

ABAXIS INC  
Form 10-Q  
February 09, 2017

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2016

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 000-19720

ABAXIS, INC.  
(Exact name of registrant as specified in its charter)

California 77-0213001  
(State of Incorporation) (I.R.S. Employer Identification No.)

3240 Whipple Road  
Union City, California 94587  
(Address of principal executive offices)

(510) 675-6500  
(Registrant's telephone number including area code)

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

Yes      No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes      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. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes            No

As of February 7, 2017, there were 22,540,000 shares of the registrant's common stock outstanding.

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ABAXIS, INC.  
 Form 10-Q  
 For the Quarter Ended December 31, 2016

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## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

## ABAXIS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

	December 31, 2016	March 31, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 85,653	\$ 88,323
Short-term investments	52,291	41,474
Receivables (net of allowances of \$303 at December 31, 2016 and \$479 at March 31, 2016)	35,245	35,148
Inventories	39,192	35,131
Prepaid expenses and other current assets	6,225	6,351
Net deferred tax assets, current	4,881	4,810
Current assets of discontinued operations	66	961
Total current assets	223,553	212,198
Long-term investments	21,738	22,458
Investment in unconsolidated affiliates	3,000	2,705
Property and equipment, net	33,709	26,842
Intangible assets, net	1,209	1,324
Net deferred tax assets, non-current	4,492	3,903
Other assets	6,290	1,950
Total assets	\$ 293,991	\$ 271,380
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 8,922	\$ 7,292
Accrued payroll and related expenses	6,184	8,349
Accrued taxes	477	1,145
Current liabilities of discontinued operations	87	112
Other accrued liabilities	10,091	9,393
Deferred revenue	1,560	1,600
Warranty reserve	1,577	1,281
Total current liabilities	28,898	29,172
Non-current liabilities:		
Deferred revenue	1,601	2,274
Warranty reserve	2,616	1,927
Net deferred tax liabilities	242	384
Notes payable, less current portion	303	379
Other non-current liabilities	1,170	932
Total non-current liabilities	5,932	5,896
Total liabilities	34,830	35,068
Commitments and contingencies (Note 12)		
Shareholders' equity:	-	-

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Preferred stock, no par value: 5,000,000 shares authorized; no shares issued and outstanding

Common stock, no par value: 35,000,000 shares authorized; 22,537,000 and 22,408,000 shares issued and outstanding at December 31, 2016 and March 31, 2016, respectively

	133,262	127,016
Retained earnings	125,910	109,303
Accumulated other comprehensive loss	(11	) (7
Total shareholders' equity	259,161	236,312
Total liabilities and shareholders' equity	\$ 293,991	\$ 271,380

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

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ABAXIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except share and per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Revenues	\$52,772	\$52,876	\$169,020	\$161,941
Cost of revenues	23,368	23,274	75,357	70,985
Gross profit	29,404	29,602	93,663	90,956
Operating expenses:				
Research and development	4,776	4,428	14,915	13,840
Sales and marketing	10,629	10,395	33,707	31,766
General and administrative	3,159	3,524	11,714	11,301
Total operating expenses	18,564	18,347	60,336	56,907
Income from operations	10,840	11,255	33,327	34,049
Interest and other income (expense), net	(52	) 231	6,197	716
Income from continuing operations before income tax provision	10,788	11,486	39,524	34,765
Income tax provision	3,929	3,532	14,288	11,993
Income from continuing operations	6,859	7,954	25,236	22,772
Discontinued operations (Note 4)				
Income (loss) from discontinued operations, net of tax	(15	) 4	(70	) (3
Net income	\$6,844	\$7,958	\$25,166	\$22,769
Net income per share:				
Basic				
Continuing operations	\$0.30	\$0.35	\$1.12	\$1.00
Discontinued operations	-	-	-	-
Basic net income per share	\$0.30	\$0.35	\$1.12	\$1.00
Diluted				
Continuing operations	\$0.30	\$0.35	\$1.11	\$1.00
Discontinued operations	-	-	-	-
Diluted net income per share	\$0.30	\$0.35	\$1.11	\$1.00
Shares used in the calculation of net income per share:				
Weighted average common shares outstanding - basic	22,535,000	22,725,000	22,508,000	22,684,000
Weighted average common shares outstanding - diluted	22,789,000	22,889,000	22,753,000	22,884,000
Cash dividends declared per share	\$0.14	\$0.11	\$0.38	\$0.33

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

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ABAXIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Net income	\$ 6,844	\$ 7,958	\$ 25,166	\$ 22,769
Other comprehensive income (loss):				
Net change in unrealized gain (loss) on investments	(18 )	(16 )	(8 )	(15 )
Tax provision (benefit) on other comprehensive income (loss)	(8 )	(6 )	(4 )	(6 )
Other comprehensive income (loss), net of tax	(10 )	(10 )	(4 )	(9 )
Comprehensive income	\$ 6,834	\$ 7,948	\$ 25,162	\$ 22,760

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

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ABAXIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended December 31,	
	2016	2015
Cash flows from operating activities:		
Net income	\$25,166	\$22,769
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,329	5,192
Investment premium amortization, net	439	898
Net loss on disposals of property and equipment	81	32
Impairment loss of intangible assets	-	13
Foreign exchange (gain) loss	755	(134 )
Share-based compensation expense	8,317	8,236
Excess tax benefits from share-based awards	(346 )	(1,628 )
Deferred income taxes	(604 )	(263 )
Equity in net (income) loss of unconsolidated affiliate	34	(56 )
Gain on sale of equity method investment	(6,053 )	-
Changes in assets and liabilities:		
Receivables, net	729	(2,400 )
Inventories	(8,121 )	159
Prepaid expenses and other current assets	181	(2,369 )
Other assets	(4,340 )	(485 )
Accounts payable	1,646	155
Accrued payroll and related expenses	(2,165 )	(4,189 )
Accrued taxes	(755 )	(4,539 )
Other liabilities	1,704	(5,372 )
Deferred revenue	(713 )	(488 )
Warranty reserve	985	(62 )
Net cash provided by operating activities	22,269	15,469
Cash flows from investing activities:		
Purchases of available-for-sale investments	(2,991 )	(1,726 )
Purchases of held-to-maturity investments	(40,772)	(41,064 )
Proceeds from maturities and redemptions of available-for-sale investments	2,300	-
Proceeds from maturities and redemptions of held-to-maturity investments	30,919	19,212
Purchases of property and equipment	(8,014 )	(4,405 )
Acquisitions, net of cash acquired	(785 )	(1,131 )
Cash paid for investment in unconsolidated affiliate	(2,999 )	-
Proceeds from sale of equity method investment	8,526	-
Net cash used in investing activities	(13,816)	(29,114 )
Cash flows from financing activities:		
Tax withholdings related to net share settlements of restricted stock units	(2,188 )	(5,237 )
Excess tax benefits from share-based awards	346	1,628
Proceeds from the exercise of warrants	-	12
Dividends paid	(8,559 )	(7,494 )
Net cash used in financing activities	(10,401)	(11,091 )
Effect of exchange rate changes on cash and cash equivalents	(722 )	123

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Net decrease in cash and cash equivalents	(2,670 )	(24,613 )
Cash and cash equivalents at beginning of period	88,323	107,015
Cash and cash equivalents at end of period	\$85,653	\$82,402
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	\$14,836	\$17,623
Supplemental disclosure of non-cash flow information:		
Change in unrealized gain (loss) on investments, net of tax	\$(4 )	\$(9 )
Transfers of equipment between inventory and property and equipment, net	\$4,148	\$902
Net change in capitalized share-based compensation	\$(109 )	\$60
Common stock withheld for employee taxes in connection with share-based compensation	\$2,188	\$5,237
Repayment of notes payable by credits from municipal agency	\$76	\$76

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

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ABAXIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Abaxis, Inc. (“Abaxis,” the “Company,” “our,” “us,” or “we”), incorporated in California in 1989, develops, manufactures and markets portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. We conduct business worldwide and manage our business on the basis of the following two reportable segments: the medical market and the veterinary market.

Basis of Presentation

We have prepared the unaudited condensed consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim periods. The unaudited condensed consolidated financial statements included herein reflect all normal recurring adjustments, which are, in the opinion of our management, necessary to state fairly the results of operations and financial position for the periods presented. The results for the three and nine month periods ended December 31, 2016 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2017 or for any interim or future period.

These unaudited condensed consolidated financial statements and related notes should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

Principles of Consolidation. The accompanying condensed consolidated financial statements include the accounts of Abaxis and our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Discontinued Operations. On March 18, 2015, we entered into an Asset Purchase Agreement with Antech Diagnostics, Inc. (“Antech”) pursuant to which we sold substantially all of the assets of our Abaxis Veterinary Reference Laboratories (“AVRL”) business. The sale transaction closed on March 31, 2015. The historical operating results of our AVRL business are retrospectively adjusted and presented as discontinued operations in our condensed consolidated balance sheets and condensed consolidated statements of income for all periods presented. See Note 4, “Discontinued Operations” for additional information. Unless noted otherwise, all discussions herein with respect to the Company’s condensed consolidated financial statements relate to the Company’s continuing operations.

Management Estimates. The preparation of these condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, the reported amounts of revenues and expenses during the reporting period, and related disclosures. Significant management estimates made in preparing the condensed consolidated financial statements relate to allowance for doubtful accounts, sales and other allowances, estimated selling price of our products, valuation of inventory, fair value of investments, fair value and useful lives of intangible assets, income taxes, valuation allowance for deferred tax assets, share-based compensation, legal exposures and warranty reserves. Our management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Our actual results may differ materially from these estimates.

### Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 filed with the SEC on May 31, 2016, and have not changed significantly since such filing.

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NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Revenue from Contracts with Customers: In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which supersedes the revenue recognition requirements in Accounting Standards Codification (“ASC”) ASC 606, “Revenue Recognition.” ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On July 9, 2015, the FASB decided to delay the effective date of the new standard by one year.

The FASB has since issued additional updates of its new standard on revenue recognition issued in May 2014. In March 2016, an amendment was issued to clarify the implementation guidance on principal versus agent consideration. The guidance requires entities to determine whether the nature of its promise to provide goods or services to a customer is performed in a principal or agent capacity and to recognize revenue in a gross or net manner based on its principal/agent designation. In April 2016, amendments were issued to clarify the identification of performance obligations and the licensing implementation guidance in the initial standard. Amendments were issued in May 2016 related to its guidance on assessing collectability, presentation of sales tax, noncash consideration, and completed contracts and contract modification at transition, which reduce the potential for diversity in practice, and the cost and complexity of application at transition and on an ongoing basis. The new guidance allows for the amendment to be applied either retrospectively to each prior reporting period presented or retrospectively as a cumulative-effect adjustment as of the date of adoption. ASU 2014-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

Simplifying the Measurement of Inventory: In July 2015, the FASB issued ASU No. 2015-11, “Simplifying the Measurement of Inventory (Topic 330)” (“ASU 2015-11”), which amends the guidelines for the measurement of inventory. Under the amendments, an entity should measure inventory valued using a first-in, first-out or average cost method at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

Balance Sheet Classification of Deferred Taxes: In November 2015, the FASB issued ASU No. 2015-17, “Balance Sheet Classification of Deferred Taxes (Topic 740)” (“ASU 2015-17”), which amends the accounting guidance related to balance sheet classification of deferred taxes. The amendment requires that deferred tax assets and liabilities be classified as noncurrent in the statement of financial position, thereby simplifying the current guidance that requires an entity to separate deferred tax assets and liabilities into current and noncurrent amounts. ASU 2015-17 is effective beginning in the first quarter of fiscal year 2018. Early adoption is permitted. The amendment can be adopted either prospectively or retrospectively. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

Recognition and Measurement of Financial Assets and Financial Liabilities: In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)” (“ASU 2016-01”), which changes accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, it clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. ASU 2016-01 is effective beginning in the first quarter of fiscal year 2019. Early

adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Leases:** In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which amends a number of aspects of lease accounting, including requiring lessees to recognize almost all leases with a term greater than one year as a right-of-use asset and corresponding liability, measured at the present value of the lease payments. ASU 2016-02 is effective for us beginning in the first quarter of fiscal year 2020 and is required to be adopted using a modified retrospective approach. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Employee Share-Based Payment Accounting:** In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting (Topic 718)” (“ASU 2016-09”), which simplifies several aspects of employee share-based payment accounting, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 will become effective for us beginning in the first quarter of fiscal year 2018. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

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**Financial Instruments - Credit Losses:** In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326)” (“ASU 2016-13”), which will change the impairment model for most financial assets and require additional disclosures. The amended guidance requires financial assets that are measured at amortized cost, be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets. The amended guidance also requires us to consider historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount in estimating credit losses. ASU 2016-13 becomes effective for us commencing in the first quarter of fiscal 2019 and will be applied through a cumulative-effect adjustment to retained earnings at the beginning of the year of adoption. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments:** In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230)” (“ASU 2016-15”), to provide clarification on cash flow classification related to eight specific issues including contingent consideration payments made after a business combination and distributions received from equity method investees. ASU 2016-15 is effective beginning in the first quarter of fiscal year 2019 on a retrospective basis. Early adoption is permitted. We are evaluating the impact of the adoption of this standard on our consolidated financial statements.

**NOTE 3. ACQUISITIONS**

In November 2014, we entered into Share Purchase Agreements, through our wholly-owned subsidiary, pursuant to which, we acquired 100% of the outstanding stock of Quality Clinical Reagents Limited (“QCR”) and Trio Diagnostics (Ireland) Ltd (“Trio”), both based in the United Kingdom. QCR and Trio are distributors of laboratory instrumentation and consumables to the veterinary profession in the United Kingdom. Our primary reason for the acquisitions was to continue servicing and supplying Abaxis veterinary products to our customer base. The acquisition date fair value of the purchase consideration was \$6.5 million, which included the following (in thousands):

Cash	\$3,196
Installment payment obligations (1)	2,336
Settlement of preexisting business relationship at fair value	931
Total	\$6,463

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(1) The installment payment obligation is denominated in British pounds (“GBP”) and the amount in the table above is based on the GBP to U.S. dollar exchange rate at the acquisition date.

During the third quarter of fiscal 2016, we paid the first installment obligation of GBP 750,000, or \$1.1 million, based on the GBP to U.S. dollar exchange rate on the date of payment. We paid the remaining installment obligation of GBP 750,000 less post-closing indemnification obligations of certain of the sellers totaling \$0.8 million during the third quarter of fiscal 2017, based on the GBP to U.S. dollar exchange rate on the date of payment. Additionally, the post-closing indemnification obligations totaled \$0.1 million, based on the GBP to U.S. dollar exchange rate at the obligation date, which we recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income. The Share Purchase Agreements contain certain customary representations and warranties. Additionally, in connection with the acquisition, we recorded a settlement of the preexisting business relationship related to accounts receivable due from QCR and Trio that existed on the acquisition date. The book value of the accounts receivable approximated their fair value due to their short-term nature and no gain or loss was recorded.

The following table summarizes the acquisition date fair value of net tangible assets acquired and liabilities assumed from QCR and Trio (in thousands):

	Fair Value
Net tangible assets acquired	\$ 5,248
Intangible assets:	
Customer relationships	1,535
Tradename	16
Deferred tax liabilities	(336 )
Total	\$ 6,463

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The useful lives for the customer relationships and tradename intangible assets acquired in the acquisition are ten years and two years, respectively, and are amortized on a straight-line basis.

We evaluated certain assets and liabilities related to the QCR and Trio acquisition during the measurement period, which terminated 12 months from the acquisition date. Changes to amounts recorded as assets or liabilities and corresponding adjustments to the purchase price allocation were insignificant.

Abaxis UK, our wholly-owned subsidiary in the United Kingdom, was formed by our acquisition of Quality Clinical Reagents Limited and Trio Diagnostics (Ireland) Ltd in November 2014. Our condensed consolidated financial statements include the operating results of our business combination and the consolidation of Abaxis UK from the date of acquisition.

The condensed consolidated financial statements include the operating results of our business combination and the consolidation of Abaxis UK from the date of acquisition.

## NOTE 4. DISCONTINUED OPERATIONS

On March 18, 2015, we entered into an asset purchase agreement (“APA”) with Antech pursuant to which we sold substantially all of the assets of our AVRL business. The sale transaction closed on March 31, 2015. The total purchase price under the APA was \$21.0 million in cash. During the fourth quarter of fiscal 2015, we received \$20.1 million in cash proceeds and we recorded a gain on sale of discontinued operations, net of tax of \$7.7 million. During the fourth quarter of fiscal 2016, we recorded \$0.6 million, net of tax, as a gain on sale of discontinued operations, upon meeting certain conditions by the first anniversary of the closing date in March 2016.

The AVRL business represents a separate asset group and the sale of assets in this business qualifies as a discontinued operation and accordingly, we reported the results of operations of this business in discontinued operations within the condensed consolidated statements of operations for all periods presented as applicable.

The results from discontinued operations were as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Discontinued operations:				
Revenues	\$ 178	\$ 167	\$ 524	\$ 586
Cost of revenues	178	166	524	811
Gross profit (loss)	-	1	-	(225 )
Sales and marketing expense	-	-	-	(91 )
General and administrative expense	24	-	111	-
Other income	-	3	-	127
Income (loss) before income tax provision (benefit)	(24 )	4	(111 )	(7 )
Income tax provision (benefit)	(9 )	-	(41 )	(4 )
Net income (loss) from discontinued operations	\$ (15 )	\$ 4	\$ (70 )	\$ (3 )

The current and non-current assets and liabilities of discontinued operations were as follows (in thousands):

	December 31, 2016	March 31, 2016
Receivables, net	\$ 66	\$ 949
Prepaid expenses and other current assets	-	12
Total current assets of discontinued operations	\$ 66	\$ 961

Other current liabilities	87	112
Total current liabilities of discontinued operations	\$ 87	\$ 112

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## NOTE 5. INVESTMENTS

Our investments are classified as either available-for-sale or held-to-maturity. The following table summarizes available-for-sale and held-to-maturity investments as of December 31, 2016 and March 31, 2016 (in thousands).

	Available-for-Sale Investments			
	Gross		Gross	
	Amortized Cost	Unrealized Gain	Unrealized (Loss)	Fair Value
December 31, 2016				
Corporate bonds	\$ 6,684	\$ -	\$ (20 )	\$ 6,664
Total available-for-sale investments	\$ 6,684	\$ -	\$ (20 )	\$ 6,664
	Held-to-Maturity Investments			
	Gross		Gross	
	Amortized Cost	Unrecognized Gain	Unrecognized (Loss)	Fair Value
December 31, 2016				
Certificates of deposit	\$ 498	\$ -	\$ -	\$ 498
Commercial paper	8,580	1	(4 )	8,577
Corporate bonds	58,287	-	(229 )	58,058
Total held-to-maturity investments	\$ 67,365	\$ 1	\$ (233 )	\$ 67,133
	Available-for-Sale Investments			
	Gross		Gross	
	Amortized Cost	Unrealized Gain	Unrealized (Loss)	Fair Value
March 31, 2016				
Corporate bonds	\$ 7,037	\$ -	\$ (12 )	\$ 7,025
Total available-for-sale investments	\$ 7,037	\$ -	\$ (12 )	\$ 7,025
	Held-to-Maturity Investments			
	Gross		Gross	
	Amortized Cost	Unrecognized Gain	Unrecognized (Loss)	Fair Value
March 31, 2016				
Certificates of deposit	\$ 2,737	\$ 3	\$ -	\$ 2,740
Commercial paper	12,455	-	(6 )	12,449
Corporate bonds	41,715	-	(117 )	41,598
Total held-to-maturity investments	\$ 56,907	\$ 3	\$ (123 )	\$ 56,787

The amortized cost of our held-to-maturity investments approximates their fair value. As of December 31, 2016 and March 31, 2016, we did not have other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity or available-for-sale. As of December 31, 2016 and March 31, 2016, we had unrealized loss on available-for-sale investments, net of related income taxes, of \$11,000 and \$7,000, respectively. During the three and nine months ended December 31, 2016 and 2015, we did not have any redemption of investments in accordance with callable provisions.

The following table summarizes the amortized cost and fair value of our investments, classified by stated maturity as of December 31, 2016 and March 31, 2016 (in thousands).

