continue to engage, in restructuring actions, which require us to make significant estimates in several areas including: realizable values of assets made redundant or obsolete; expenses for severance and other employee separation costs; the ability and timing to generate sublease income, as well as our ability to terminate lease obligations at the amounts we have estimated; and other exit costs. Should the actual amounts differ from our estimates, the amount of the restructuring charges could be materially impacted. For a description of our restructuring actions, refer to our discussion of restructuring and other charges, net in the Results of Operations section.

Accrued Warranty

We provide for the estimated cost of product warranties at the time revenue is recognized. Our standard product warranty terms generally include repairs or replacement of a product at no additional charge for a specified period of time, which is generally 12 to 24 months after shipment. The workmanship of our products produced by our contract manufacturer is covered under warranties provided by the contract manufacturer for 12 to 24 months. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our estimated warranty obligation is based upon ongoing product failure rates, internal repair costs, contract manufacturing repair charges for repairs not covered by the contract manufacturer's warranty, average cost per repair and current period product shipments. If actual product failure rates, repair rates, service delivery costs, or post-sales support costs differ from our estimates, revisions to the estimated warranty liability would be required. Additionally, we accrue warranty costs for specific customer product repairs that are in excess of our warranty obligation calculation described above. Accrued warranty reserves are included in short-term and long-term other accrued liabilities in the accompanying condensed consolidated balance sheets.

Derivative Liability

In connection with the issuance of the Notes, on January 3, 2018, we issued to an affiliate of Hale Capital and another purchaser Warrants to purchase up to 6,006,667 shares of common stock at an exercise price equal to $1.00 per share (the "Warrants").

The Warrants contain a cash settlement feature contingent upon the occurrence of certain events defined in the Warrants. As a result of this cash settlement feature, the Warrants are subject to derivative accounting as prescribed under ASC 815. Accordingly, the fair value of the Warrants on the date of issuance was recorded in our condensed consolidated balance sheets as a liability.

The Warrant liability was recorded in our condensed consolidated balance sheets at its fair value on the date of issuance and is revalued on each subsequent balance sheet date until such instrument is exercised or expires, with any changes in the fair value between reporting periods recorded in the condensed consolidated statements of operations.

We estimate the fair value of this liability using a Monte Carlo pricing model that is based on the individual characteristics of the Warrants on the valuation date, which includes assumptions for expected volatility, expected life and risk-free interest rate, as well as the present value of the minimum cash payment component of the instrument. Changes in the assumptions used could have a material impact on the resulting fair value. The primary inputs affecting the value of the Warrant liability are our stock price and expected future volatility in our stock price. Increases in the fair value of the underlying stock or increases in the volatility of the stock price generally result in a corresponding increase in the fair value of the Warrant liability; conversely, decreases in the fair value of the underlying stock or decreases in the volatility of the stock price generally result in a corresponding decrease in the fair value of the Warrant liability.

Income Taxes

Income tax accounting requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities. Valuation allowances are established to reduce deferred tax assets if it is "more likely than not" that all or a portion of the asset will not be realized due to inability to generate sufficient taxable income in the relevant period to utilize the deferred tax asset. Tax law and rate changes are reflected in the period such changes are enacted. We recognize uncertain tax positions after evaluating whether certain tax positions are more likely than not to be sustained by taxing authorities. In addition, we recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense.

Stock-Based Compensation

We measure stock-based compensation at the grant date, based on the fair value of the award, and recognizes expense on a straight-line basis over the employee's requisite service period. For PRSUs, the requisite service period is equal to the period of time over which performance objectives underlying the award are expected to be achieved and vested. The number of shares that ultimately vest depends on the achievement of certain performance criteria over the measurement period. For non-market based performance-based restricted stock, quarterly, we reevaluate the period during which the performance objective will be met and the number of shares expected to vest. The amount of quarterly expense recorded each period is based on our estimate of the number of awards that will ultimately vest.

We estimate the fair value of stock options and purchase rights under our employee stock purchase plans using a Black-Scholes option-pricing model. The Black-Scholes option-pricing model incorporates several highly subjective assumptions including expected volatility, expected term and interest rates.

In reaching our determination of expected volatility, we use the historic volatility of our shares of common stock. We base the expected term of our stock options on historic experience. The expected term for purchase rights under our employee stock plans is based on the 18 month offering period. The risk-free rate is based on the U.S. Treasury constant maturities in effect at the time of grant for the expected term of the option or share.

The calculation includes several assumptions that require management's judgment. The expected term of the option or share is determined based on assumptions about patterns of employee exercises and represents a probability-weighted average time-period from grant until exercise of stock options, subject to information available at time of grant. Determining expected volatility generally begins with calculating historical volatility for a similar long-term period and then considers the ways in which the future is reasonably expected to differ from the past.