December 31, 2016	December 31, 2016
Available-for-Sale Investments	Held-to-Maturity Investments
Fair Value	Fair Value

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	Amortized Cost		Amortized Cost	
Due in less than one year	\$ 5,057	\$ 5,044	\$ 47,247	\$ 47,186
Due in 1 to 4 years	1,627	1,620	20,118	19,947
Total investments	\$ 6,684	\$ 6,664	\$ 67,365	\$ 67,133

	March 31, 2016 Available-for-Sale Investments Amortized		March 31, 2016 Held-to-Maturity Investments Amortized	
	Cost	Fair Value	Cost	Fair Value
Due in less than one year	\$ 4,314	\$ 4,311	\$ 37,163	\$ 37,128
Due in 1 to 4 years	2,723	2,714	19,744	19,659
Total investments	\$ 7,037	\$ 7,025	\$ 56,907	\$ 56,787

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## NOTE 6. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument.

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

The following table summarizes financial assets, measured at fair value on a recurring basis, by level of input within the fair value hierarchy as of December 31, 2016 and March 31, 2016 (in thousands):

	As of December 31, 2016			
	Quoted Prices in Active Markets for Identical Assets Level 1	Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
Assets				
Cash equivalents	\$161	\$ -	\$ -	\$161
Available-for-sale investments:				
Corporate bonds	-	6,664	-	6,664
Total assets at fair value	\$161	\$ 6,664	\$ -	\$6,825

As of March 31, 2016			
Quoted Prices in Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs	Significant Unobservable Inputs

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	Level			
	1	Level 2	Level 3	Total
Assets				
Cash equivalents	\$9,834	\$ -	\$ -	\$9,834
Available-for-sale investments:				
Corporate bonds	-	7,025	-	7,025
Total assets at fair value	\$9,834	\$ 7,025	\$ -	\$16,859

As of December 31, 2016 and March 31, 2016, our Level 1 financial assets consisted of money market mutual funds. Our cash equivalents are highly liquid instruments with original or remaining maturities of three months or less at the time of purchase that are readily convertible into cash. The fair value of our Level 1 financial assets is based on quoted market prices of the underlying security.

As of December 31, 2016 and March 31, 2016, our Level 2 financial assets consisted primarily of corporate bonds. For our Level 2 financial assets, we review trading activity and pricing for these investments as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from third party data providers. These inputs represent quoted prices for similar assets in active markets or these inputs have been derived from observable market data.

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As of December 31, 2016 and March 31, 2016, we did not have any Level 1 and Level 2 financial liabilities or Level 3 financial assets or liabilities measured at fair value on a recurring basis. We did not have any transfers between Level 1 and Level 2 or transfers in or out of Level 3 during the three and nine months ended December 31, 2016 and 2015.

## NOTE 7. INVENTORIES

Inventories include material, labor and manufacturing overhead, and are stated at the lower of cost (first-in, first-out method) or market. Components of inventories were as follows (in thousands):

	December 31, 2016	March 31, 2016
Raw materials	\$ 17,472	\$ 15,737
Work-in-process	5,684	6,039
Finished goods	16,036	13,355
Inventories	\$ 39,192	\$ 35,131

## NOTE 8. INVESTMENT IN UNCONSOLIDATED AFFILIATES

In February 2011, we purchased a 15% equity ownership interest in Scandinavian Micro Biodevices APS (“SMB”), developer and manufacturer of point-of-care diagnostic products for veterinary use, for \$2.8 million in cash. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. We accounted for our investment in SMB using the equity method due to our significant influence over SMB’s operations.

In August 2016, we sold our 15% equity ownership interest in SMB in connection with Zoetis Inc.’s acquisition of SMB. The total purchase price for our equity method investment in SMB was approximately \$9.7 million in cash, subject to a holdback for certain adjustments that may occur. The holdback payment is expected to be released 18 months following the closing date. In connection with the sale, we received a cash payment of \$8.5 million and recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the nine months ended December 31, 2016.

Our allocated portions of SMB’s net income (loss) during the three months ended December 31, 2016 and 2015, were \$0 and \$25,000, respectively, and during the nine months ended December 31, 2016 and 2015, were \$(34,000) and \$56,000, respectively. Our proportionate share of SMB’s net income or loss is recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income.

In June 2016, we invested a total of \$3.0 million in a privately-held company. Our investment is recorded under the cost method as we do not exercise significant influence over the investee’s operating or financial activities. The carrying value of our cost method investment is reviewed quarterly for changes in circumstances or the occurrence of events that suggest our investment may not be recoverable. The fair value of cost method investments is not adjusted if there are no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment.

See Note 19, “Subsequent Events,” for information regarding a letter agreement that we entered into with our cost method investee after December 31, 2016.

## NOTE 9. WARRANTY RESERVES

We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments and reagent discs.

Instruments. Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service experience. The estimated accrual for warranty exposure is based on historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. During the nine months ended December 31, 2015, we recorded an adjustment to pre-existing warranties of \$0.2 million, which reduced our warranty reserves and our cost of revenues, based on our historical experience and our projected performance rate of instruments.

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Reagent Discs. We record a provision for defective reagent discs when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. The warranty cost includes the replacement costs and freight of a defective reagent disc. The balance of accrued warranty reserve related to replacement of defective reagent discs as of December 31, 2016 and March 31, 2016 was \$0.6 million and \$0.5 million, respectively, which was classified as a current liability on the condensed consolidated balance sheets.

We evaluate our estimates for warranty reserves on an ongoing basis and believe we have the ability to reasonably estimate warranty costs. However, unforeseeable changes in factors may impact the estimate for warranty and such changes could cause a material change in our warranty reserve accrual in the period in which the change was identified.

The change in our accrued warranty reserve during the three and nine months ended December 31, 2016 and 2015 is summarized as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2016	2015	2016	2015
Balance at beginning of period	\$ 3,950	\$ 2,824	\$ 3,208	\$ 3,156
Provision for warranty expense	568	619	2,068	1,150
Warranty costs incurred	(325 )	(349 )	(1,083 )	(989 )
Adjustment to pre-existing warranties	-	-	-	(223 )
Balance at end of period	4,193	3,094	4,193	3,094
Non-current portion of warranty reserve	2,616	1,822	2,616	1,822
Current portion of warranty reserve	\$ 1,577	\$ 1,272	\$ 1,577	\$ 1,272

## NOTE 10. BORROWINGS

Notes Payable. We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City (“the Agency”) whereby the Agency provides us with an unsecured loan of up to \$1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of December 31, 2016, our short-term and long-term notes payable balances were \$0.1 million and \$0.3 million, respectively, and as of March 31, 2016, our short-term and long-term notes payable balances were \$0.1 million and \$0.4 million, respectively. The short-term balance was recorded in “Other accrued liabilities” on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date Abaxis ceases operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon an event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of December 31, 2016.

In accordance with the terms of the loan agreement, the Agency will provide Abaxis with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by Abaxis to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income.

## NOTE 11. OTHER CURRENT ACCRUED LIABILITIES

Other current accrued liabilities consist of the following (in thousands):

	December 31, 2016	March 31, 2016
Accrued liabilities for customer sales incentive programs	\$ 6,128	\$ 4,973
Installment payment obligation accrued related to acquisition	-	1,077
Other current accrued liabilities	3,963	3,343
Total other current accrued liabilities	\$ 10,091	\$ 9,393

As of December 31, 2016, accrued liabilities for customer sales incentive programs consisted primarily of (i) a liability to distributors or end-users for cash rebates upon meeting certain requirements during a qualifying period and (ii) a liability to resellers for incentives that we estimate at the time of initial sale and adjust as earned by end-users during a specified promotional period.

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We paid the remaining installment obligation of GBP 750,000 less post-closing indemnification obligations of certain of the sellers totaling \$0.8 million during the third quarter of fiscal 2017, based on the GBP to U.S. dollar exchange rate on the date of payment, related to our acquisition of QCR and Trio in November 2014. See Note 3, “Acquisitions” for additional information on our acquisition of QCR and Trio.

Other current accrued liabilities included notes payable and various expenses that we accrued for transaction taxes and professional costs.

## NOTE 12. COMMITMENTS AND CONTINGENCIES

### Commitments

**Purchase Commitments.** We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately \$6.7 million as of December 31, 2016. These purchase order commitments primarily include our purchase obligations to purchase from Diatron of Hungary through fiscal 2018.

### Litigation

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

## NOTE 13. EQUITY COMPENSATION PLANS AND SHARE-BASED COMPENSATION

### Equity Compensation Plans

Our share-based compensation plans are described below.

**2014 Equity Incentive Plan.** Our 2014 Equity Incentive Plan (as amended, the “2014 Plan”), which was approved by our shareholders on October 22, 2014, is the successor to and continuation of the 2005 Equity Incentive Plan (the “2005 Plan”). The terms of the 2014 Plan provide for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, other stock awards and performance awards that may be settled in cash, stock or other property. At its October 22, 2014 effective date, the total number of shares of the Company’s common stock available for issuance under the 2014 Plan was 1,712,409 shares, which was equal to the sum of (i) the shares remaining available for issuance pursuant to the exercise of options or issuance or settlement of stock awards that had not previously been granted under the 2005 Plan, as of the effective date of the 2014 Plan and (ii) the Returning Shares (as defined below), as of the effective date of the 2014 Plan. The “Returning Shares” are shares subject to outstanding stock awards granted under the 2005 Plan (the “2005 Available Pool”), as of the effective date of the 2014 Plan, (i) expire or terminate for any reason prior to exercise or settlement, (ii) are forfeited, cancelled or otherwise returned to us because of the failure to meet a contingency or condition required for the vesting of such shares, or (iii) are reacquired or withheld (or not issued) by us to satisfy a tax withholding obligation in connection with a stock award or to satisfy the purchase price or exercise price of a stock award.

On October 26, 2016, our shareholders approved an amendment to the 2014 Plan to, among other things, (i) increase the aggregate number of shares of common stock reserved for issuance under the 2014 Plan by 900,000 shares and (ii) update the means of adjustment when calculating the attainment of performance goals for performance awards under the 2014 Plan for purposes of the requirements of Section 162(m) of the Internal Revenue Code.

**2005 Equity Incentive Plan.** Our 2005 Plan was originally approved by our shareholders in October 2005 and restated and amended our 1998 Stock Option Plan. Our 2005 Plan allowed for the grant of stock options, stock appreciation

rights, restricted stock awards, restricted stock units, performance cash awards, performance shares, performance units, deferred compensation awards or other share-based awards to employees, directors and consultants. Our 2005 Plan was succeeded by our 2014 Plan upon adoption of our 2014 Plan on October 22, 2014, and no additional awards may be made under our 2005 Plan. However, as described above, the 2005 Available Pool became available for issuance under the 2014 Plan, and Returning Shares may become available under the 2014 Plan, from time to time.

As of December 31, 2016, the 2014 Plan provided for the issuance of a maximum of 2,612,409 shares, of which 1,300,000 shares of common stock were available for future issuance under the 2014 Plan pursuant to stock awards that had not previously been granted. Shares that are canceled or forfeited from an award and shares withheld in satisfaction of tax withholding obligations are again available for issue under the 2014 Plan.

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We issue new shares of common stock from our authorized shares for share-based awards upon the exercise of stock options or vesting of restricted stock units.

## Share-Based Compensation

Share-based compensation expense and related restricted stock unit award activity is presented on a consolidated basis, unless otherwise presented as continuing or discontinued operations.

The following table summarizes total share-based compensation expense, net of tax, related to restricted stock units during the three and nine months ended December 31, 2016 and 2015, which is included in our condensed consolidated statements of income (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	December 31, 2016	2015	December 31, 2016	2015
Cost of revenues (1)	\$ 360	\$ 256	\$ 1,326	\$ 950
Research and development	602	484	1,880	1,591
Sales and marketing (2)	797	677	2,218	2,679
General and administrative	673	980	2,893	3,016
Share-based compensation expense before income taxes	2,432	2,397	8,317	8,236
Income tax benefit	(839 )	(845 )	(2,881 )	(2,904 )
Total share-based compensation expense after income taxes	\$ 1,593	\$ 1,552	\$ 5,436	\$ 5,332
Net impact of share-based compensation on:				
Basic net income per share	\$ 0.07	\$ 0.07	\$ 0.24	\$ 0.24
Diluted net income per share	\$ 0.07	\$ 0.07	\$ 0.24	\$ 0.23

Cost of revenues reported in the table include share-based compensation expense from continuing and discontinued operations. During the three months ended December 31, 2016 and 2015, share-based compensation expense included in cost of revenues from continuing operations was \$0.4 million and \$0.3 million, respectively, and from (1) discontinued operations was \$0 and \$0, respectively. During the nine months ended December 31, 2016 and 2015, share-based compensation expense included in cost of revenues from continuing operations was \$1.3 million and \$0.8 million, respectively, and from discontinued operations was \$0 and \$0.1 million, respectively.

Sales and marketing expenses reported in the table include share-based compensation expense from continuing and discontinued operations. During the three months ended December 31, 2016 and 2015, share-based compensation expense included in sales and marketing expenses from continuing operations was \$0.8 million and \$0.7 million, (2) respectively, and from discontinued operations was \$0 and \$0, respectively. During the nine months ended December 31, 2016 and 2015, share-based compensation expense included in sales and marketing expenses from continuing operations was \$2.2 million and \$2.5 million, respectively, and from discontinued operations was \$0 and \$0.2 million, respectively.

Share-based compensation has been classified in the condensed consolidated statements of income or capitalized on the condensed consolidated balance sheets in the same manner as cash compensation paid to employees. Capitalized share-based compensation costs as of December 31, 2016 and March 31, 2016 were \$12,000 and \$0.1 million, respectively, which were included in "Inventories" on our condensed consolidated balance sheets.

## Cash Flow Impact

Cash flows resulting from excess tax benefits are classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for vested restricted stock units in excess of the deferred tax asset attributable to share-based compensation expense for such share-based awards. Excess tax benefits are considered realized when the tax deductions reduce taxes that otherwise would be payable. Excess tax benefits classified as a financing cash inflow for the three months ended December 31, 2016 and 2015 were \$9,000 and \$0.2 million, respectively, and for the nine months ended December 31, 2016 and 2015 were \$0.3 million and \$1.6 million, respectively.

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Restricted Stock Units

Since fiscal 2007, we have granted restricted stock unit awards to employees and directors as part of our share-based compensation program. Restricted stock unit awards to consultants were not significant. Awards of restricted stock units are issued at no cost to the recipient and may have time-based vesting criteria, or a combination of time-based and performance-based vesting criteria, as described below. From time to time, restricted stock unit awards granted to employees may be subject to accelerated vesting upon achieving certain performance-based milestones.

The Compensation Committee of our Board of Directors (the “Compensation Committee”) in its discretion, may provide in the event of a change in control for the acceleration of vesting and/or settlement of the restricted stock unit held by a participant upon such conditions and to such extent as determined by the Compensation Committee. Our Board of Directors has adopted an executive change in control severance plan, which it may terminate or amend at any time, that provides that awards granted to executive officers will accelerate fully on a change of control. The vesting of non-employee director and officer awards granted under the 2014 Plan automatically will also accelerate in full upon a change in control. Beginning in fiscal 2015, the Compensation Committee discontinued the practice of granting such “single trigger” acceleration of vesting benefits to new executive officers pursuant to which an executive officer’s outstanding stock option(s) and other unvested equity-based instruments would accelerate in full upon the occurrence of a change of control. Starting in fiscal 2015, we grant “double-trigger” acceleration arrangements to new executive officers, which requires both the occurrence of a change of control and the termination by us (or our successor) for any reason other than cause, death or disability within 18 months following such change of control date, with the termination constituting a separation in service and subject to execution of a valid and effective release of claims against us, for the acceleration of vesting of the executive officer’s equity awards in full.

Restricted Stock Unit Awards (Time Vesting)

We grant restricted stock unit awards with only time-based vesting terms, which we refer to as RSUs. The RSUs entitle holders to receive shares of common stock at the end of a specified period of time. For RSUs, vesting is based on continuous employment or service of the holder. Upon vesting, the equivalent number of common shares are typically issued net of tax withholdings. If the service vesting conditions are not met, unvested RSUs will be forfeited. Generally, RSUs vest according to one of the following time-based vesting schedules:

RSU awards to employees: Four-year time-based vesting as follows: five percent vesting after the first year; additional ten percent after the second year; additional 15 percent after the third year; and the remaining 70 percent after the fourth year of continuous employment with the Company.

RSU awards to non-employee directors: 100 percent vesting after one year of continuous service to the Company.

The fair value of RSUs used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Such value is recognized as an expense over the corresponding requisite service period. The share-based compensation expense is reduced for an estimate of the RSU awards that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. As of December 31, 2016, the total unrecognized compensation expense related to RSU awards granted amounted to \$19.4 million, which is expected to be recognized over a weighted average service period of 2.1 years.

Restricted Stock Unit Awards (Performance Vesting)

We grant restricted stock unit awards subject to performance criteria, which we refer to as PSUs to our executive officers and to certain employees. The PSUs vest only if both of the following criteria are satisfied: (1) our consolidated income from operations during the fiscal year in which the grant occurred, as certified by the

Compensation Committee, is in excess of the applicable target amount described below; and (2) the recipient remains in the continuous service of the Company until the applicable vesting date set forth as follows for PSUs granted in fiscal 2015, 2016 and 2017 (other than the PSUs granted to our Chief Executive Officer, Mr. Clinton Severson in fiscal 2017).

• 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;

• 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;

• 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and

• 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

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The PSUs that we granted to Mr. Severson in fiscal 2017 vest as follows:

approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;  
approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;  
approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and  
approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

We recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of PSUs used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously recognized compensation expense is reversed.

The share-based compensation expense is reduced for an estimate of the PSUs that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. If the service vesting conditions are not met, unvested PSUs will be forfeited. Upon vesting on the third and fourth anniversary date of grant of the PSUs, the equivalent number of common shares are typically issued net of tax withholdings.

For the PSUs granted in fiscal 2015 and 2016, we have determined that the performance targets have been met and accordingly, we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2016.

In April 2016, the Compensation Committee approved the grant of PSUs for an aggregate of 152,000 shares of common stock to our executive officers and to certain of our employees (the "FY2017 PSUs"). As of December 31, 2016, we reviewed each of the underlying performance targets related to the outstanding FY2017 PSUs and determined that it was not probable that the performance targets of the FY2017 PSUs would be met for 84,000 of the 152,000 shares of common stock and consequently, upon our determination of non-achievement of the performance metrics, the related compensation expense was reversed. As of December 31, 2016, we assessed that it was probable that the performance targets of the outstanding FY2017 PSUs would be met for 68,000 of the 152,000 shares of common stock granted and accordingly, we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2016.

We assess the probability of achievement of the performance targets of the FY2017 PSUs at the end of each quarter. If it becomes probable that the performance targets will be achieved, a cumulative adjustment will be recorded as if ratable share-based compensation expense had been recorded since the grant date. Additional share-based compensation of \$0.6 million would have been recorded during the nine months ended December 31, 2016 for FY2017 PSUs with respect to 84,000 shares of common stock had the achievement of performance targets been deemed probable.

As of December 31, 2016, the total unrecognized compensation expense related to PSU awards granted and expected to vest amounted to \$6.8 million, which is expected to be recognized over a weighted average service period of 1.7 years.

See Note 19, "Subsequent Events," for information regarding modifications to the FY2017 PSUs approved by the Compensation Committee after December 31, 2016.

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## Restricted Stock Unit Activity

The following table summarizes restricted stock unit activity for the nine months ended December 31, 2016.

	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value (1)	Number of Shares	Weighted Average Grant Date Fair Value (1)
Nonvested at March 31, 2016	524,000	\$ 45.37	311,000	\$ 48.29
Granted	203,000	45.97	152,000	44.54
Vested (2)	(152,000 )	41.54	(24,000 )	40.82
Canceled and forfeited	(29,000 )	46.46	-	-
Nonvested at December 31, 2016	546,000	\$ 46.60	439,000	\$ 47.40

(1) The weighted average grant date fair value of restricted stock units is based on the number of shares and the closing market price of our common stock on the date of grant.

(2) The number of restricted stock units vested includes shares that we withheld on behalf of our employees to satisfy the statutory tax withholding requirements.

Total intrinsic value of restricted stock units vested during the three months ended December 31, 2016 and 2015 was \$0.3 million and \$1.1 million, respectively, and during the nine months ended December 31, 2016 and 2015 was \$8.1 million and \$15.3 million, respectively.

The total grant date fair value of restricted stock units vested during the three months ended December 31, 2016 and 2015 was \$0.2 million and \$0.7 million, respectively, and during the nine months ended December 31, 2016 and 2015 was \$7.3 million and \$8.6 million, respectively.

## NOTE 14. SHAREHOLDERS' EQUITY

## Share Repurchase Program

Between August 2011 and July 2013, our Board of Directors authorized the repurchase of up to a total of \$67.3 million of our common stock. In July 2016, our Board of Directors approved a \$30.0 million increase to our existing share repurchase program. As of December 31, 2016, \$54.0 million was available to purchase common stock under our share repurchase program.

Since the share repurchase program began, through December 31, 2016, we have repurchased 1.6 million shares of our common stock at a total cost of \$43.3 million, including commission expense. During the three and nine months ended December 31, 2016 and 2015, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

## Dividend Payments

During the three months ended December 31, 2016 and 2015, our total quarterly dividend payout was \$3.2 million and \$2.5 million, respectively. During the nine months ended December 31, 2016 and 2015, our total quarterly dividend payout was \$8.6 million and \$7.5 million, respectively. Our dividend payout was made from retained earnings.

See Note 19, "Subsequent Events," for information regarding cash dividends declared by our Board of Directors after December 31, 2016.

#### Common Stock Warrants

During the nine months ended December 31, 2016 and 2015, we issued 0 and 4,000, respectively, shares of common stock upon the exercise of vested warrants at an exercise price of \$3.00 per share. During the three months ended December 31, 2016 and 2015, we did not issue any shares of common stock pursuant to the exercise of vested warrants. As of December 31, 2016 and March 31, 2016, there were no warrants outstanding.

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## NOTE 15. NET INCOME PER SHARE

Basic net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares that would have been outstanding during the period assuming the issuance of common shares for all potential dilutive common shares outstanding using the treasury stock method. Dilutive potential common shares outstanding include outstanding restricted stock units and warrants.

The computations for basic and diluted net income from continuing and discontinued operations per share are as follows (in thousands, except share and per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Income from continuing operations	\$6,859	\$7,954	\$25,236	\$22,772
Income (loss) from discontinued operations, net of tax	(15	) 4	(70	) (3
Net income	\$6,844	\$7,958	\$25,166	\$22,769
Weighted average common shares outstanding:				
Basic	22,535,000	22,725,000	22,508,000	22,684,000
Effect of dilutive securities:				
Restricted stock units	254,000	164,000	245,000	199,000
Warrants	-	-	-	1,000
Diluted	22,789,000	22,889,000	22,753,000	22,884,000
Net income per share:				
Basic				
Continuing operations	\$0.30	\$0.35	\$1.12	\$1.00
Discontinued operations	-	-	-	-
Basic net income per share	\$0.30	\$0.35	\$1.12	\$1.00
Diluted				
Continuing operations	\$0.30	\$0.35	\$1.11	\$1.00
Discontinued operations	-	-	-	-
Diluted net income per share	\$0.30	\$0.35	\$1.11	\$1.00

For our PSUs, if the performance criteria are achieved during the period, these awards will be considered outstanding for the purpose of computing diluted net income per share if the effect is dilutive. Because the performance criteria for FY2017 PSUs were not achieved during the three and nine months ended December 31, 2016, these awards were not included in the diluted net income per share calculation.

Restricted stock units for 0 and 95,000 shares during the three months ended December 31, 2016 and 2015, respectively, and 2,000 and 84,000 shares during the nine months ended December 31, 2016 and 2015, respectively, were outstanding but not included in the computation of diluted net income per share because the effect would be antidilutive.

Warrants are excluded from the computation of diluted weighted average shares outstanding if the exercise price of the warrants is greater than the average market price of our common stock during the period because the inclusion of these warrants would be antidilutive to net income per share. There were no warrants excluded from the computation

of diluted weighted average shares outstanding during the three and nine months ended December 31, 2016 and 2015.

NOTE 16. INCOME TAXES

During the three months ended December 31, 2016 and 2015, our income tax provision was \$3.9 million, based on an effective tax rate of 36%, and \$3.5 million, based on an effective tax rate of 31%, respectively. The increase in the effective tax rate during the three months ended December 31, 2016, as compared to the same period last year, was primarily attributable to lower federal benefits for qualified production activities during the three months ended December 31, 2016 and the impact of the benefit from the retroactive reinstatement of the federal research credit on December 18, 2015, when the federal research credit was permanently extended, retroactive to January 1, 2015, and as a result, in the third quarter of fiscal 2016, the period in which the legislation was enacted, we recognized the retroactive benefit of the federal research credit.

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During the nine months ended December 31, 2016 and 2015, our income tax provision was \$14.3 million, based on an effective tax rate of 36%, and \$12.0 million, based on an effective tax rate of 34%, respectively. The increase in the effective tax rate during the nine months ended December 31, 2016, as compared to the same period last year, was primarily attributable to lower federal benefits for qualified production activities during the nine months ended December 31, 2016 and the impact of the benefit from the retroactive reinstatement of the federal research credit on December 18, 2015, when the federal research credit was permanently extended, retroactive to January 1, 2015, and as a result, in the third quarter of fiscal 2016, the period in which the legislation was enacted, we recognized the retroactive benefit of the federal research credit.

We are subject to income taxes in the U.S. and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. We did not have any unrecognized tax benefits as of December 31, 2016 and March 31, 2016. During the three and nine months ended December 31, 2016 and 2015, we did not recognize any interest or penalties related to unrecognized tax benefits. During the three months ended December 31, 2016, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015. As of December 31, 2016, there had been no proposed assessments and we are unable to estimate the range of possible outcomes at this time.

## NOTE 17. SEGMENT REPORTING INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by our chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

Abaxis develops, manufactures and markets portable blood analysis systems for use in human or veterinary patient care setting to provide clinicians with rapid blood constituent measurements. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenue or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold by market and customer group. For the products that we manufacture and sell, each reportable segment has similar manufacturing processes, technology and shared infrastructures. The accounting policies for segment reporting are the same as for the Company as a whole. We do not segregate assets by segments since our chief operating decision maker, or decision making group, does not use assets as a basis to evaluate a segment's performance.

### Medical Market

In the medical market reportable segment, we serve a worldwide customer group consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines. The products manufactured and sold in this segment primarily consist of Piccolo chemistry analyzers and medical reagent discs.

### Veterinary Market

In the veterinary market reportable segment, we serve a worldwide customer group consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables and VetScan

rapid tests.

In March 2015, we entered into an asset purchase agreement with Antech pursuant to which we sold substantially all of the assets of our AVRL business to Antech, see Note 4, “Discontinued Operations.” We have reclassified the assets, liabilities, results of operations and the gain on sale of AVRL in our condensed consolidated balance sheets and statements of income for all periods presented to reflect them as discontinued operations. Previously reported financial information have been revised to reflect the reclassification of AVRL within our veterinary market segment as a discontinued operation.

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## Total Revenues, Cost of Revenues and Gross Profit by Segment

The table below summarizes revenues, cost of revenues and gross profit from our two operating segments and from certain unallocated items and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands).

	Three Months Ended		Nine Months Ended	
	December 31, 2016	2015	December 31, 2016	2015
Revenues:				
Medical Market	\$ 8,652	\$ 11,002	\$27,130	\$28,317
Veterinary Market	43,198	40,896	139,219	131,084
Other (1)	922	978	2,671	2,540
Total revenues	52,772	52,876	169,020	161,941
Cost of revenues:				
Medical Market	4,328	5,815	14,117	14,861
Veterinary Market	19,015	17,425	61,097	56,026
Other (1)	25	34	143	98
Total cost of revenues	23,368	23,274	75,357	70,985
Gross profit:				
Medical Market	4,324	5,187	13,013	13,456
Veterinary Market	24,183	23,471	78,122	75,058
Other (1)	897	944	2,528	2,442
Gross profit	\$ 29,404	\$ 29,602	\$93,663	\$90,956

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(1) Represents unallocated items, not specifically identified to any particular business segment.

#### NOTE 18. REVENUES BY PRODUCT CATEGORY AND GEOGRAPHIC REGION AND SIGNIFICANT CONCENTRATIONS

##### Revenue Information

The following is a summary of our revenues by product category and represents our results from continuing operations (in thousands):

Revenues by Product Category	Three Months Ended		Nine Months Ended	
	December 31, 2016	2015	December 31, 2016	2015
Instruments (1)	\$ 9,349	\$ 11,601	\$29,271	\$31,910
Consumables (2)	40,353	38,434	130,554	121,906
Other products (3)	3,070	2,841	9,195	8,088
Product sales, net	52,772	52,876	169,020	161,904
Development and licensing revenues	-	-	-	37
Total revenues	\$ 52,772	\$ 52,876	\$ 169,020	\$ 161,941

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(1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers and i STAT analyzers.

(2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i STAT cartridges and

rapid tests.

(3) Other products include products using the Orbos process and extended maintenance agreements.

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The following is a summary of our revenues by geographic region based on customer location and represents our results from continuing operations (in thousands):

Revenues by Geographic Region	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2016	2015	2016	2015
North America	\$ 41,538	\$ 41,109	\$ 135,328	\$ 128,596
Europe	7,999	7,546	24,390	23,531
Asia Pacific and rest of the world	3,235	4,221	9,302	9,814
Total revenues	\$ 52,772	\$ 52,876	\$ 169,020	\$ 161,941

## Significant Concentrations

During the three months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Patterson Companies, Inc. and Abbott Point of Care, Inc., accounted for 21%, 14%, 10% and 10%, respectively, of our total worldwide revenues. During the nine months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Patterson Companies, Inc. and Abbott Point of Care, Inc., accounted for 20%, 14%, 11% and 10%, respectively, of our total worldwide revenues.

During the three months ended December 31, 2015, three distributors, MWI Veterinary Supply, Inc., Abbott Point of Care, Inc. and Patterson Companies, Inc., accounted for 20%, 12% and 12%, respectively, of our total worldwide revenues. During the nine months ended December 31, 2015, four distributors, MWI Veterinary Supply, Inc., Henry Schein Animal Health, Patterson Companies, Inc. and Abbott Point of Care, Inc. accounted for 20%, 14% , 11% and 10%, respectively, of our total worldwide revenues.

Starting in the second quarter of fiscal 2016, our revenues from Patterson Companies, Inc. include both Patterson's veterinary business and Animal Health International, Inc., as a result of Patterson's acquisition of Animal Health International, Inc. Starting in fiscal 2016, our revenues from Henry Schein, Inc., include both Henry Schein Animal Health and scil animal care company GmbH, as a result of Henry Schein Inc.'s acquisition of scil animal care company GmbH in Europe.

Concentration of credit risk with respect to accounts receivable is primarily limited to certain distributors to whom we make significant sales. Three distributors accounted for 28%, 14% and 10%, respectively, of our total receivable balance as of December 31, 2016. Two distributors accounted for 25% and 14%, respectively, of our total receivable balance as of March 31, 2016.

## NOTE 19. SUBSEQUENT EVENTS

In January 2017, we entered into a letter agreement with the privately-held company which we had invested \$3.0 million in June 2016. Under the terms of the letter agreement, the privately-held company will, pending negotiation and execution of a definitive agreement, commence chemistry development activities for us using its intellectual product and technology. As consideration for these development efforts, we will pay a total of up to \$1.5 million to the investee, in the form of an upfront payment of \$0.3 million in January 2017, and any remaining obligation to the investee is contingent upon the achievement of certain development milestones.

In January 2017, our Board of Directors declared a cash dividend of \$0.14 per share on our outstanding common stock to be paid on March 15, 2017 to all shareholders of record as of the close of business on March 1, 2017.

On January 25, 2017, the Compensation Committee of our Board of Directors approved an amendment to our FY2017 PSUs so the performance vesting condition refers to the Company's consolidated income from continuing operations

before income tax provision, rather than income from operations. The service vesting condition and all other terms and conditions of our FY2017 PSUs were not changed.

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

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements, that reflect our current views with respect to future events and financial performance. In this report, the words "will," "anticipates," "believes," "expects," "intends," "plans," "future," "projects," "estimates," "would," "should," "might" and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties, including but not limited to those discussed below, in Part II, Item 1A of this report and in Part I, Item 1A of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC"), that could cause actual results to differ materially from historical results or those anticipated. Such risks and uncertainties relate to our manufacturing operations, including the vulnerability of our manufacturing operations to potential interruptions and delays and our ability to manufacture products free of defects, fluctuations in our quarterly results of operations and difficulty in predicting future results, our dependence on Abbott Point of Care, Inc. ("Abbott") for our U.S. medical sales, the performance of our independent distributors and our ability to manage their inventory levels effectively, market acceptance of our existing and future products, our dependence on certain sole or limited source suppliers, expansion of our sales, marketing and distribution efforts, the effect of exchange rate fluctuations on international operations, dependence on key personnel, the protection of our intellectual property and claims of infringement of intellectual property asserted by third parties, competition and other risks detailed under "Risk Factors" in this Quarterly Report on Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We assume no obligation to update any forward-looking statements as circumstances change.

Business Overview

Abaxis, Inc. is a worldwide developer, manufacturer and marketer of portable blood analysis systems that are used in a broad range of medical specialties in human or veterinary patient care to provide clinicians with rapid blood constituent measurements. Until March 2015, Abaxis also provided veterinary reference laboratory diagnostic and consulting services for veterinarians through AVRL. See the section below entitled "Discontinued Operations" for further information.

Our corporate headquarters are located in Union City, California, from which we conduct our manufacturing, warehousing, research and development, regulatory, sales and marketing and administrative activities. We market and sell our products worldwide primarily through independent distributors, supplemented by our direct sales force. Our sales force is primarily located in the United States. Abaxis Europe GmbH, our wholly-owned subsidiary, markets and distributes diagnostic systems for medical and veterinary uses in the European and Asia Pacific markets.

We manage our business in two operating segments, the medical market and veterinary market, as described below. See "Segment Results" in this section for a detailed discussion of financial results.

**Medical Market.** We serve a worldwide customer group in the medical market consisting of physicians' office practices across multiple specialties, urgent care, outpatient and walk-in clinics (free-standing or hospital-connected), health screening operations, home care providers (national, regional or local), nursing homes, ambulance companies, oncology treatment clinics, dialysis centers, pharmacies, hospital laboratories, military installations (ships, field hospitals and mobile care units), pharmaceutical clinical trials and cruise ship lines.

For our products in the human medical market, we employ primarily independent distributors to market our products. Starting in January 2013, we transitioned the majority of our medical product sales to Abbott as our exclusive distributor in the medical market. Pursuant to our Exclusive Agreement with Abbott (the "Abbott Agreement"), Abbott obtained the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzers and associated consumables

in the professionally-attended human healthcare market in the United States and China (including Hong Kong). Effective September 2013, we amended the Abbott Agreement to limit Abbott's territory under such agreement to the United States. Under the Abbott Agreement, we have certain responsibilities for providing technical support and warranty services to Abbott in support of its marketing and sales efforts. The initial term of the Abbott Agreement ends on December 31, 2017, and after the initial term, the Abbott Agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date.

We will continue to sell and distribute these medical products outside of the market segments as to which Abbott has exclusive rights. For example, during the third quarter of fiscal 2016, we sold 200 Piccolo Xpress instruments to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China. Under our Abbott Agreement, we will continue to sell and distribute to Catapult Health LLC and specified customer segments in the United States, including pharmacy and retail store clinics, shopping malls, clinical research organizations and cruise ship lines.

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**Veterinary Market.** Our VetScan products serve a worldwide customer group in the veterinary market consisting of companion animal hospitals, animal clinics with mixed practices of small animals, birds and reptiles, equine and bovine practitioners, veterinary emergency clinics, veterinary referral hospitals, universities, government, pharmaceutical companies, biotechnology companies and private research laboratories. Our veterinary market product offerings include VetScan chemistry analyzers and veterinary reagent discs, VetScan hematology instruments and related reagent kits, VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables and VetScan rapid tests. Until March 2015, we provided veterinary reference laboratory diagnostic and consulting services for veterinarians through our Abaxis Veterinary Reference Laboratories (“AVRL”) division. In March 2015, we sold our AVRL business to Antech Diagnostics, Inc., the VCA laboratory division (“Antech”). As a result, AVRL is presented as discontinued operations in our condensed consolidated financial statements.

We depend on a number of distributors in North America that distribute our VetScan products. In September 2012, we entered into a distribution agreement with MWI Veterinary Supply, Inc. (“MWI”) to purchase, market and sell the full line of Abaxis veterinary products throughout the United States. In the United States veterinary market segment, we also rely on various independent regional distributors. We continue to enter into additional distributor relationships to expand our distribution base in North America. In October 2014, we entered into distribution agreements with Henry Schein Animal Health and Patterson Companies, Inc. to sell the full line of Abaxis veterinary products throughout the United States. We depend on our distributors to assist us in promoting our VetScan products, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our sales revenues until our customers identify another distributor or purchase products directly from us. In addition to selling through distributors, we also directly supply our VetScan products to large group purchasing organizations, hospital networks and other buying groups in the United States, such as Veterinary Centers of America (“VCA”), a veterinary hospital chain in North America. In May 2014, we entered into a product supply agreement with VCA to supply our VetScan chemistry analyzers and diagnostic reagent discs for placement at VCA’s animal hospitals located in North America that operates more than 700 animal hospitals. In May 2014, we entered into a non-exclusive co-marketing agreement with VCA’s Antech Diagnostic laboratory services to supply our VetScan chemistry analyzers in combination with Antech Diagnostic laboratory services as a diagnostic solution to serve veterinary practices throughout North America. In the third quarter of fiscal 2016, we also entered into a five-year supply agreement with Banfield Pet Hospitals, an organization with more than 900 pet hospitals within the United States and Puerto Rico. Under our supply agreement, we will provide our VetScan hematology analyzers and associated consumables to all of Banfield’s pet hospital locations, for which installation and training began in the first quarter of fiscal 2017 and was completed at the end of September 2016.

## Discontinued Operations

In March 2015, we entered into an asset purchase agreement with Antech pursuant to which we sold substantially all of the assets of our AVRL business to Antech. The transaction closed on March 31, 2015. We determined that our AVRL business met the criteria to be classified as a discontinued operation, which required retrospective application to financial information for all periods presented. Accordingly, the historical financial statements appearing in this report have been revised to reflect this reclassification. Unless otherwise noted, references to revenues and expenses in this report are to our revenues and expenses excluding those from AVRL operations. See Note 4 of the Notes to Condensed Consolidated Financial Statements contained in this report for additional information.

The total purchase price under the asset purchase agreement was \$21.0 million in cash. We received \$20.1 million in cash proceeds during the fourth quarter of fiscal 2015 and we recognized a pre-tax gain of \$12.3 million (\$7.7 million after-tax) on sale of discontinued operations during fiscal 2015. Additionally, upon meeting certain conditions by the first anniversary of the closing date in March 2016, we recognized a pre-tax gain of \$0.9 million (\$0.6 million after-tax) on sale of discontinued operations during fiscal 2016.

The pre-tax gain on this sale reflects the excess of the sum of the cash proceeds received over the costs incurred in connection with the sale of AVRIL. During the fourth quarter of fiscal 2015, we recorded costs of \$7.8 million related to cash payments for employee-related costs, including severance, contract termination and other associated costs. In connection with the transaction, we recorded disposal and an impairment charge on long-lived assets of \$1.9 million during fiscal 2015. These items partially offset the cash proceeds that we received in accordance with the terms of the asset purchase agreement.