The input factors used in the valuation model are based on subjective future expectations combined with management's judgment. If there is a difference between the assumptions used in determining stock-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining stock-based compensation costs. These changes may materially impact the results of operations in the event such changes are made. In addition, if we were to modify any awards, additional charges would be taken.

“Safe Harbor” Statement under the Private Securities Litigation Reform Act of 1995

This report contains forward-looking statements including:

- the Company's business strategy;
- changes in reporting segments;
- expectations and goals for revenues, gross margin, R&D expenses, SG&A expenses and profits;
- the impact of our restructuring events on future operating results, including statements related to future growth, expense savings or reduction or operational and administrative efficiencies;
- timing of revenue recognition;
- expected customer orders;
- our projected liquidity;
- future operations and market conditions;
- industry trends or conditions and the business environment;
- future levels of inventory and backlog and new product introductions;
- financial performance, revenue growth, management changes or other attributes of Radisys following acquisition or divestiture activities;
- continued implementation of the Company's next-generation datacenter product;
- the expected timing of completion of the Merger;
- the expected benefits and costs of the Merger;
- management plans relating to the Merger;
- the satisfaction of all closing conditions to the Merger, including the ability to obtain regulatory approvals; and
- other statements that are not historical facts.

All statements that relate to future events or to our future performance are forward-looking statements. In some cases, forward-looking statements can be identified by terms such as “may,” “will,” “should,” “expect,” “plan,” “seek,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continue,” “seek to continue,” “consider,” “intend,” or other comparable terminology. These forward-looking statements are made pursuant to safe-harbor provisions of the Private Securities

Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results or our industries' actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

These factors include, among others, the Company's ability to raise additional capital, increased tier-one commercial deployments across multiple product lines, the continued implementation of the Company’s next-generation datacenter product, customer implementation of traffic management solutions, the outcome of product trials, the market success of customers' products and solutions, the development and transition of new products and solutions, the enhancement of existing products and solutions to meet customer needs and respond to emerging technological trends, the Company's ability to raise additional growth capital, the Company's dependence on certain customers and high degree of customer concentration, the Company's use of one contract manufacturer for a significant portion of the production of its products, including the success of transitioning contract manufacturing partners, matters affecting the software and embedded product industry, including changes in industry standards, changes in customer requirements and new product introductions, actions by regulatory authorities or other third parties, cash generation, changes in tariff and trade policies and other risks associated with foreign operations, fluctuations in currency exchange rates, key employee attrition, the quality of the Company’s hardware, software, support and services offerings, defects in the Company’s software or hardware products, the availability of raw materials, the limited number of direct and indirect suppliers for some of the components the Company and its contract manufacturer and integrations partners use, volatility in the price of the Company’s common stock as it affects the valuation of its warrants, unfavorable or volatile market conditions, the Company’s ability to protect its intellectual property, the cost of increased IT security requirements, vulnerabilities, threats and more sophisticated and targeted computer crime and cyberattacks, the ability of the Company to successfully complete any restructuring, acquisition or divestiture activities, risks relating to fluctuations in the Company's operating results, the uncertainty of revenues and profitability and the potential need to raise additional funding, the satisfaction or timely satisfaction of conditions to the closing of the Merger (including receipt of required regulatory approvals), unexpected costs, liabilities or delays related to the Merger, lower revenues than expected following the Merger, operating costs, customer loss and business disruption (including, without limitation, difficulties in maintaining relationships with employees, customers, clients or suppliers) following the Merger, uncertainties surrounding the Merger, the outcome of any legal proceedings related to the Merger, risks that the pending Merger disrupts current plans and operations, limitations placed on the Company’s ability to operate its business under the Merger Agreement, other risks to consummation of the Merger, including circumstances that could give rise to the termination of the Merger Agreement and the risk that the Merger will not be consummated within the expected time period or at all and other factors described in "Risk Factors" and elsewhere in our Annual Report on Form 10-K for the year ended December 31, 2017, as updated in the subsequent quarterly reports on Form 10-Q. Although forward-looking statements help provide additional information about us, investors should keep in mind that forward-looking statements are only predictions, at a point in time, and are inherently less reliable than historical information.

We do not guarantee future results, levels of activity, performance or achievements, and we do not assume responsibility for the accuracy and completeness of these statements. The forward-looking statements contained in this report are made and based on information as of the date of this report. We assume no obligation to update any of these statements based on information after the date of this report.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk from changes in interest rates, foreign currency exchange rates, and equity trading prices, which could affect our financial position and results of operations.