#### Overview of Financial Results

In the third quarter of fiscal 2017, total revenues were \$52.8 million, a decrease of 1% from last year's comparable quarter. The net decrease in revenues was primarily attributable to a decrease in instrument sales, which totaled \$9.3 million, a decrease of 19% from last year's comparable quarter, due to a decrease in the unit sales of Piccolo chemistry analyzers sold to Abbott and impacted by sales of Piccolo chemistry analyzers to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China, in the third quarter of fiscal 2016. The net decrease in revenues was partially offset by an increase in revenues from consumable sales, which were \$40.4 million, an increase of 5% over last year's comparable quarter, primarily attributable to an increase in the unit sales of hematology reagent kits resulting from our supply agreement with Banfield Pet Hospitals starting in the first quarter of fiscal 2017.

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Gross profit in the third quarter of fiscal 2017 was \$29.4 million, a decrease of 1% over last year's comparable quarter, primarily impacted by changes in the product mix in our veterinary market, attributable to lower unit sales of reagent discs, which have a higher margin contribution.

Total operating expenses in the third quarter of fiscal 2017 were \$18.6 million, an increase of \$0.2 million, or 1%, compared to the same period last year, primarily attributable to an increase in research and development spending and promotional and marketing expenses to support our growth in both North America and in the international markets, partially offset by a decrease in personnel-related expenses.

Income from continuing operations in the third quarter of fiscal 2017 was \$6.9 million, a decrease of \$1.1 million, or 14%, compared to the same period last year, primarily attributable to a net decrease in gross profit, an increase in operating expenses, discussed above, and an increase in income tax provision resulting from lower federal benefits for qualified production activities during the third quarter of fiscal 2017 and the impact of the benefit from the retroactive reinstatement of the federal research credit on December 18, 2015, when the federal research credit was permanently extended, retroactive to January 1, 2015, and as a result, in the third quarter of fiscal 2016, the period in which the legislation was enacted, we recognized the retroactive benefit of the federal research credit. Our diluted net income per share from continuing operations was \$0.30 in the third quarter of fiscal 2017, compared to \$0.35 for the same period last year.

Cash, cash equivalents and investments increased by \$7.4 million during the nine months ended December 31, 2016 to a total of \$159.7 million as of December 31, 2016. During the nine months ended December 31, 2016, operating cash flows were \$22.3 million, an increase of \$6.8 million, compared to \$15.5 million for the same period last year, primarily attributable to a gain from sale of an equity method investment. Key non-operating uses of cash during the nine months ended December 31, 2016 included payments of \$3.0 million for an investment in a privately-held company, \$2.2 million made for tax withholdings related to net share settlements of restricted stock units and payment of \$8.6 million in cash dividends to shareholders.

## Factors that May Impact Future Performance

Our industry is impacted by numerous competitive, regulatory and other significant factors. Our sales for any future periods are not predictable with a significant degree of certainty, and may depend on a number of factors outside of our control. In particular, we are highly dependent upon the efforts and priorities of our distributors in promoting and creating a demand for our products and as such, we do not have full control over the marketing and sale of our products into these markets. Should these efforts be unsuccessful, or should we fail to maintain or effectively manage these relationships, our business, financial condition and results of operations are likely to be adversely affected. We generally operate with a limited order backlog because our products are typically shipped shortly after orders are received. Product sales in any quarter are generally dependent on orders booked and shipped in that quarter. As a result, any shortfall in product sales during a quarter would negatively affect our results of operations and financial condition during that quarter. In addition, our sales may be adversely impacted by pricing pressure from competitors. Our ability to increase our revenues and profitability will depend, in part, on our ability to increase the sales volumes of our products, to increase the sales performance of our independent distributors, and to successfully compete with our competitors.

Abbott controls the marketing and sale of our primary medical products into most of the U.S. medical market and, accordingly, we are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in such market. Should these efforts be unsuccessful, our business, financial condition and results of operations may be adversely affected. For example, during fiscal 2014, we were adversely impacted by the timing of purchases of our medical products sold to Abbott as it integrated our products into its sales process and sold its inventory, and in the third quarter of fiscal 2017, we were similarly negatively impacted by a reduction of orders from Abbott as a result of excess instrument inventory.

In the United States veterinary market, we rely on our national and independent regional distributors. We are also dependent upon the efforts and priorities of these distributors in promoting and creating a demand for our products and do not have full control over the marketing and sale of our products into these markets. Should these efforts be unsuccessful, or should we fail to maintain or effectively manage these relationships, our business, financial condition and results of operations are likely to be adversely affected. For example, during fiscal 2014, our strategy of increasing demand for our veterinary products through the expansion of our distribution partners, did not lead to the increased demand for our products in the veterinary clinics that we had anticipated resulting in excess channel inventory. In response, we took additional steps to more closely monitor and manage channel inventory in an effort to normalize the veterinary product inventories at our distribution partners in the United States. As a result of these efforts, we believe that our distributors' purchases of our veterinary chemistry analyzers and related reagent discs in fiscal 2015 were substantially in line with in-clinic sales. For the hematology, i-STAT and VSpro specialty veterinary products that we sell in the United States, sales orders from our largest distributors in the veterinary market decreased during the first half of fiscal 2015 as compared to the same period in fiscal 2014, resulting from excess channel inventory created during the first half of fiscal 2014; however, as a result of our efforts in closely monitoring and managing channel inventory, we believe that these distributors' purchases of hematology, i-STAT and VSpro specialty veterinary products were substantially in line with in-clinic sales in the third quarter of fiscal 2015. We only began selling through our distributors Henry Schein Animal Health and Patterson Companies, Inc. in the third quarter of fiscal 2015 and our revenues in future quarters may be impacted by the timing of purchases of our products sold by them as these new distributors integrate our products into their sales process. We will continue to closely monitor and manage channel inventory at our distribution partners in the United States.

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In the second and third quarters of fiscal 2017, in the North America veterinary market, we experienced a decrease in the unit sales of veterinary reagent discs sold, primarily attributable to lower average utilization per customer, a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory, as compared to the same period in fiscal 2016. As a result, this reduced our revenue growth and contributed to lower gross profit margins in the veterinary market in the second and third quarters of fiscal 2017. Looking forward, as we believe competition in the veterinary market will remain intense, we have implemented and intend to continue implementing new strategies to improve customer retention and monitor our installed base of customers and distribution inventory more closely. Additionally, in the future, we plan to continue to introduce new products that are designed to enhance our veterinary product portfolio. For example, in September 2016, we completed the development of our connectivity product, the VetScan FUSE, which is currently in beta-testing. The VetScan FUSE is a web-based integration system that provides connectivity between our point-of-care diagnostic instruments and the veterinary practice management systems. Additionally, we expect to launch a new point-of-care urine sediment analyzer into the veterinary market within twelve months, as well as a new point-of-care urine chemistry analyzer before the middle of 2017. See Total Revenues – Continuing Operations within the Results of Operations section below, for a further discussion regarding the change in total revenues in North America.

## CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and pursuant to the rules and regulations of the Securities and Exchange Commission. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and the sensitivity of these estimates to deviations in the assumptions used in making them. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. However, there can be no assurance that our actual results will not differ from these estimates.

We have identified the policies below as critical because they are not only important to understanding our financial condition and results of operations, but also because application and interpretation of these policies requires both judgment and estimates of matters that are inherently uncertain and unknown. Accordingly, actual results may differ materially from our estimates. The impact and any associated risks related to these policies on our business operations are discussed below. A more detailed discussion on the application of these and other accounting policies are included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

**Revenue Recognition.** Our primary customers are distributors and direct customers in both the medical and veterinary markets. Revenues from product sales, net of estimated sales allowances, discounts and rebates, are recognized when (i) evidence of an arrangement exists, (ii) upon shipment of the products or rendering of services to the customer, (iii) the sales price is fixed or determinable and (iv) collection of the resulting receivable is reasonably assured. Rights of return are not provided.

Amounts collected in advance of revenue recognition are recorded as a current or non-current deferred revenue liability based on the time from the balance sheet date to the future date of revenue recognition. We recognize revenue associated with extended maintenance agreements ratably over the life of the contract.

**Multiple Element Revenue Arrangements.** Our sales arrangements may contain multiple element revenue arrangements in which a customer may purchase a combination of instruments, consumables or extended maintenance agreements. Additionally, we provide incentives in the form of free goods or extended maintenance agreements to customers in connection with the sale of our instruments. We participate in selling arrangements in the veterinary market that include multiple deliverables, such as instruments and consumables. Judgments as to the allocation of consideration from an arrangement to the multiple elements of the arrangement, and the appropriate timing of revenue

recognition are critical with respect to these arrangements.

A multiple element arrangement includes the sale of one or more tangible product offerings with one or more associated services offerings, each of which are individually considered separate units of accounting. We allocate revenues to each element in a multiple element arrangement based upon the relative selling price of each deliverable. When applying the relative selling price method, we determine the selling price for each deliverable using vendor-specific objective evidence (“VSOE”) of selling price, if it exists, or third-party evidence (“TPE”) of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our best estimate of selling price for that deliverable. Revenue allocated to each element is then recognized when all revenue recognition criteria are met for each element.

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Revenues from our multiple element arrangements are allocated separately to the instruments, consumables, extended maintenance agreements and incentives based on the relative selling price method. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product when it is sold separately. Revenues allocated to each element are then recognized when the basic revenue recognition criteria, as described above, are met for each element. Revenues associated with incentives in the form of free goods are deferred until the goods are shipped to the customer. Revenues associated with incentives in the form of extended maintenance agreements are deferred and recognized ratably over the life of the extended maintenance contract, generally one to three years.

Starting in fiscal 2016, we entered into sales contracts as the lessor of instruments under sales-type lease agreements with our customers. In the veterinary market, we may offer arrangements to end users for monthly payments of instrument and consumable purchases over a term of six years. The present value of lease receivables, including accrued interest, was \$7.4 million and \$2.1 million, as of December 31, 2016 and March 31, 2016, respectively. Our short-term and long-term lease receivables are recorded within "Receivables" and "Other Assets," respectively, on our condensed consolidated balance sheets. Interest income is recognized monthly over the lease term using the effective-interest method.

Customer Programs. From time to time, we offer customer marketing and incentive programs. Our most significant customer programs are described as follows:

Instrument Trade-In Programs. We periodically offer trade-in programs to customers for trading in an existing instrument to purchase a new instrument and we will either provide incentives in the form of free goods or reduce the sales price of the instrument. These incentives in the form of free goods are recorded based on the relative selling price method according to the policies described above.

Instrument Rental Programs. We periodically offer programs to customers whereby certain instruments are made available to customers for rent or on an evaluation basis. These programs typically require customers to purchase a minimum quantity of consumables during a specified period for which we recognize revenue on the related consumables according to the policies described above. Depending on the program offered, customers may purchase the instrument during the rental or evaluation period. Proceeds from such sale are recorded as revenue according to the policies described above. Rental income, if any, is also recorded as revenue according to the policies described above.

Sales Incentive Programs. We periodically offer customer sales incentive programs and we record reductions to revenue related to these programs. Incentives may be provided in the form of rebates to distributors for volume-based purchases or upon meeting other specified requirements, end-user rebates and discounts. A summary of our revenue reductions is described below. Other rebate programs offered to distributors or customers vary from period to period in the medical and veterinary markets and were not significant.

Volume-based Incentives. Volume-based incentives, in the form of rebates, are offered from time to time to distributors and group purchasing organizations upon meeting the sales volume requirements during a qualifying period and are recorded as a reduction to gross revenues during a qualifying period. The pricing rebate program is primarily offered to distributors and group purchasing organizations in the North America veterinary market, upon meeting the sales volume requirements of veterinary products during the qualifying period. Factors used in the rebate calculations include the identification of products sold subject to a rebate during the qualifying period and which rebate percentage applies. Based on these factors and using historical trends, adjusted for current changes, we estimate the amount of the rebate and record the rebate as a deduction to gross revenues when we record the sale of the product. The rebate is recorded as a reserve to offset accounts receivable as settlements are made through offsets to outstanding customer invoices. Settlement of the rebate accruals from the date of sale ranges from one to nine months after sale. Changes in the rebate accrual at the end of each period are based upon distributors and group purchasing organizations meeting the purchase requirements during the quarter.

Distributor Rebate Incentives. From time to time, we offer a customer sales incentive program, whereby distributors were offered a rebate upon meeting certain requirements. We recognize the rebate obligation as a reduction of revenue at the later of the date on which we sell the product or the date the program is offered. These customer sales incentive programs require management to estimate the rebate amounts to distributors who will qualify for the incentive during the promotional period. We record the estimated liability in other current accrued liabilities on our condensed consolidated balance sheets. Management's estimates are based on historical experience and the specific terms and conditions of the incentive programs.

End-User Rebates and Discounts. From time to time, cash rebates are offered to end-users who purchase certain products or instruments during a promotional period and are recorded as a reduction to gross revenues. Additionally, we periodically offer sales incentives to end-users, in the form of sales discounts, to purchase consumables for a specified promotional period, typically over five years from the sale of our instrument, and we reimburse resellers for the value of the sales discount provided to the end-user. We estimate the amount of the incentive earned by end-users during a quarter and record a liability to the reseller as a reduction to gross revenues. Factors used in the liability calculation of incentives earned by end-users include the identification of qualified end-users under the sales program during the period and using historical trends. Settlement of the liability to the reseller ranges from one to twelve months from the date an end-user earns the incentive.

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Royalty Revenues. Our royalty revenue depends on the licensees' use of our technology, and therefore, may vary from period to period and impact our revenues during a quarter. For the three and nine months ended December 31, 2016 and 2015, our royalty revenues have not been significant.

Allowance for Doubtful Accounts. We recognize revenue when collection from the customer is reasonably assured. We maintain an allowance for doubtful accounts based on our assessment of the collectability of the amounts owed to us by our customers. We regularly review the allowance and consider the following factors in determining the level of allowance required: the customer's payment history, the age of the receivable balance, the credit quality of our customers, the general financial condition of our customer base and other factors that may affect the customers' ability to pay. An additional allowance is recorded based on certain percentages of our aged receivables, using historical experience to estimate the potential uncollectible. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered. If our actual collections experience changes, revisions to our allowances may be required, which could adversely affect our operating income.

Fair Value Measurements. We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities. As of December 31, 2016, our investments in cash equivalents, which we classified as available-for-sale, totaled \$0.2 million, using Level 1 inputs since these investments are traded in an active market. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required.

Level 2: Directly or indirectly observable inputs as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full term of the financial instrument. As of December 31, 2016, our available-for-sale investments in corporate bonds, totaled \$6.7 million, using Level 2 inputs, based on market pricing and other observable market inputs for similar securities obtained from various third party data providers.

Level 3: Unobservable inputs that are supported by little or no market data and require the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions. As of December 31, 2016, we did not have any Level 3 financial assets or liabilities measured at fair value on a recurring basis.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, our own assumptions are developed to reflect those that market participants would use in pricing the asset or liability at the measurement date. As of December 31, 2016, we also had \$67.4 million in investments classified as

held-to-maturity and carried at amortized cost.

Investment in Unconsolidated Affiliates. In February 2011, we purchased a 15% equity ownership interest in Scandinavian Micro Biodevices APS (“SMB”) for \$2.8 million in cash. We used the equity method to account for our investment in this entity because we did not control it, but had the ability to exercise significant influence over it. Equity method investments are recorded at original cost and adjusted periodically to recognize (1) our proportionate share of the investees’ net income or losses after the date of investment, (2) additional contributions made and dividends or distributions received, and (3) impairment losses resulting from adjustments to net realizable value. We eliminate all intercompany transactions in accounting for our equity method investments. We record our proportionate share of the investees’ net income or losses in “Interest and other income (expense), net” on our condensed consolidated statements of income.

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In August 2016, we sold our 15% equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB. The total purchase price for our equity method investment in SMB was approximately \$9.7 million in cash, subject to a holdback for certain adjustments that may occur. The holdback payment is expected to be released 18 months following the closing date. In connection with the sale, we received a cash payment of \$8.5 million and recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the nine months ended December 31, 2016.

In June 2016, we invested a total of \$3.0 million in a privately-held company. Our investment is recorded under the cost method as we do not exercise significant influence over the investee's operating or financial activities. The carrying value of our cost method investment is reviewed quarterly for changes in circumstances or the occurrence of events that suggest our investment may not be recoverable. The fair value of cost method investments is not adjusted if there are no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment. Additionally, in January 2017, we entered into a letter agreement with our investee. Under the terms of the letter agreement, the privately-held company will, pending negotiation and execution of a definitive agreement, commence chemistry development activities for us using its intellectual product and technology. As consideration for these development efforts, we will pay a total of up to \$1.5 million to the investee, in the form of an upfront payment of \$0.3 million in January 2017, and any remaining obligation to the investee is contingent upon the achievement of certain development milestones.

**Warranty Reserves.** We provide for the estimated future costs to be incurred under our standard warranty obligation on our instruments. Our standard warranty obligation on instruments ranges from one to five years, depending on the specific product. The estimated contractual warranty obligation is recorded when the related revenue is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated. Cost of revenues reflects estimated warranty expense for instruments sold in the current period and any adjustments in estimated warranty expense for the installed base under our standard warranty obligation based on our quarterly evaluation of service experience. While we engage in product quality programs and processes, including monitoring and evaluating the quality of our suppliers, our estimated accrual for warranty exposure is based on our historical experience as to product failures, estimated product failure rates, estimated repair costs, material usage and freight incurred in repairing the instrument after failure and known design changes under the warranty plan.

We also provide for the estimated future costs to be incurred under our standard warranty obligation on our reagent discs. A provision for defective reagent discs is recorded and classified as a current liability when the related sale is recognized and any additional amount is recorded when such cost is probable and can be reasonably estimated, at which time they are included in cost of revenues. The warranty cost includes the replacement costs and freight of a defective reagent disc.

As of December 31, 2016, our current portion of warranty reserves for instruments and reagent discs totaled \$1.6 million and our non-current portion of warranty reserves for instruments totaled \$2.6 million, which reflects our estimate of warranty obligations based on the estimated product failure rates, the number of instruments in standard warranty, estimated repair and related costs of instruments, and an estimate of defective reagent discs and replacement and related costs of a defective reagent disc. The change in total accrued warranty reserve from March 31, 2016 to December 31, 2016 was due to an increase in the number of instruments in standard warranty and our estimated product failure rates and repair and related costs of instruments.

Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. We review the historical warranty cost trends and analyze the adequacy of the ending accrual balance of warranty reserves each quarter. The determination of warranty reserves requires us to make estimates of the estimated product failure rate, expected costs to repair or replace the instruments and to replace defective reagent discs under warranty. If actual repair or

replacement costs of instruments or replacement costs of reagent discs differ significantly from our estimates, adjustments to cost of revenues may be required. Additionally, if factors change and we revise our assumptions on the product failure rate of instruments or reagent discs, then our warranty reserves and cost of revenues could be materially impacted in the quarter of such revision, as well as in following quarters.

**Inventories.** We state inventories at the lower of cost or market, cost being determined using standard costs which approximate actual costs using the first-in, first-out (FIFO) method. Inventories include material, labor and manufacturing overhead. We establish provisions for excess, obsolete and unusable inventories after evaluation of future demand of our products and market conditions. If future demand or actual market conditions are less favorable than those estimated by management or if a significant amount of the material were to become unusable, additional inventory write-downs may be required, which would have a negative effect on our operating income.

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**Property and Equipment.** Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization expense is calculated using the straight-line method using the estimated useful lives of the assets. Construction in progress primarily consists of purchased material and internal payroll and related costs used in the development of production lines. Property and equipment includes instruments transferred from inventory and held for loan or evaluation or demonstration purposes to customers. Units held for loan, evaluation or demonstration purposes are carried at cost and depreciated over their estimated useful lives of three to five years. Depreciation expense related to these instruments is recorded in cost of revenues or in the respective operating expense line based on the function and purpose for which it is being used. Proceeds from the sale of evaluation units are recorded as revenue. During the three and nine months ended December 31, 2016 purchases of capital equipment primarily related to increasing our manufacturing capacity and to support our growth and transfers of equipment from inventory to property and equipment, primarily attributable to our instrument rental program. Transfers of equipment between inventory to property and equipment, net, during the three months ended December 31, 2016 and 2015 were \$0.7 million and \$0.2 million, respectively, and during the nine months ended December 31, 2016 and 2015, were \$4.1 million and \$0.9 million, respectively.

**Intangible Assets.** Intangible assets, consisting of customer relationships, tradename, and other rights acquired from third parties, are presented at cost, net of accumulated amortization. The intangible assets are amortized using the straight-line method over their estimated useful lives of 2-10 years, which approximates the economic benefit. If our underlying assumptions regarding the estimated useful life of an intangible asset change, then the amortization period, amortization expense and the carrying value for such asset would be adjusted accordingly. During the three and nine months ended December 31, 2016 and 2015, our changes in estimated useful life of intangible assets were not significant, except as noted below in “Valuation of Long-Lived Assets.”

**Valuation of Long-Lived Assets.** We evaluate the carrying value of our long-lived assets, such as property and equipment and amortized intangible assets, whenever events or changes in business circumstances or our planned use of long-lived assets indicate that the carrying amount of an asset may not be fully recoverable or their useful lives are no longer appropriate. We look to current and future profitability, as well as current and future undiscounted cash flows, excluding financing costs, as primary indicators of recoverability. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than the carrying amount. If impairment is determined to exist, any related impairment loss is calculated based on fair value and long-lived assets are written down to their respective fair values. During the three months ended December 31, 2016 and 2015, we did not recognize any impairment charges on long-lived assets. During the nine months ended December 31, 2016 and 2015, we recognized impairment charges on long-lived assets of \$0 and \$13,000, respectively.

**Income Taxes.** We account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be recovered.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of evidence indicates that it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions that are more likely than not to be sustained upon audit, the second step is to measure the tax benefit as the largest amount that is more than 50 percent likely to be realized upon settlement. Significant judgment is required to evaluate uncertain tax positions.

We are subject to income taxes in the U.S. and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. As of December 31, 2016 and March 31, 2016, we had no significant uncertain tax positions. Our policy is to include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. During the three and nine months ended December 31, 2016 and 2015, we did not recognize any interest or penalties related to uncertain tax positions in the condensed consolidated statements of income, and as of December 31, 2016 and March 31, 2016, we had no accrued interest or penalties. During the three months ended December 31, 2016, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015. As of December 31, 2016, there had been no proposed assessments and we are unable to estimate the range of possible outcomes at this time.

**Share-Based Compensation Expense.** We account for share-based compensation arrangements using the fair value method. We recognize share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award to employees and directors. As required by fair value provisions of share-based compensation, employee share-based compensation expense recognized is calculated over the requisite service period of the awards and reduced for estimated forfeitures. The forfeiture rate is estimated based on historical data of our share-based compensation awards that are granted and cancelled prior to vesting and upon historical experience of employee turnover. Changes in estimated forfeiture rates and differences between estimated forfeiture rates and actual experience may result in significant, unanticipated increases or decreases in share-based compensation expense from period to period. To the extent we revise our estimate of the forfeiture rate in the future, our share-based compensation expense could be materially impacted in the quarter of revision, as well as in following quarters.

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Restricted Stock Unit Awards (Time Vesting)

The fair value of restricted stock unit awards with only time-based vesting terms, which we refer to as RSUs, used in our expense recognition method is measured based on the number of shares granted and the closing market price of our common stock on the date of grant. Share-based compensation expense is recognized net of an estimated forfeiture rate, over the requisite service period of the RSU. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. As a result, if factors change and we use different assumptions, our share-based compensation expense could be materially different in the future.

Restricted Stock Unit Awards (Performance Vesting)

We began granting restricted stock unit awards subject to performance vesting criteria, which we refer to as PSUs, to our executive officers and certain other employees starting in fiscal 2013. PSUs consist of the right to receive shares of common stock, subject to achievement of time-based criteria and certain corporate performance-related goals over a specified period, as established by the Compensation Committee of our Board of Directors (the “Compensation Committee”). We recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition. The fair value of PSUs used in our expense recognition method is measured based on the number of shares granted, the closing market price of our common stock on the date of grant and an estimate of the probability of the achievement of the performance goals. The amount of share-based compensation expense recognized in any one period can vary based on the attainment or expected attainment of the performance goals. If such performance goals are not ultimately met, no compensation expense is recognized and any previously recognized compensation expense is reversed.

The PSUs vest only if both of the following criteria are satisfied: (1) our consolidated income from operations during the fiscal year in which the grant occurred, as certified by the Compensation Committee, is in excess of the applicable target amount described below (the “performance vesting condition”); and (2) the recipient remains in the continuous service of the Company until the applicable vesting date set forth as follows for PSUs granted in fiscal 2015, 2016 and 2017 (other than the PSUs granted to our Chief Executive Officer, Mr. Clinton Severson in fiscal 2017) (the “service vesting condition”).

• 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;

• 25% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;

• 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and

• 25% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

The PSUs that we granted to Mr. Severson in fiscal 2017 vest as follows:

• approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant;

• approximately 18% of the shares subject to an award vest in full upon achieving 90% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant;

• approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the third anniversary of the date of grant; and

• approximately 32% of the shares subject to an award vest in full upon achieving 100% of the consolidated income from operations target described above and continuous service until the fourth anniversary of the date of grant.

The share-based compensation expense is reduced for an estimate of the PSUs that are expected to be forfeited. The forfeiture estimate is based on historical data and other factors, and compensation expense is adjusted for actual results. If the service vesting conditions are not met, unvested PSUs will be forfeited. Upon vesting on the third and fourth anniversary date of grant of the PSUs, the equivalent number of common shares are typically issued net of tax withholdings.

For the PSUs granted in fiscal 2015 and 2016, we have determined that the performance targets have been met and accordingly, we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2016. In April 2016, the Compensation Committee approved the grant of PSUs for an aggregate of 152,000 shares of common stock to our executive officers and to certain of our employees (the "FY2017 PSUs"). As of December 31, 2016, we reviewed each of the underlying performance targets related to the outstanding FY2017 PSUs and determined that it was not probable that the performance targets of the FY2017 PSUs would be met for 84,000 of the 152,000 shares of common stock and consequently, upon our determination of non-achievement of the performance metrics described above, the related compensation expense was reversed. As of December 31, 2016, we assessed that it was probable that the performance targets of the outstanding FY2017 PSUs would be met for 68,000 of the 152,000 shares of common stock granted and accordingly, we recorded share-based compensation expense ratably over the vesting terms of the PSUs during the three and nine months ended December 31, 2016.

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In January 2017, the Compensation Committee of our Board of Directors approved an amendment to our FY2017 PSUs so the performance vesting condition refers to the our consolidated income from continuing operations before income tax provision, rather than income from operations. Accordingly, starting in the fourth quarter of fiscal 2017, we recognize any related share-based compensation expense ratably over the service period based on the most probable outcome of the performance condition, as described above. The service vesting condition and all other terms and conditions of our FY2017 PSUs were not changed.

## Results of Operations

Previously reported financial information has been revised to reflect the reclassification of the AVRL business within our veterinary market segment as discontinued operations. See Note 4 to the Condensed Consolidated Financial Statements in this report for additional information.

Total Revenues – Continuing Operations

Revenues by Product Category. The following table and the discussion that follows, presents revenues from continuing operations by product category and represents our results for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

Revenues by Product Category	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Instruments (1)	\$9,349	\$11,601	\$(2,252)	(19)%	\$29,271	\$31,910	\$(2,639)	(8)%
Percentage of total revenues	18%	22%			17%	20%		
Consumables (2)	40,353	38,434	1,919	5%	130,554	121,906	8,648	7%
Percentage of total revenues	76%	73%			77%	75%		
Other products (3)	3,070	2,841	229	8%	9,195	8,088	1,107	14%
Percentage of total revenues	6%	5%			6%	5%		
Product sales, net	52,772	52,876	(104)	<(1)%	169,020	161,904	7,116	4%
Percentage of total revenues	100%	100%			100%	100%		
Development and licensing revenues	-	-	-	-	-	37	(37)	(100)%
Percentage of total revenues	-%	-%			-%	<1%		
Total revenues	\$52,772	\$52,876	\$(104)	<(1)%	\$169,020	\$161,941	\$7,079	4%

(1) Instruments include chemistry analyzers, hematology instruments, VSpro specialty analyzers and i-STAT analyzers.

(2) Consumables include reagent discs, hematology reagent kits, VSpro specialty cartridges, i-STAT cartridges and rapid tests.

(3) Other products include products using the Orbos process and extended maintenance agreements.

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Revenues by Geographic Region. The following table and the discussion that follows, presents our revenues from continuing operations by geographic region and represents our results for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

Revenues by Geographic Region	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
North America	\$41,538	\$41,109	\$ 429	1 %	\$135,328	\$128,596	\$ 6,732	5 %
Percentage of total revenues	79 %	78 %			80 %	79 %		
Europe	7,999	7,546	453	6 %	24,390	23,531	859	4 %
Percentage of total revenues	15 %	14 %			14 %	15 %		
Asia Pacific and rest of the world	3,235	4,221	(986 )	(23 )%	9,302	9,814	(512 )	(5 )%
Percentage of total revenues	6 %	8 %			6 %	6 %		
Total revenues	\$52,772	\$52,876	\$ (104 )	<(1 )%	\$169,020	\$161,941	\$ 7,079	4 %

### Three Months Ended December 31, 2016 Compared to Three Months Ended December 31, 2015

North America. During the three months ended December 31, 2016, total revenues in North America increased by 1%, or \$0.4 million, as compared to the same period in fiscal 2016. The change in total revenues in North America was primarily attributable to the following:

Total sales of our Piccolo chemistry analyzers and medical reagent discs in North America decreased by 20%, or \$1.3 million, primarily attributable to a decrease in sales of Piccolo chemistry analyzers and medical reagent discs to Abbott.

Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America increased by 1%, or \$0.3 million, primarily attributable to an increase in the unit sales of VetScan chemistry analyzers resulting from an increase in sales-type lease agreements with our customers, partially offset by a decrease in the unit sales of veterinary reagent discs sold due to lower average utilization per customer, a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory.

Total sales of our VetScan hematology instruments and hematology reagent kits in North America increased by 16%, or \$0.9 million, primarily attributable to an increase in the unit sales of hematology reagent kits due to our supply agreement with Banfield Pet Hospitals starting in the first quarter of fiscal 2017, partially offset by a decrease in the unit sales of VetScan hematology instruments sold to various distributors.

Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables and VetScan rapid tests in North America increased by 3%, or \$0.2 million, primarily attributable to an increase in the unit sales of i-STAT consumables to various distributors and an increase in revenues from VetScan rapid tests, due to an increase in the unit sales of VetScan Canine Heartworm Rapid Test Kit and VetScan Feline FeLV/FIV Rapid Test.

Revenues from other products in North America increased by 15%, or \$0.3 million, primarily attributable to an increase in other veterinary products sold.

Europe. During the three months ended December 31, 2016, total revenues in Europe increased by 6%, or \$0.5 million, as compared to the same period in fiscal 2016, primarily attributable to an increase in revenues from VetScan chemistry analyzers and VetScan hematology instruments sold in the United Kingdom, partially offset by a decrease in revenues due to the impact of a lower exchange rate between the GBP and U.S. dollar, as compared to the same

period last year.

Asia Pacific and rest of the world. During the three months ended December 31, 2016, total revenues in Asia Pacific and rest of the world decreased by 23%, or \$1.0 million, as compared to the same period in fiscal 2016, primarily attributable to the impact of sales of Piccolo chemistry analyzers to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China, in the third quarter of fiscal 2016, partially offset by an increase in the unit sales of veterinary reagent discs sold to various distributors.

Significant concentrations. During the three months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Patterson Companies, Inc. and Abbott Point of Care, Inc., accounted for 21%, 14%, 10% and 10%, respectively, of our total worldwide revenues. Starting in the second quarter of fiscal 2016, our revenues from Patterson Companies, Inc. include both Patterson's veterinary business and Animal Health International, Inc., as a result of Patterson's acquisition of Animal Health International, Inc. Starting in fiscal 2016, our revenues from Henry Schein, Inc., include both Henry Schein Animal Health and scil animal care company GmbH, as a result of Henry Schein Inc.'s acquisition of scil animal care company GmbH in Europe.

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Nine Months Ended December 31, 2016 Compared to Nine Months Ended December 31, 2015

North America. During the nine months ended December 31, 2016, total revenues in North America increased by 5%, or \$6.7 million, as compared to the same period in fiscal 2016. The change in total revenues in North America was primarily attributable to the following:

Total sales of our Piccolo chemistry analyzers and medical reagent discs in North America increased by 1%, or \$0.2 million, primarily attributable to an increase in medical reagent discs sold to Abbott, resulting from an expanded installed base of customers of Piccolo chemistry analyzers, partially offset by a decrease in sales of Piccolo chemistry analyzers to Abbott.

Total sales of our VetScan chemistry analyzers and veterinary reagent discs in North America increased by 2%, or \$1.3 million, primarily attributable to an increase in the unit sales of VetScan chemistry analyzers resulting from an increase in sales-type lease agreements with our customers, partially offset by a decrease in the unit sales of veterinary reagent discs sold due to lower average utilization per customer, a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory.

Total sales of our VetScan hematology instruments and hematology reagent kits in North America increased by 12%, or \$2.2 million, primarily attributable to an increase in the unit sales of hematology reagent kits due to our supply agreement with Banfield Pet Hospitals starting in the first quarter of fiscal 2017, partially offset by a decrease in the unit sales of VetScan hematology instruments sold to various distributors.

Total sales of our VetScan VSpro specialty analyzers and related consumables, VetScan i-STAT analyzers and related consumables and VetScan rapid tests in North America increased by 8%, or \$1.9 million, primarily attributable to an increase in revenues from VetScan rapid tests, due to an increase in the unit sales of VetScan Canine Heartworm Rapid Test Kit and VetScan Feline FeLV/FIV Rapid Test and the release of the VetScan VUE in the first quarter of fiscal 2017, an app-based automated rapid assay test reader used with our VetScan rapid tests.

Revenues from other products in North America increased by 21%, or \$1.2 million, primarily attributable to an increase in other veterinary products sold.

Europe. During the nine months ended December 31, 2016, total revenues in Europe increased by 4%, or \$0.9 million, as compared to the same period in fiscal 2016, primarily attributable to an increase in revenues from VetScan chemistry analyzers and VetScan hematology instruments sold in the United Kingdom, partially offset by a decrease in revenues from Piccolo chemistry analyzers sold to various distributors and the impact of a lower exchange rate between the GBP and U.S. dollar, as compared to the same period last year.

Asia Pacific and rest of the world. During the nine months ended December 31, 2016, total revenues in Asia Pacific and rest of the world decreased by 5%, or \$0.5 million, as compared to the same period in fiscal 2016, primarily attributable to the impact of sales of Piccolo chemistry analyzers to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China, in the third quarter of fiscal 2016, partially offset by an increase in the unit sales of veterinary reagent discs to various distributors.

Significant concentrations. During the nine months ended December 31, 2016, four distributors, MWI Veterinary Supply, Inc., Henry Schein, Inc., Patterson Companies, Inc. and Abbott Point of Care, Inc., accounted for 20%, 14%, 11% and 10%, respectively, of our total worldwide revenues.

Segment Results – Continuing Operations

Total Revenues, Cost of Revenues and Gross Profit by Segment. We identify our reportable segments as those customer groups that represent more than 10% of our combined revenues or gross profit or loss of all reported operating segments. We manage our business on the basis of the following two reportable segments: (i) the medical market and (ii) the veterinary market, which are based on the products sold by market and customer group.

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Three Months Ended December 31, 2016 Compared to Three Months Ended December 31, 2015

The following table and the discussion that follow, presents revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items and represents our results from continuing operations for the three months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,		2015	Percent of Revenues (1)	2016	Percent of Revenues (1)	Change	
	2016	Percent of Revenues (1)					Dollar Change	Percent Change
<b>Revenues:</b>								
Medical Market	\$8,652	100	% \$11,002	100	%	\$(2,350)	(21)	)%
Percentage of total revenues	16	%	21	%				
Veterinary Market	43,198	100	% 40,896	100	%	2,302	6	%
Percentage of total revenues	82	%	77	%				
Other (2)	922		978			(56)	(6)	)%
Percentage of total revenues	2	%	2	%				
Total revenues	52,772		52,876			(104)	<(1)	)%
<b>Cost of revenues:</b>								
Medical Market	4,328	50	% 5,815	53	%	(1,487)	(26)	)%
Veterinary Market	19,015	44	% 17,425	43	%	1,590	9	%
Other (2)	25		34			(9)	(26)	)%
Total cost of revenues	23,368		23,274			94	<1	%
<b>Gross profit:</b>								
Medical Market	4,324	50	% 5,187	47	%	(863)	(17)	)%
Veterinary Market	24,183	56	% 23,471	57	%	712	3	%
Other (2)	897		944			(47)	(5)	)%
Gross profit	\$29,404		\$29,602			\$(198)	(1)	)%

(1) The percentage reported is based on revenues by operating segment.

(2) Represents unallocated items, not specifically identified to any particular business segment.

Medical Market

## Revenues for Medical Market Segment

During the three months ended December 31, 2016, total revenues in the medical market decreased by 21%, or \$2.4 million, as compared to the same period in fiscal 2016. The change in the medical market revenues was primarily attributable to the following:

Total revenues from Piccolo chemistry analyzers decreased by 58%, or \$2.3 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to a decrease in the unit sales of Piccolo chemistry analyzers sold in North America to Abbott and the impact of sales of Piccolo chemistry analyzers to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China, in the third quarter of fiscal 2016.

Total revenues from medical reagent discs decreased by 1%, or \$0.1 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to a decrease in the unit sales of medical reagent discs sold in North America to Abbott.

Gross Profit for Medical Market Segment

Gross profit for the medical market segment decreased by 17%, or \$0.9 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016. Gross profit percentages for the medical market segment during the three months ended December 31, 2016 and 2015 were 50% and 47%, respectively. In absolute dollars, the net decrease in gross profit was primarily attributable to a decrease in the unit sales of Piccolo chemistry analyzers. The increase in gross profit percentage was impacted by changes in the product mix in our medical market, attributable to a higher margin contribution from reagent discs.

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Veterinary Market

Revenues for Veterinary Market Segment

During the three months ended December 31, 2016, total revenues in the veterinary market increased by 6%, or \$2.3 million, as compared to the same period in fiscal 2016. The change in the veterinary market revenues was primarily attributable to the following:

Total revenues from veterinary instruments of \$7.7 million during each of the three months ended December 31, 2016 and 2015. During the three months ended December 31, 2016, revenues were impacted by an increase in the unit sales of VetScan chemistry analyzers in North America resulting from an increase in sales-type lease agreements with our customers and an increase in revenues from VetScan chemistry analyzers and VetScan hematology instruments sold in the United Kingdom, partially offset by a decrease in the unit sales of VetScan hematology instruments sold to various distributors in North America.

Total revenues from consumables in the veterinary market increased by 6%, or \$2.0 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to (a) an increase in the unit sales of veterinary reagent discs sold to various distributors in Asia Pacific and rest of the world, (b) an increase in the unit sales of hematology reagent kits sold in North America due to our supply agreement with Banfield Pet Hospitals starting in the first quarter of fiscal 2017, (c) an increase in the unit sales of i-STAT consumables to various distributors in North America and (d) an increase in revenues from VetScan rapid tests, primarily due to an increase in the unit sales of VetScan Canine Heartworm Rapid Test Kits and VetScan Feline FeLV/FIV Rapid Tests. These increases were partially offset by a decrease in the unit sales of veterinary reagent discs sold in North America due to lower average utilization per customer, a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory and the impact of a lower exchange rate between the GBP and U.S. dollar, as compared to the same period last year.

Total revenues from other products in the veterinary market increased by 21%, or \$0.3 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to an increase in other veterinary products sold in North America.

Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 3%, or \$0.7 million, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016. Gross profit percentages for the veterinary market segment during the three months ended December 31, 2016 and 2015 were 56% and 57%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to an increase in the unit sales of VetScan chemistry analyzers and VetScan hematology reagent kits, partially offset by a decrease in revenues on veterinary products sold due to the impact of a lower exchange rate between the GBP and U.S. dollar, as compared to the same period last year. The gross profit percentage was impacted by changes in our product mix.