Foreign Currency Risk. We pay the expenses of our international operations in local currencies, namely, the Canadian Dollar, Euro, Chinese Yuan, Indian Rupee, and British Pound Sterling. Our international operations are subject to risks typical of an international business, including, but not limited to: differing economic conditions, changes in political climate, differing tax structures, foreign exchange rate volatility and other regulations and restrictions. Accordingly, future results could be materially and adversely affected by changes in these or other factors. We are also exposed to foreign exchange rate fluctuations as the balance sheets and income statements of our foreign subsidiaries are translated into U.S. Dollars during the consolidation process. Because exchange rates vary, these results, when translated, may vary from expectations and adversely affect overall expected profitability.

Based on our policy, we have established a foreign currency exposure management program which uses derivative foreign exchange contracts to address nonfunctional currency exposures. In order to reduce the potentially adverse effects of foreign currency exchange rate fluctuations, we have entered into forward exchange contracts. These hedging transactions limit our exposure to changes in the U.S. Dollar to the Indian Rupee exchange rate, and as of September 30, 2018 the total notional or contractual value of the contracts we held was $2.0 million. These contracts will mature over the next 3 months.

Holding other variables constant, a 10% adverse fluctuation, in relation to our hedge positions, of the U.S. Dollar relative to the Indian Rupee would require an adjustment of $0.2 million, decreasing our Indian Rupee hedge asset as of September 30, 2018, to a liability of $0.4 million. A 10% favorable fluctuation, in relation to our hedge positions, of the U.S. Dollar relative to the Indian Rupee would result in an adjustment of $0.2 million, increasing our hedge liability as of September 30, 2018 to nil. We do not expect a 10% fluctuation to have any material impact on our operating results as the underlying hedged transactions will move in an equal and opposite direction. If there is an unfavorable movement in the Indian Rupee relative to our hedged positions this would be offset by reduced expenses, after conversion to the U.S. Dollar, associated with obligations paid for in the Indian Rupee.

Item 4. Controls and Procedures

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that the Company’s “disclosure controls and procedures” (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective.

During our most recent fiscal quarter ended September 30, 2018, no change occurred in the Company's "internal control over financial reporting" (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION
Item 1A. Risk Factors

There are many factors that affect our business and the results of our operations, many of which are beyond our control. 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 and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2017, and in Part II, Item 1A. Risk Factors in our Quarterly Report on Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018, which could materially affect our business, financial condition or future results. Other than as set forth below, there have been no material changes with regard to the risk factors previously disclosed in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018. The risks described in this report, in our Annual Report on Form 10-K for the year ended December 31, 2017 and in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018 are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Nasdaq may delist our securities from quotation on its exchange which could limit investors' ability to make transactions in our securities and subject us to additional trading restrictions.

Our securities are listed on Nasdaq, a national securities exchange. However, we cannot assure you that our securities will continue to be listed on Nasdaq in the future. Nasdaq requires us to meet certain corporate governance requirements on an ongoing basis in order to continue the listing of our common stock. On July 9, 2018, Nasdaq sent a letter acknowledging our noncompliance with Nasdaq's audit committee requirements regarding the minimum number of audit committee members. Nasdaq has provided us with a cure period in order to regain compliance as follows: (1) until the earlier of our next annual shareholders' meeting or July 2, 2019; or (2) if our next annual shareholders' meeting is held before December 31, 2018, then we must evidence compliance no later than December 31, 2018. We intend to rely upon the cure period provided by Nasdaq. If we fail to regain compliance before the cure period ends, our common stock may be subject to delisting.
If Nasdaq delists our securities from trading on its exchange, we could face significant material adverse consequences, including:

- an event of default would occur under our note purchase agreement with Hale Capital Partners and CIDM LendCo, LLC;
- a limited availability of market quotations for our securities;
- reduced liquidity with respect to our securities;
- a determination that our ordinary shares are "penny stock" which will require brokers trading in our ordinary shares to adhere to more stringent rules, possibly resulting in a reduced level of trading activity in the secondary trading market for our ordinary shares;
- a limited amount of news and analyst coverage for our company; and
- a decreased ability to issue additional securities or obtain additional financing in the future.

Item 6. Exhibits

(a) Exhibits

Exhibit 31.1*	Certification of the Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2*	Certification of the Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Presentation Linkbase
101.DEF*	XBRL Taxonomy Definition Linkbase

* Filed herewith
** Furnished herewith

SIGNATURES

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.

	RADISYS CORPORATION
Dated: November 8, 2018	By: /s/ Brian Bronson Brian Bronson President and Chief Executive Officer
Dated: November 8, 2018	By: /s/ Jonathan Wilson Jonathan Wilson Chief Financial Officer and Vice President of Finance (Principal Financial and Accounting Officer)