Other

Our other category primarily consists of products sold using our patented Orbos Discrete Lyophilization Process. The change in gross profit in our other category was not significant during the three months ended December 31, 2016, as compared to the same period in fiscal 2016.

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Nine Months Ended December 31, 2016 Compared to Nine Months Ended December 31, 2015

The following table and the discussion that follow, presents revenues, cost of revenues, gross profit and percentage of revenues by operating segments and from certain unallocated items and represents our results from continuing operations for the nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Nine Months Ended December 31,		Percent of		Change Dollar Change	Percent Change
	2016	Percent of Revenues (1)	2015	Percent of Revenues (1)		
Revenues:						
Medical Market	\$27,130	100	% \$28,317	100	% \$(1,187)	(4)%
Percentage of total revenues	16	%	17	%		
Veterinary Market	139,219	100	% 131,084	100	% 8,135	6%
Percentage of total revenues	82	%	81	%		
Other (2)	2,671		2,540		131	5%
Percentage of total revenues	2	%	2	%		
Total revenues	169,020		161,941		7,079	4%
Cost of revenues:						
Medical Market	14,117	52	% 14,861	52	% (744)	(5)%
Veterinary Market	61,097	44	% 56,026	43	% 5,071	9%
Other (2)	143		98		45	46%
Total cost of revenues	75,357		70,985		4,372	6%
Gross profit:						
Medical Market	13,013	48	% 13,456	48	% (443)	(3)%
Veterinary Market	78,122	56	% 75,058	57	% 3,064	4%
Other (2)	2,528		2,442		86	4%
Gross profit	\$93,663		\$90,956		\$2,707	3%

(1) The percentage reported is based on revenues by operating segment.

(2) Represents unallocated items, not specifically identified to any particular business segment.

Medical Market

## Revenues for Medical Market Segment

During the nine months ended December 31, 2016, total revenues in the medical market decreased by 4%, or \$1.2 million, as compared to the same period in fiscal 2016. The change in the medical market revenues was primarily attributable to the following:

Total revenues from Piccolo chemistry analyzers decreased by 39%, or \$3.1 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to (a) a decrease in the unit sales of Piccolo chemistry analyzers sold in North America to Abbott, (b) a decrease in revenues from Piccolo chemistry analyzers sold to various distributors in Europe and (c) the impact of sales of Piccolo chemistry analyzers to Fuzhou Kelian Medical Devices, Ltd., a point-of-care diagnostics distributor based in China, in the third quarter of fiscal 2016.

Total revenues from medical reagent discs increased by 9%, or \$1.8 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to an increase in medical reagent discs sold in North America to Abbott, resulting from an expanded installed base of customers of Piccolo chemistry

analyzers.

#### Gross Profit for Medical Market Segment

Gross profit for the medical market segment decreased by 3%, or \$0.4 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016. Gross profit percentages for the medical market segment during the nine months ended December 31, 2016 and 2015 were 48% and 48%, respectively. In absolute dollars, the net decrease in gross profit was primarily attributable to a decrease in the unit sales of Piccolo chemistry analyzers, partially offset an increase in the unit sales of medical reagent discs.

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Veterinary Market

Revenues for Veterinary Market Segment

During the nine months ended December 31, 2016, total revenues in the veterinary market increased by 6%, or \$8.1 million, as compared to the same period in fiscal 2016. The change in the veterinary market revenues was primarily attributable to the following:

Total revenues from veterinary instruments increased by 2%, or \$0.4 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to an increase in the unit sales of VetScan chemistry analyzers in North America resulting from an increase in sales-type lease agreements with our customers and an increase in revenues from VetScan chemistry analyzers and VetScan hematology instruments sold in the United Kingdom, partially offset by a decrease in the unit sales of VetScan hematology instruments sold to various distributors in North America.

Total revenues from consumables in the veterinary market increased by 7%, or \$6.9 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to an increase in the unit sales of hematology reagent kits sold in North America due to our supply agreement with Banfield Pet Hospitals starting in the first quarter of fiscal 2017 and an increase in revenues from VetScan rapid tests, primarily due to an increase in the unit sales of VetScan Canine Heartworm Rapid Test Kits and VetScan Feline FeLV/FIV Rapid Tests and the release of the VetScan VUE in the first quarter of fiscal 2017, an app-based automated rapid assay test reader used with our VetScan rapid tests. These increases were partially offset by a decrease in the unit sales of veterinary reagent discs sold in North America due to a lower average utilization per customer, a relatively flat installed base of customers of chemistry analyzers and fluctuation in distribution inventory.

Total revenues from other products in the veterinary market increased by 20%, or \$0.8 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to an increase in other veterinary products sold in North America.

Gross Profit for Veterinary Market Segment

Gross profit for the veterinary market segment increased by 4%, or \$3.1 million, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016. Gross profit percentages for the veterinary market segment during the nine months ended December 31, 2016 and 2015 were 56% and 57%, respectively. In absolute dollars, the net increase in gross profit was primarily attributable to an increase in the unit sales of VetScan chemistry analyzers, VetScan hematology reagent kits and VetScan rapid tests and lower manufacturing costs on VetScan hematology instruments due in part to fluctuations in the Euro exchange rates, partially offset by a decrease in the average selling prices of VetScan chemistry analyzers, VetScan hematology instruments and VetScan hematology reagent kits. The gross profit percentage was impacted by changes in our product mix.

Other

Our other category primarily consists of products sold using our patented Orbos Discrete Lyophilization Process. The change in gross profit in our other category was not significant during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016.

Three and Nine Months Ended December 31, 2016 Compared to Three and Nine Months Ended December 31, 2015

Cost of Revenues – Continuing Operations

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The following table and the discussion that follows, presents our cost of revenues and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Cost of revenues	\$23,368	\$23,274	\$ 94	<1%	\$75,357	\$70,985	\$4,372	6 %
Percentage of total revenues	44 %	44 %			45 %	44 %		

Cost of revenues includes the cost of materials, direct labor costs, costs associated with manufacturing, assembly, packaging, warranty repairs, test and quality assurance for our instruments and consumables and manufacturing overhead, including costs of personnel and equipment associated with manufacturing support.

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The increase in cost of revenues, in absolute dollars, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, was impacted by an increase in the unit sales of VetScan chemistry analyzers and VetScan hematology reagent, partially offset by a decrease in the unit sales of Piccolo chemistry analyzers. Cost of revenues, as a percentage of total revenues, during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, was impacted by changes in our product mix.

The increase in cost of revenues, in absolute dollars, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, was impacted by an increase in the unit sales of medical reagent discs, VetScan chemistry analyzers, VetScan hematology reagent kits and VetScan rapid tests, partially offset by a decrease in the unit sales of Piccolo chemistry analyzers and lower manufacturing costs on VetScan hematology instruments due in part to fluctuations in the Euro exchange rates. Cost of revenues, as a percentage of total revenues, during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, was impacted by changes in our product mix.

Gross Profit – Continuing Operations

The following table and the discussion that follows, presents our gross profit and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Total gross profit	\$29,404	\$29,602	\$(198 )	(1 )%	\$93,663	\$90,956	\$2,707	3 %
Total gross margin	56 %	56 %			55 %	56 %		

Gross profit during the three months ended December 31, 2016 decreased by 1%, or \$0.2 million, as compared to the same period in fiscal 2016, primarily attributable to a decrease in the unit sales of Piccolo chemistry analyzers and a decrease in revenues on veterinary products sold due to the impact of a lower exchange rate between the GBP and U.S. dollar, as compared to the same period last year, partially offset by an increase in the unit sales of VetScan chemistry analyzers and VetScan hematology reagent kits. The gross profit percentage was impacted by a higher margin contribution from medical reagent discs and changes in our product mix in the veterinary market.

Gross profit during the nine months ended December 31, 2016 increased by 3%, or \$2.7 million, as compared to the same period in fiscal 2016, primarily attributable to an increase in the unit sales of medical reagent discs, VetScan chemistry analyzers, VetScan hematology reagent kits and VetScan rapid tests and lower manufacturing costs on VetScan hematology instruments due in part to fluctuations in the Euro exchange rates, partially offset by a decrease in the unit sales of Piccolo chemistry analyzers and a decrease in the average selling prices of VetScan chemistry analyzers, VetScan hematology instruments and VetScan hematology reagent kits. The gross profit percentage was impacted by changes in our product mix in the veterinary market.

Research and Development – Continuing Operations

The following table and the discussion that follows, presents our research and development expenses and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change

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Research and development expenses	\$ 4,776	\$ 4,428	\$ 348	8	%	\$14,915	\$13,840	\$1,075	8	%
Percentage of total revenues	9	%	8	%		9	%	9	%	

Research and development expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), consulting expenses and materials and related expenses associated with the development of new tests and test methods, clinical trials, product improvements and optimization and enhancement of existing products and expenses related to regulatory and quality assurance. Research and development expenses are primarily based on the project activities planned and the level of spending depends on budgeted expenditures. Research and development expenses for the periods presented above are related primarily to new product development and enhancement of existing products in both the medical and veterinary markets, including the development of electronic connectivity technology and additional projects related to high sensitivity immunoassay.

Research and development expenses increased during the three and nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to expenses related to new product development and enhancement of existing products in both the medical and veterinary markets. Share-based compensation expense included in research and development expenses during the three months ended December 31, 2016 and 2015 was \$0.6 million and \$0.5 million, respectively, and during the nine months ended December 31, 2016 and 2015 was \$1.9 million and \$1.6 million, respectively.

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We anticipate that our research and development expenses, both in absolute dollars and as a percentage of revenues, will increase in fiscal 2017 from fiscal 2016, as we complete new products and enhance existing products for both the medical and veterinary markets.

Sales and Marketing – Continuing Operations

The following table and the discussion that follows, presents our sales and marketing expenses and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
Sales and marketing expenses	\$ 10,629	\$ 10,395	\$ 234	2 %	\$ 33,707	\$ 31,766	\$ 1,941	6 %
Percentage of total revenues	20 %	20 %			20 %	20 %		

Sales and marketing expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), commissions and travel-related expenses for personnel engaged in selling, costs associated with advertising, lead generation, marketing programs, trade shows and services related to customer and technical support.

Sales and marketing expenses increased during the three and nine months ended December 31, 2016, as compared to the same periods in fiscal 2016, primarily attributable to increased costs related to headcount and promotional and marketing spending to support our growth in both North America and internationally. Share-based compensation expense included in sales and marketing expenses during the three months ended December 31, 2016 and 2015 was \$0.8 million and \$0.7 million, respectively, and during the nine months ended December 31, 2016 and 2015 was \$2.2 million and \$2.5 million, respectively.

General and Administrative – Continuing Operations

The following table and the discussion that follows, presents our general and administrative expenses and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,				Nine Months Ended December 31,			
	2016	2015	Dollar Change	Percent Change	2016	2015	Dollar Change	Percent Change
General and administrative expenses	\$ 3,159	\$ 3,524	\$ (365 )	(10 )%	\$ 11,714	\$ 11,301	\$ 413	4 %
Percentage of total revenues	6 %	7 %			7 %	7 %		

General and administrative expenses consist of personnel costs (including salaries, benefits and share-based compensation expense), and expenses for outside professional services related to general corporate functions, including accounting and legal, and other general and administrative expenses.

General and administrative expenses decreased during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to decreased personnel costs, including a decrease in share-based compensation expense related to adjustments for our determination that it was not probable that performance targets would be met. Share-based compensation expense included in general and administrative expenses during the three months ended December 31, 2016 and 2015 was \$0.7 million and \$1.0 million, respectively.

General and administrative expenses increased during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to increased spending on professional services to support our growing operations. Share-based compensation expense included in general and administrative expenses during the nine months ended December 31, 2016 and 2015 was \$2.9 million and \$3.0 million, respectively.

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The following table and the discussion that follows, presents our interest and other income (expense), net and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,			Nine Months Ended December 31,		
	2016	2015	Dollar Change	2016	2015	Dollar Change
Interest and other income (expense), net	\$ (52 )	\$ 231	\$ (283 )	\$ 6,197	\$ 716	\$ 5,481

Interest and other income (expense), net consists primarily of interest earned on cash and cash equivalents and investments, foreign currency exchange gains and losses and our equity in net income (loss) of an unconsolidated affiliate.

Interest and other income (expense), net decreased during the three months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to foreign currency exchange rate fluctuations.

Interest and other income (expense), net increased during the nine months ended December 31, 2016, as compared to the same period in fiscal 2016, primarily attributable to a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment. See Note 8 of the Notes to Condensed Consolidated Financial Statements contained in this report for additional information.

Income Tax Provision – Continuing Operations

The following table and the discussion that follows, presents our income tax provision and represents our results from continuing operations for the three and nine months ended December 31, 2016 and 2015 (in thousands, except percentages):

	Three Months Ended December 31,			Nine Months Ended December 31,		
	2016	2015	Dollar Change	2016	2015	Dollar Change
Income tax provision	\$ 3,929	\$ 3,532	\$ 397	\$ 14,288	\$ 11,993	\$ 2,295
Effective tax rate	36 %	31 %		36 %	34 %	

The increase in the effective tax rate during the three months ended December 31, 2016, as compared to the same period last year, was primarily attributable to lower federal benefits for qualified production activities during the three months ended December 31, 2016 and the impact of the benefit from the retroactive reinstatement of the federal research credit on December 18, 2015, when the federal research credit was permanently extended, retroactive to January 1, 2015, and as a result, in the third quarter of fiscal 2016, the period in which the legislation was enacted, we recognized the retroactive benefit of the federal research credit.

The increase in the effective tax rate during the nine months ended December 31, 2016, as compared to the same period last year, was primarily attributable to lower federal benefits for qualified production activities during the nine months ended December 31, 2016 and the impact of the benefit from the retroactive reinstatement of the federal research credit on December 18, 2015, when the federal research credit was permanently extended, retroactive to January 1, 2015, and as a result, in the third quarter of fiscal 2016, the period in which the legislation was enacted, we recognized the retroactive benefit of the federal research credit.

We are subject to income taxes in the U.S. and various foreign jurisdictions. Accordingly, we are subject to a variety of examinations by taxing authorities in these locations. We did not have any unrecognized tax benefits as of December 31, 2016 and March 31, 2016. During the three and nine months ended December 31, 2016 and 2015, we did not recognize any interest or penalties related to unrecognized tax benefits. During the three months ended December 31, 2016, the state of California commenced an examination of our tax returns for fiscal years 2014 and 2015. As of December 31, 2016, there had been no proposed assessments and we are unable to estimate the range of possible outcomes at this time.

#### Discontinued Operations

On March 18, 2015, we entered into an asset purchase agreement (“APA”) with Antech pursuant to which we sold substantially all of the assets of our AVRL business. The sale transaction closed on March 31, 2015. The total purchase price under the APA was \$21.0 million in cash. During the fourth quarter of fiscal 2015, we recognized and received \$20.1 million in cash proceeds and we recorded a gain on sale of discontinued operations, net of tax, of \$7.7 million. During the fourth quarter of fiscal 2016, we recorded a pre-tax gain of \$0.9 million (\$0.6 million after-tax) on sale of discontinued operations, upon meeting certain conditions by the first anniversary of the closing date.

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## Liquidity and Capital Resources – Continuing and Discontinued Operations

## Cash, Cash Equivalents and Investments

The following table summarizes our cash, cash equivalents and short-term and long-term investments at December 31, 2016 and March 31, 2016 (in thousands, except percentages):

	December 31, 2016	March 31, 2016		
Cash and cash equivalents	\$ 85,653	\$ 88,323		
Short-term investments	52,291	41,474		
Long-term investments	21,738	22,458		
Total cash, cash equivalents and investments	\$ 159,682	\$ 152,255		
Percentage of total assets	54	%	56	%

As of December 31, 2016, we had net working capital of \$194.7 million compared to \$183.0 million as of March 31, 2016.

## Cash Flow Changes

Cash provided by (used in) operating, investing and financing activities during the nine months ended December 31, 2016 and 2015 were as follows (in thousands):

	Nine Months Ended December 31,	
	2016	2015
Net cash provided by operating activities	\$ 22,269	\$ 15,469
Net cash used in investing activities	(13,816 )	(29,114 )
Net cash used in financing activities	(10,401 )	(11,091 )
Effect of exchange rate changes on cash and cash equivalents	(722 )	123
Net decrease in cash and cash equivalents	\$ (2,670 )	\$ (24,613 )

Cash and cash equivalents as of December 31, 2016 were \$85.7 million compared to \$88.3 million as of March 31, 2016. The decrease in cash and cash equivalents during the nine months ended December 31, 2016 was primarily due to purchases of investments of \$43.8 million, purchases of property and equipment of \$8.0 million, an investment in a privately-held company of \$3.0 million, payments made for tax withholdings related to net share settlements of restricted stock units of \$2.2 million and payment of cash dividends totaling \$8.6 million. These decreases were partially offset by net cash provided by operating activities of \$22.3 million, proceeds from maturities and redemptions of investments of \$33.2 million and proceeds from sale of an equity method investment of \$8.5 million.

## Cash Flows from Operating Activities

During the nine months ended December 31, 2016, we generated \$22.3 million in cash from operating activities, compared to \$15.5 million during the nine months ended December 31, 2015. The cash provided by operating activities during the nine months ended December 31, 2016 was the result of net income of \$25.2 million, adjusted for the effects of non-cash adjustments including depreciation and amortization of \$5.3 million and share-based compensation expense of \$8.3 million, partially offset by a decrease of \$0.3 million related to excess tax benefits from share-based awards and the following changes in assets and liabilities.

Receivables, net increased by \$0.1 million, from \$35.1 million as of March 31, 2016 to \$35.2 million as of December 31, 2016, primarily attributable to the timing of collections activities during the third quarter of fiscal 2017.

Inventories increased by \$4.1 million from \$35.1 million as of March 31, 2016 to \$39.2 million as of December 31, 2016, primarily due to an increase in the inventory levels due to lower sales than planned during the third quarter of fiscal 2017.

Prepaid expenses and other current assets decreased by \$0.1 million, from \$6.4 million as of March 31, 2016 to \$6.2 million as of December 31, 2016, primarily attributable to the timing of estimated income taxes.

Current assets of discontinued operations decreased by \$0.9 million, from \$1.0 million as of March 31, 2016 to \$66,000 as of December 31, 2016, primarily attributable to a receivable relating to the sale of discontinued operations due upon meeting certain conditions by the first anniversary of the closing date in March 2016.

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Non-current net deferred tax assets increased by \$0.6 million, from \$3.9 million as of March 31, 2016 to \$4.5 million as of December 31, 2016, primarily as a result of the timing for the deduction of share-based compensation expenses.

Other assets increased by \$4.3 million, from \$2.0 million as of March 31, 2016 to \$6.3 million as of December 31, 2016, primarily attributable to long-term receivables due to extended payment terms by customers under certain of our sales programs.

Accounts payable increased by \$1.6 million, from \$7.3 million as of March 31, 2016 to \$8.9 million as of December 31, 2016, primarily due to the timing and payment of services and inventory purchases.

Accrued payroll and related expenses decreased by \$2.2 million, from \$8.3 million as of March 31, 2016 to \$6.2 million as of December 31, 2016, primarily attributable to lower accrued payroll payments from timing of payments and a reduction in accrued bonus as of December 31, 2016 because qualifiers for bonus payments were not met in the third quarter of fiscal 2017.

Accrued taxes decreased by \$0.7 million, from \$1.1 million as of March 31, 2016 to \$0.5 million as of December 31, 2016, primarily due to the timing of estimated income tax payments.

Other accrued liabilities, current, increased by \$0.7 million, from \$9.4 million as of March 31, 2016 to \$10.1 million as of December 31, 2016 and other liabilities, non-current, increased by \$0.2 million, from \$0.9 million at March 31, 2016 to \$1.2 million as of December 31, 2016. The net current and non-current other liabilities increased primarily attributable to an increase in liabilities related to the types of customer sales incentive programs offered during a promotional period, partially offset by our installment payment obligation related to our November 2014 acquisition of QCR and Trio.

As of December 31, 2016 and March 31, 2016, the current portion of deferred revenue was \$1.6 million and \$1.6 million, respectively, and the non-current portion of deferred revenue was \$1.6 million and \$2.3 million, respectively. Net current and non-current deferred revenue decreased by \$0.7 million from March 31, 2016 to December 31, 2016, primarily attributable to deferred revenue recognized ratably over the life of extended maintenance contracts offered to customers in the form of free services in connection with the sale of our instruments.

As of December 31, 2016 and March 31, 2016, the current portion of warranty reserve was \$1.6 million and \$1.3 million, respectively, and the non-current portion of warranty reserve was \$2.6 million and \$1.9 million, respectively. Net current and non-current warranty reserve increased by \$1.0 million. The change in current and non-current warranty reserve from March 31, 2016 to December 31, 2016 is primarily due to an increase in the number of instruments in standard warranty. Warranty reserve is primarily based on (a) the number of instruments in standard warranty, estimated product failure rates and estimated repair costs and (b) an estimate of defective reagent discs and replacement costs of reagent discs. Management periodically evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. If an unusual performance rate related to warranty claims is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, timing of product sales, accounts receivable collections performance, inventory and supply chain management, and the timing and amount of payments. Furthermore, we anticipate that we will incur incremental costs to support our future operations, including research and design costs related to the continuing development of our current and future products; clinical trials for our current and future products, expansion of our international operations and acquisition of capital equipment for our manufacturing facility.

Cash Flows from Investing Activities

Net cash used in investing activities during the nine months ended December 31, 2016 totaled \$13.8 million, compared to net cash used of \$29.1 million during the nine months ended December 31, 2015. Changes in net cash used in investing activities were attributable to the following:

Cash used in investing activities during the nine months ended December 31, 2016 was primarily due to purchases of investments in commercial paper and corporate bonds totaling \$43.8 million during the nine months ended December 31, 2016. The cash used in investing activities was partially offset by proceeds from maturities and redemptions of investments in certificates of deposit, commercial paper and corporate bonds of \$33.2 million during the nine months ended December 31, 2016.

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Cash proceeds from the sale of a 15% equity ownership interest in Scandinavian Micro Biodevices APS (“SMB”) of \$8.5 million during the nine months ended December 31, 2016. In connection with the sale, we recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) during the nine months ended December 31, 2016.

Our capital expenditures totaled \$8.0 million during the nine months ended December 31, 2016. Purchases of capital equipment primarily relate to increasing our manufacturing capacity, support our growth and transfers of equipment from inventory to property and equipment, primarily attributable to our instrument rental program. We expect to continue to make significant capital expenditures as necessary in the normal course of our business.

Cash used in our investment in a privately-held company was \$3.0 million during the nine months ended December 31, 2016.

- Cash used to satisfy our installment payment obligation of \$0.8 million during the nine months ended December 31, 2016 related to our November 2014 acquisition of QCR and Trio.

## Cash Flows from Financing Activities

Net cash used in financing activities during the nine months ended December 31, 2016 totaled \$10.4 million, compared to net cash used of \$11.1 million during the nine months ended December 31, 2015. Cash used in financing activities during the nine months ended December 31, 2016 was primarily due to payments made for tax withholdings related to net share settlements of restricted stock units of \$2.2 million and cash dividend payments of \$8.6 million. During the nine months ended December 31, 2016, we did not purchase any shares pursuant to our share repurchase program described below.

## Dividend Payments

During the three months ended December 31, 2016 and 2015, our total quarterly dividend payout was \$3.2 million and \$2.5 million, respectively. During the nine months ended December 31, 2016 and 2015, our total quarterly dividend payout was \$8.6 million and \$7.5 million, respectively. Our dividend payout was made from retained earnings.

In January 2017, our Board of Directors declared a cash dividend of \$0.14 per share on our outstanding common stock to be paid on March 15, 2017 to all shareholders of record as of the close of business on March 1, 2017. Future declarations of quarterly dividends, if any, and the establishment of future record and payment dates are subject to the final determination of our Board of Directors.

## Share Repurchase Program

Between August 2011 and July 2013, our Board of Directors authorized the repurchase of up to a total of \$67.3 million of our common stock. In July 2016, our Board of Directors approved a \$30.0 million increase to our existing share repurchase program. As of December 31, 2016, \$54.0 million was available to purchase common stock under our share repurchase program.

Since the share repurchase program began, through December 31, 2016, we have repurchased 1.6 million shares of our common stock at a total cost of \$43.3 million, including commission expense. During the three and nine months ended December 31, 2016 and 2015, we did not repurchase any shares of our common stock. The repurchases are made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. Repurchased shares are retired.

## Financial Condition

We believe that our cash and cash equivalents, investments and expected cash flows from operations will be sufficient to fund our operations, capital requirements, share repurchase program and anticipated quarterly dividends for at least the next twelve months. Our future capital requirements will largely depend upon the increased customer demand and market acceptance of our point-of-care diagnostic products. However, our sales for any future periods are not predictable with a significant degree of certainty. Regardless, we may seek to raise additional funds to pursue strategic opportunities.

#### Contractual Obligations

#### Purchase Commitments

We have purchase commitments, consisting of supply and inventory related agreements, totaling approximately \$6.7 million as of December 31, 2016. These purchase order commitments primarily include our purchase obligations to purchase from Diatron of Hungary through fiscal 2018.

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### Notes Payable

We have a ten year loan agreement with the Community Redevelopment Agency of the City of Union City (“the Agency”) whereby the Agency provides us with an unsecured loan of up to \$1.0 million, primarily to purchase capital equipment. The loan was effective January 2011, bears interest at 5.0% and is payable quarterly. As of December 31, 2016, our short-term and long-term notes payable balances were \$0.1 million and \$0.3 million, respectively, and as of March 31, 2016, our short-term and long-term notes payable balances were \$0.1 million and \$0.4 million, respectively. The short-term balance was recorded in “Other accrued liabilities” on the condensed consolidated balance sheets. The entire outstanding balance of the note is payable in full on the earlier of: (i) December 2020, or (ii) the date Abaxis ceases operations in Union City, California. The Agency also has the right to accelerate the maturity date and declare all balances immediately due and payable upon an event of default as defined in the loan agreement. We evaluate covenants in our loan agreement on a quarterly basis, and we were in compliance with such covenants as of December 31, 2016.

In accordance with the terms of the loan agreement, the Agency will provide Abaxis with an annual credit that can be applied against the accrued interest and outstanding principal balance on a quarterly basis. The Agency determines the annual credit based on certain taxes paid by Abaxis to the City of Union City, California for a specified period, as defined in the loan agreement. We anticipate that our annual credits from the Agency will be used to fully repay our notes payable due to the Agency. We may carry forward unused quarterly credits to apply against our outstanding balance in a future period. Credits applied to repay our notes payable and accrued interest are recorded in “Interest and other income (expense), net” on the condensed consolidated statements of income.

### Contingencies

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

### Off-Balance Sheet Arrangements

As of December 31, 2016, we did not have any off-balance sheet arrangements, as defined in Item 303 of Regulation S-K promulgated under the Securities Act of 1933. In addition, we identified no variable interests in any variable interest entities.

## RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is included in Note 2 of the Notes to Condensed Consolidated Financial Statements contained in this report.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our financial position is exposed to a variety of risks related to changes in interest rates and foreign currency rates and investment in privately held companies. As a matter of management policy, we do not currently enter into transactions involving derivative financial instruments.

#### Interest Rate Risk

Our investment objective is to invest excess cash in cash equivalents and in various types of investments to maximize yields without significantly increased risk. As of December 31, 2016, our short-term and long-term investments totaled \$52.3 million and \$21.7 million, respectively, consisting of investments in certificates of deposit, commercial

paper and corporate bonds. For our securities classified as available-for-sale, we record these investments at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive gain (loss), net of any tax effects, in shareholders' equity. The fair value of our investment portfolio is subject to change as a result of changes in market interest rates and investment risk related to the issuers' credit worthiness. Changes in market interest rates would not be expected to have a material impact on the fair value of these assets as of December 31, 2016, as the assets consisted of highly liquid securities.

We are exposed to the impact of interest rate changes with respect to our short-term and long-term investments. As of December 31, 2016, we had \$67.4 million in investments classified as held-to-maturity and carried at amortized cost. We have the ability to hold the investments classified as held-to-maturity in our investment portfolio as of December 31, 2016 until maturity and therefore, we believe we have no material exposure to interest rate risk. As of December 31, 2016, our investments classified as available-for-sale totaled \$6.7 million, consisting primarily of fixed income securities and thus changes in interest rates would not have a material effect on our business, operating results or financial condition. We have not experienced any significant loss on our investment portfolio during fiscal 2016 or during the three and nine months ended December 31, 2016.

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### Foreign Currency Rate Fluctuations

We operate primarily in the United States and a majority of our revenues, cost of revenues, operating expenses and capital purchasing activities are transacted in U.S. dollars. However, we are exposed to foreign currency risks that arise from normal business operations. These risks are primarily related to remeasuring local currency balances and results of our foreign subsidiaries, into U.S. dollars and third-party transactions denominated in a currency other than the U.S. dollar. As currency exchange rates change, remeasurement of the accounts of our foreign subsidiaries into U.S. dollars affects year-over-year comparability of operating results.

The functional currency of our wholly-owned subsidiaries is in U.S. dollars. Foreign currency denominated account balances of our subsidiaries are remeasured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for nonmonetary assets. The effects of foreign currency transactions, and of remeasuring the financial condition into the functional currency, resulted in foreign currency gains and losses, which were included in "Interest and other income (expense), net" on our condensed consolidated statements of income. For our sales denominated in foreign currencies, we are exposed to foreign currency exchange rate fluctuations on revenue and collection of receivables. During the three months ended December 31, 2016, our revenues were negatively impacted by foreign currency exchange rates, which reduced revenues by approximately \$0.7 million, compared to last year's comparable quarter. Continued change in the values of the Euro, the British pound sterling and other foreign currencies against the U.S. Dollar could have an impact on our business, financial condition and results of operations.

Our most significant third-party transactions denominated in foreign currency are inventory purchases of hematology products from Diatron MI PLC, which are primarily denominated in Euros. To the extent the U.S. dollar strengthens against the Euro currency, the translation of the foreign currency denominated transactions may result in reduced cost of revenues and operating expenses. Similarly, our cost of revenues and operating expenses will increase if the U.S. dollar weakens against the Euro currency. We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 10% for our foreign currency denominated transactions could be experienced in the near term. If the U.S. dollar weakened or strengthened by 10% against the Euro, the impact of changes in the exchange rate would not have had a material effect on our business, operating results or financial condition for the three and nine months ended December 31, 2016. To date, we have not engaged in any foreign currency hedging transactions. As our international operations grow, we will continue to reassess our approach to managing the risks relating to fluctuations in currency rates.

### Investments in Privately Held Companies

In February 2011, we purchased a 15% equity ownership interest in SMB, a privately-held developer and manufacturer of point-of-care diagnostic products for veterinary use, for \$2.8 million in cash. SMB, based in Farum, Denmark, has been the original equipment manufacturer of the Abaxis VetScan VSpro point-of-care specialty analyzer since 2008. The investment was recorded in "Investment in unconsolidated affiliates" in our condensed consolidated balance sheets and we used the equity method to account for our investment in this entity because we did not control it, but had the ability to exercise significant influence over it. In August 2016, we sold our 15% equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB. The total purchase price for our equity method investment in SMB was approximately \$9.7 million in cash, subject to a holdback for certain adjustments that may occur. The holdback payment is expected to be released 18 months following the closing date. In connection with the sale, we received a cash payment of \$8.5 million and recorded a pre-tax gain of \$6.1 million (\$3.8 million after tax) on the sale of our equity method investment during the nine months ended December 31, 2016.

In June 2016, we invested a total of \$3.0 million in a privately-held company. Our investment is recorded under the cost method as we do not exercise significant influence over the investee's operating or financial activities. The investment is inherently risky and we could lose our entire investment in this company. To date, we have not recorded

an impairment charge on this investment. Additionally, in January 2017, we entered into a letter agreement with our investee. Under the terms of the letter agreement, the privately-held company will, pending negotiation and execution of a definitive agreement, commence chemistry development activities for us using its intellectual product and technology. As consideration for these development efforts, we will pay a total of up to \$1.5 million to the investee, in the form of an upfront payment of \$0.3 million in January 2017, and any remaining obligation to the investee is contingent upon the achievement of certain development milestones.

Other than the foregoing, there have been no material changes in our market risk during the three and nine months ended December 31, 2016 compared to the disclosures in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”), as of December 31, 2016. Based on such evaluation, our principal executive officer and principal financial officer have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act.

Inherent Limitations on Controls and Procedures

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even an effective system of internal control will provide only reasonable assurance that the objectives of the internal control system are met.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in various litigation matters in the normal course of business. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

RISK FACTORS THAT MAY AFFECT OUR PERFORMANCE

Our future performance is subject to a number of risks. If any of the following risks actually occur, our business could be harmed and the trading price of our common stock could decline. In evaluating our business, you should carefully consider the following risks in addition to the other information in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 as filed with the Securities and Exchange Commission on May 31, 2016, as amended. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. It is not possible to predict or identify all such factors and, therefore, you should not consider the following risks to be a complete statement of all the potential risks or uncertainties that we face.

When used in these risk factors, the words “anticipates,” “believes,” “continue,” “could,” “estimates,” “expects,” “future,” “intends,” “may,” “might,” “plans,” “projects,” “will” and similar expressions identify forward-looking statements. Our actual results could differ materially from those that we project in the forward-looking statements as a result of factors that we have set forth throughout this document as well as additional risks not presently known to us or that we currently believe are immaterial that may also significantly impair our business operations.

Our facilities and manufacturing operations are vulnerable to interruption as a result of natural disasters, system failures and other business disruptions. Any such interruption may harm our business.

Our business depends on the efficient and uninterrupted operation of our manufacturing operations, which are co-located with our corporate headquarters in Union City, California. These manufacturing operations are vulnerable to damage or interruption from earthquakes, fire, floods, power loss, telecommunications failures, break-ins and similar events. A failure of manufacturing operations, be it in the development and manufacturing of our Piccolo or VetScan blood chemistry analyzers or the reagent discs used in the blood chemistry analyzers, could result in our inability to supply customer demand. We do not have a backup facility to provide redundant manufacturing capacity in the event of a system failure or other significant loss or problem. Accordingly, if our manufacturing operations in Union City, California were interrupted, we may be required to bring an alternative facility online, a process that could take several weeks to several months or more. The occurrence of a business disruption could harm our revenue and financial condition and increase our costs and expenses. Although we carry property and business interruption insurance to insure against the financial impact of certain events of this nature, our coverage may not be adequate to compensate us for all losses that may occur.

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We face significant competition. We may not be able to compete effectively with larger, more established entities or their products, or with future organizations or future products, which could cause our sales to decline.

The diagnostic market is a well-established field in which there are a number of competitors that have substantially greater financial and operational resources and larger, more established marketing, sales and service organizations than we do. We compete primarily with the following organizations: commercial clinical laboratories, hospitals' clinical laboratories, and manufacturers of bench top multi-test blood analyzers and other testing systems that health care providers can use at the point of care.

Historically, hospitals and commercial laboratories perform most of the human diagnostic testing, and veterinary specialized commercial laboratories perform most of the veterinary medical testing. We have identified five principal factors that we believe customers typically use to evaluate our products and those of our competitors. These factors include the following: range of tests offered, immediacy of results, cost effectiveness, ease of use and reliability of results. We believe that we compete effectively on each of these factors except for the range of tests offered. Clinical laboratories are effective at processing large panels of tests using skilled technicians and complex equipment. Currently, while our offering of instruments and reagent discs does not provide the same broad range of tests as hospitals and commercial laboratories, we believe that in certain markets, our products provide a sufficient breadth of test menus to compete successfully with clinical laboratories given the advantages of our products with respect to the other four factors. In addition, we cannot assure you that we will continue to be able to compete effectively on cost effectiveness, ease of use, immediacy of results or reliability of results. We also cannot assure you that we will ever be able to compete effectively on the basis of range of tests offered.

Our principal competitors in the point-of-care human medical diagnostic market are Alere, Alfa Wassermann S.P.A., Ortho-Clinical Diagnostics, Inc. and F. Hoffmann-La Roche Ltd. Additionally, in certain segments of the human medical diagnostic market, we compete with Abbott's i-STAT division. Many of our competitors in the human medical diagnostic market have significantly larger product lines to offer and greater financial and other resources than we do. In particular, many of these competitors have large sales forces and well-established distribution channels and brand names.

Our principal competitors in the veterinary diagnostic market are Idexx Laboratories, Inc. and Heska Corporation. Idexx has a larger veterinary product and service offering than we do and a large sales infrastructure network and well-established brand name. Consequently, we must develop our distribution channels and significantly expand our direct sales force in order to compete more effectively in these markets. If we are unable to effectively manage our distribution channels in our highly competitive industry, we may fail to retain customers or obtain new customers and our business will suffer.

We would fail to achieve anticipated revenues if the market does not accept our products.

We believe that our core compact blood chemistry analyzer product differs substantially from current blood chemistry analyzers on the market. We compete with centralized laboratories that offer a greater number of tests than our products, at a lower cost, but require more time. We also compete with other point-of-care analyzers that often require more maintenance and offer a narrower range of tests. However, these point-of-care analyzers are generally marketed by larger companies which have greater resources for sales and marketing, in addition to a recognized brand name and established distribution relationships.

In the human medical market, we believe that our blood chemistry analyzers offer customers many advantages, including substantial improvements in clinical efficiencies. However, the implementation of point-of-care diagnostics in the current healthcare environment involves changes to current standard practices, such as using large clinical laboratories, and adopting our technology requires a shift in both the procedures and mindset of care providers. The human medical market in particular is highly regulated, structured and subject to government and managed care

influences; accordingly, the market can be difficult to penetrate and slower to adapt to new technologies. If we or our distribution partner, Abbott, are unable to convince large numbers of medical clinics, hospitals and other point-of-care environments of the benefits of our Piccolo blood chemistry analyzers and our other products, we could fail to achieve anticipated revenue.

Historically, in the veterinary market, we have marketed our VetScan products through both direct sales and distribution channels to veterinarians. We continue to develop products, such as VetScan FUSE, a web-based integration system that provides connectivity between our point-of-care diagnostic instruments and the veterinary practice management systems, new point-of-care urine sediment and chemistry analyzers and new animal blood tests to expand our product offerings; however, we cannot be assured that these products will be accepted by the veterinary market. Any failure to achieve market acceptance with our current or future products would harm our business and financial condition. Moreover, we may identify new areas for serving our veterinary market customers that may not be accepted by the market or achieve our financial goals to increase revenues and profitability at acceptable levels. For example, we sold our AVRL business in March 2015, as it failed to perform to our expectations.

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We are not able to predict sales in future quarters and a number of factors affect our periodic results, which may result in significant variance in our quarterly results of operations and may negatively impact our stock price.

We are not able to accurately predict our sales in future quarters. Our revenues in the medical and veterinary markets are derived primarily by selling to distributors that resell our products to the ultimate user. While we are better able to predict sales of our reagent discs and other consumable products, as we sell these discs primarily for use with our instruments that we sold in prior periods, we generally are unable to predict with much certainty sales of our instruments, as we typically sell our instruments to new users or as an upgrade for to our existing customers, which can fluctuate on a quarterly basis. We generally operate with a limited order backlog, because we ship our products shortly after we receive the orders from our customers. As a result, our product sales in any quarter are generally dependent on orders that we receive and ship in that quarter. Accordingly, our sales in any one quarter or period are not indicative of our sales in any future period.

The sales cycle for our products can fluctuate, which may cause revenue and results of operations to vary significantly from period to period. We believe this fluctuation is primarily due (i) to seasonal patterns in the decision making processes by our independent distributors and direct customers, (ii) to inventory or timing considerations by our distributors and (iii) on the purchasing requirements of the U.S. government to acquire our products. Accordingly, we believe that period to period comparisons of our results of operations are not necessarily meaningful. In the future, our periodic results of operations may vary significantly depending on, but not limited to, a number of factors, including:

- new product or service announcements made by us or our competitors;
- changes in our pricing structures or the pricing structures of our competitors;
- the sales performance of our independent distributors;
- excess inventory levels and inventory imbalances at our independent distributors;
- our ability to develop, introduce and market new products or services on a timely basis, or at all;
- our manufacturing capacities and our ability to increase the scale of these capacities;
- the mix of sales among our instruments and consumable products;
- the amount of our research and development, sales and marketing and general and administrative expenses;  
and
- changes in our strategies.

As a result, it is likely that in some periods our operating results will not meet investor expectations or those of public market analysts. Any unanticipated change in revenues or operating results is likely to cause our stock price to fluctuate since such changes reflect new information available to investors and analysts. Any fluctuations in our quarterly results may not accurately reflect the underlying performance of our business and could cause a decline in the trading price of our common stock.

A failure to manage the inventory levels of our distributors effectively could adversely affect our revenues, gross margins and results of operations.

We must manage the inventory of our products held by our distributors effectively. Any excess or shortage of inventory held by our distributors could affect our results of operations. Our distributors may increase orders during

periods of product shortages and cancel or delay orders if their inventory is too high. They also may adjust their orders in response to the supply of our products, the products of our competitors that are available to them, and in response to seasonal fluctuations in customer demand. Revenues from sales to our distributors generally are recognized based upon shipment of our products to the distributors, net of estimated sales allowances, discounts and rebates. Inventory management remains an area of focus as we balance inventory levels of our instruments and consumables, especially in our United States veterinary market distribution channel, consisting of both national and regional distributors. We must also balance the need to maintain sufficient inventory levels in the distribution channel against the risk of inventory obsolescence because of the shelf life of our consumable products and customer demand. If we ultimately determine that we have excess inventory at our distributors or inventory imbalances in the distribution channel, we may have to reduce our selling prices, which could result in lower gross margins. For example, during the second half of fiscal 2014, as compared to the same period in fiscal 2013, our revenues were adversely impacted in the United States veterinary market by excess channel inventory and inventory imbalances and resulted to a decrease of sales orders from our largest distributors in the veterinary market. The excess channel inventory was the result of our distributors not selling our products to end customers at the same rate as they were purchasing products from us. In addition, we only began selling through our distributors Henry Schein Animal Health and Patterson Companies, Inc. in the third quarter of fiscal 2015 and our revenues in future quarters may be impacted by the timing of purchases of our products sold by them as these new distributors integrate our products into their sales process. Should our efforts to monitor and manage channel inventory be unsuccessful, our business, financial condition and results of operations are likely to be adversely affected.

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We rely primarily on distributors to sell our products and we rely on sole distributor arrangements in a number of countries. Our failure to successfully develop, manage and maintain these relationships could adversely affect our business, financial condition and results of operations.

We sell our medical and veterinary products primarily through a limited number of distributors. As a result, we are dependent upon these distributors to sell our products and to assist us in promoting and creating a demand for our products. We operate on a purchase order basis with the distributors and the distributors are under no contractual obligation to continue carrying our products. Further, many of our distributors may carry our competitors' products, and may promote our competitors' products over our own products.

We depend on a number of distributors in North America who distribute our VetScan products. In the United States veterinary market segment, we rely on our distribution network, consisting of both national distributors and independent regional distributors, and our ability to effectively manage this network. We depend on our distributors to assist us in promoting our products in the veterinary market, and accordingly, if one or more of our distributors were to stop selling our products in the future, we may experience a temporary sharp decline or delay in our sales revenues until our customers identify another distributor or purchase products directly from us.

Internationally, we rely on only a few distributors for our products in both the medical and veterinary diagnostic markets. We currently rely on distributors that carry either our medical or veterinary products in the following countries: Australia, Austria, Belgium, Canada, China, Czech Republic, Denmark, France, Germany, Hong Kong, India, Indonesia, Israel, Italy, Japan, Korea, Mexico, the Netherlands, New Zealand, the Philippines, Portugal, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, the United Kingdom and the United States. Our distributors in each of these countries are responsible for obtaining the necessary approvals to sell our new and existing products. These distributors may not be successful in obtaining proper approvals for our new and existing products in their respective countries, and they may not be successful in marketing our products. Furthermore, an inability of, or any delays by, our distributor in receiving the necessary approvals for our new or other products can adversely impact our revenues in a country. We plan to continue to enter into additional distributor relationships to expand our international distribution base and presence. However, we may not be successful in entering into additional distributor relationships on favorable terms, or at all. In addition, our distributors may terminate their relationship with us at any time. Historically, we have experienced a high degree of turnover among our international distributors. This turnover makes it difficult for us to establish a steady distribution network overseas. Consequently, we may not be successful in marketing our Piccolo and VetScan products internationally, and our business and financial condition may be harmed as a result.

In the United States, we rely on Abbott as our exclusive distributor in certain medical markets to sell our products. Our dependency on Abbott means that any failure to successfully develop products and maintain this relationship could adversely affect our business, financial condition and results of operations.

Abbott has the exclusive right to sell and distribute our Piccolo Xpress chemistry analyzer and associated consumables in the United States professionally-attended human healthcare market, excluding sales and distribution to Catapult Health LLC and specified customer segments, which includes pharmacy and retail store clinics, shopping malls, clinical research organizations and cruise ship lines. As a result of the Abbott Agreement, we no longer have control over the marketing and sale of our primary medical products into most of the U.S. medical market and are dependent upon the efforts and priorities of Abbott in promoting and creating a demand for such products in such market. We do not have any control over pricing, inventory levels, distribution efforts and other factors that may impact the level of sales achieved, timing of revenue recognized and other adjustments that may impact our reported sales. Moreover, we are dependent upon Abbott's forecasts and sales efforts and maintenance of pre-existing sub-distributor agreements that were assigned to Abbott. As a result, if Abbott's efforts are unsuccessful, our business, financial condition and results of operations are likely to be adversely affected. For example, the transition of this U.S. medical business had an adverse effect on our revenues during fiscal 2014, with respect to lower average selling prices

of Piccolo products sold to Abbott and the timing of purchases of our products now sold by Abbott as it integrated our products into its sales process.

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In addition, as a result of the Abbott Agreement, we have substantially reduced the size of our United States medical sales force. The initial term of the Abbott Agreement ends on December 31, 2017, and after the initial term, the agreement renews automatically for successive one-year periods unless terminated by either party based upon a notice of non-renewal six months prior to the then-current expiration date. In the event the agreement is terminated, we would be required to invest and re-establish presence and sales capabilities in markets that were served by Abbott and/or identify one or more suitable replacement distribution partner(s), which would require significant time and effort. We could not be assured of replacing the capabilities of Abbott in those markets. New sales personnel and distribution partners take time to train and gain full productivity with customers, and if we are unable to accomplish this successfully, our business, financial condition and results of operations could be adversely affected.

We depend on limited or sole suppliers, many of whom we do not have long-term contracts with, and failure of our suppliers to provide the components or products to us could harm our business.

We use several key components that are currently available from limited or sole sources as discussed below.

**Blood Chemistry Analyzer Components:** Our blood analyzer products use several technologically-advanced components that we currently purchase from a limited number of suppliers, including certain components from our single source supplier, Hamamatsu Corporation. Our analyzers also use a printer that is primarily made by Advanced Printing Systems. The loss of the supply of any of these components could force us to redesign our blood chemistry analyzers.

**Reagent Discs:** Two injection-molding manufacturers, C. Brewer Co., a division of Balda AG, and Nypro, Inc., a subsidiary of Jabil Circuit, currently make the molded plastic discs that, when loaded with reagents and welded together, form our reagent disc products. We believe that only a few manufacturers are capable of producing these discs to the narrow tolerances that we require. To date, we have only qualified these two manufacturers to manufacture the molded plastic discs.

**Reagent Chemicals:** We currently depend on the following single source vendors for some of the chemicals that we use to produce the reagents and dry reagent chemistry beads that are either inserted in our reagent discs, lateral flow rapid tests or sold as stand-alone products: Amano Enzyme USA Co., Ltd., Kikkoman Corporation Biochemical Division, Microgenics Corporation, a division of Thermo Fisher Scientific, Roche Molecular Biochemicals of Roche Diagnostics Corporation, a division of F. Hoffmann-La Roche, Ltd., SA Scientific Co., Sekisui Diagnostics, Sigma Aldrich Inc. and Toyobo Specialties.

We market original equipment manufacturer supplied products that are currently available from limited sources as discussed below.

**Hematology Instruments and Reagent Kits:** Our VetScan hematology instruments are manufactured by Diatron in Hungary and are purchased by us as a completed instrument. In addition, we currently have qualified two suppliers to produce the reagent kits for our hematology instruments: Clinical Diagnostic Solutions, Inc. and Diatron.

**VSpro Specialty Analyzers and Cartridges:** Our VetScan VSpro specialty analyzers and cartridges are manufactured by SMB in Denmark and are purchased by us as completed products.

**i-STAT Analyzers and Cartridges:** Our VetScan i-STAT analyzers and cartridges are manufactured by Abbott and are purchased by us as completed products.

**Rapid Tests:** Substantially all of our VetScan Rapid Tests are manufactured by a single source supplier, SA Scientific Co., located in the United States.

We currently have purchase obligations with Diatron to purchase Diatron hematology products. However, with our other suppliers, we primarily operate on a purchase order basis and, therefore, these suppliers are under no contractual obligation to supply us with their products or to do so at specified prices. Although we believe that there may be potential alternate suppliers available for these critical components, to date we have not qualified additional vendors beyond those referenced above and cannot assure you we would be able to enter into arrangements with additional vendors on favorable terms, or at all. For the suppliers of original equipment manufactured products with which we have long-term contracts, there can be no assurance that these suppliers will always fulfill their obligations under these contracts, or that any suppliers will not experience disruptions in their ability to supply our requirements for products. In addition, under some contracts with suppliers we have minimum purchase obligations and our failure to satisfy those obligations may result in a loss of some or all of our rights under these contracts.

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Because we are dependent on a limited number of suppliers and manufacturers for our products, we are particularly susceptible to any interruption in the supply of these products or the viability of our assembly arrangements. The loss of any one of these suppliers or a disruption in our manufacturing arrangements could adversely affect our business, financial condition and results of operations.

We must increase sales of our Piccolo and VetScan products or we may not be able to increase or sustain profitability.

Our ability to continue to be profitable and to increase profitability will depend, in part, on our ability to increase our sales volumes of our Piccolo and VetScan products. Increasing the sales volume of our products will depend upon, among other things:

- the sales performance of our independent distributors;
- our ability to improve our existing products and develop new and innovative products;
- our ability to increase our sales and marketing activities;
- our ability to effectively manage our manufacturing activities; and
- our ability to effectively compete against current and future competitors.

We cannot assure you that we will be able to successfully increase the sales volumes of our products to increase or sustain profitability.

We must continue to increase our sales, marketing and distribution efforts in the human diagnostic market or our business will not grow.

The human diagnostic market is fragmented, heavily regulated and constantly changing. Our limited sales, marketing and distribution capabilities are continually challenged to translate these changes into compelling value propositions for our prospective customers. Accordingly, we cannot assure you that:

- we will be able to maintain consistent growth through Abbott and our other independent distributors;
- the costs associated with sales, marketing and distributing our products will not be excessive; or
- government regulations or private insurer policies will not adversely affect our ability to be successful.

We depend on key members of our management and scientific staff and, if we fail to retain and recruit qualified individuals, our ability to execute our business strategy and generate sales would be harmed.

Our future success depends, to a great degree, on the principal members of our management and scientific staff. The loss of any of these key personnel, including in particular Clinton H. Severson, our Chief Executive Officer and Chairman of our Board of Directors, might impede the achievement of our business objectives. We may not be able to continue to attract and retain skilled and experienced marketing, sales and manufacturing personnel on acceptable terms in the future because numerous medical products and other high technology companies compete for the services of these qualified individuals. If we are unable to hire and train qualified personnel, we may not be able to maintain or expand our business. Additionally, if we are unable to retain key personnel, we may not be able to replace them readily or on terms that are reasonable, which also could hurt our business. We currently do not maintain key man life insurance on any of our employees.

We may experience manufacturing problems related to our instruments, which could adversely affect our business, financial condition or results of operations.

We manufacture our point-of-care chemistry analyzers at our manufacturing facility in Union City, California. Should we experience problems related to the manufacture of our blood chemistry analyzer, we could fail to achieve anticipated revenues or we may incur an additional increase in our cost of revenues. These problems may include manufacturing defects and product failures, defects in raw materials acquired from our suppliers, delays in receipt of raw materials from our suppliers, obsolescence, increases in raw materials costs and labor disturbances. There can be no assurance that our efforts to resolve manufacturing difficulties will be successful or that similar problems will not arise in the future. If we are unable to prevent such problems from occurring in the future, we may not be able to manufacture sufficient quantities to meet anticipated demand and, therefore, will not be able to effectively market and sell our blood chemistry analyzers or other instruments that we market and sell; accordingly, our business, financial condition and results of operations could be adversely affected.

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We need to successfully manufacture and market additional reagent discs for the human diagnostic market if we are to compete in that market.

We believe that we must develop and obtain regulatory clearance and third-party payor reimbursement for additional series of reagent discs with various tests for use with our Piccolo chemistry analyzers if we are to successfully compete in the human medical market. Our failure to meet these challenges will materially adversely affect our operating results and financial condition.

We rely on patents and other proprietary information, the loss of which would negatively affect our business.

As of December 31, 2016, 84 patent applications have been filed on our behalf with the United States Patent and Trademark Office (“USPTO”), of which 46 patents have been issued and 18 patents are currently active. Additionally, we have filed several international patent applications covering the same subject matter as our domestic applications. The patent position of any medical device manufacturer, including us, is uncertain and may involve complex legal and factual issues. Consequently, we may not be issued any additional patents, either domestically or internationally. Furthermore, our patents may not provide significant proprietary protection because there is a chance that they will be circumvented or invalidated. We cannot be certain that we were the first creator of the inventions covered by our issued patents or pending patent applications, or that we were the first to file patent applications for these inventions, because (1) the USPTO maintains all patent applications that are not filed in any foreign jurisdictions in secrecy until it issues the patents (when a patent application owner files a request for nonpublication) and (2) publications of discoveries in the scientific or patent literature tend to lag behind actual discoveries by several months. We may have to participate in interference proceedings, which are proceedings in front of the USPTO, to determine who will be issued a patent. These proceedings could be costly and could be decided against us.

We also rely upon copyrights, trademarks and unpatented trade secrets. Others may independently develop substantially equivalent proprietary information and techniques that would undermine our proprietary technologies. Further, others may gain access to our trade secrets or disclose such technology. Although we require our employees, consultants and advisors to execute agreements that require that our corporate information be kept confidential and that any inventions by these individuals are property of Abaxis, there can be no assurance that these agreements will provide meaningful protection or adequate remedies for our trade secrets in the event of unauthorized use or disclosure of such information. The unauthorized dissemination of our confidential information would negatively impact our business.

Changes in health care regulations and third-party payor reimbursement can negatively affect our business.

By regulating the availability of, or the maximum amount of reimbursement provided for blood testing services, third-party payors, such as managed care organizations, pay-per-service insurance plans, and the Centers for Medicare and Medicaid Services (“CMS”), can indirectly affect the pricing or the relative attractiveness of our human testing products. For example, in the United States, the CMS set the national level of reimbursement of fees for blood testing services for Medicare beneficiaries. If third-party payors decrease the reimbursement amounts for blood testing services, it may decrease the likelihood that physicians and hospitals will adopt point-of-care diagnostics as a viable means of care delivery. Consequently, we would need to charge less for our products. If the government and third-party payors do not provide for adequate coverage and reimbursement levels to allow health care providers to use our products, the demand for our products will decrease and our business and financial condition would be harmed.

In the United States, there have been and continue to be a number of legislative initiatives to contain healthcare costs. For example, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, collectively, the ACA, enacted in March 2010, made changes that significantly impact the medical device industries and clinical laboratories. Recently, the U.S. House of Representatives and Senate passed legislation,

which, if signed into law by President Trump, would repeal certain aspects of the ACA. Further, on January 20, 2017, President Trump signed an Executive Order directing federal agencies with authorities and responsibilities under the ACA to waive, defer, grant exemptions from, or delay the implementation of any provision of the ACA that would impose a fiscal or regulatory burden on states, individuals, healthcare providers, health insurers, or manufacturers of pharmaceuticals or medical devices. Congress also could consider subsequent legislation to replace elements of the ACA that are repealed. Thus, the full future impact of the ACA on our business remains unclear.

On April 1, 2014, the Protecting Access to Medicare Act of 2014, or PAMA, was signed into law, which, among other things, significantly altered the payment methodology under the Medicare Clinical Laboratory Fee Schedule, or CLFS. Some commercial payors are guided by the CLFS in establishing their reimbursement rates. Clinicians may decide not to order clinical diagnostic tests if third party payments are inadequate, and we cannot predict whether third-party payors will offer adequate reimbursement for tests utilizing our products to make them commercially attractive. Changes in healthcare policy, such as the creation of test utilization limits for diagnostic products in general or requirements that Medicare patients pay for portions of clinical laboratory tests or services received, could substantially impact the sales of our tests, increase costs and divert management's attention from our business. We expect that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand or additional pricing pressures. In addition, sales of our tests outside of the United States will subject us to foreign regulatory requirements, which may also change over time.

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We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws and other federal and state laws applicable to our sales and marketing practices. If we are unable to comply, or have not complied, with such laws, we could face substantial penalties.

Our operations are directly, or indirectly through our customers, subject to various federal and state fraud and abuse laws, including, without limitation, the federal and state anti-kickback statutes, physician payment transparency laws and false claims laws. These laws may impact, among other things, our sales and marketing and education programs and require us to implement additional internal systems for tracking certain marketing expenditures and reporting them to government authorities. In addition, we may be subject to patient privacy regulation by both the federal government and the states in which we conduct our business. If our operations are found to be in violation of any of these laws or any other governmental regulations that apply to us, we may be subject to penalties, without limitation, including civil and criminal penalties, damages, fines, disgorgement, the curtailment or restructuring of our operations, exclusion from participation in federal and state healthcare programs and imprisonment, any of which could adversely affect our ability to operate our business and our results of operations.

Approval and/or clearance by the FDA, USDA and foreign regulatory authorities for our products requires significant time and expenditures.

Before we may commercialize our human medical diagnostic products in the United States, we are required to obtain either 510(k) clearance or pre-marketing approval (“PMA”) from the FDA, unless an exemption from pre-market review applies. In our veterinary market, certain products that we sell are subject to regulations pertaining to veterinary biologics, for which we must obtain approval from the USDA’s Center for Veterinary Biologics. The process of obtaining regulatory clearances or approvals to market a medical device can be costly and time consuming, and we may not be able to successfully obtain 510(k) clearance from the FDA or may be subject to the more costly and time-consuming PMA process.

In addition, governmental agencies may change their clearance or approval policies, adopt additional regulations or revise existing regulations, or take other actions which may prevent or delay approval or clearance of our products under development or impact our ability to modify our currently approved or cleared products on a timely basis. Any delay in, or failure to receive or maintain, clearance or approval for our products could prevent us from generating revenue from these products and adversely affect our business operations and financial results.

The FDA and other regulatory authorities have broad enforcement powers. For example, the manufacture of medical devices must comply with the FDA’s Quality System Regulation (“QSR”). In addition, manufacturers must register their manufacturing facilities, list the products with the FDA, and comply with requirements relating to labeling, marketing, complaint handling, adverse event and medical device reporting, reporting of corrections and removals, and import and export. The FDA monitors compliance with the QSR and these other requirements through periodic inspections. If our facilities or those of our manufacturers or suppliers are found to be in violation of applicable laws and regulations, or if we or our manufacturers or suppliers fail to take satisfactory corrective action in response to an adverse inspection, the regulatory authority could take enforcement actions that could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers’ demands, and could have a material adverse effect on our reputation, business, results of operations and financial condition. We may also be required to bear other costs or take other actions that may have a negative impact on our future sales and our ability to generate profits.

Sales of our products outside the United States are subject to foreign regulatory requirements governing vigilance reporting, marketing approval, manufacturing, product licensing, pricing and reimbursement. These regulatory requirements vary greatly from country to country. As a result, the time required to obtain approvals outside the United States may differ from that required to obtain FDA clearance or USDA approval, and we may not be able to obtain foreign regulatory approvals on a timely basis or at all. Clearance or approval by the FDA does not ensure

approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure clearance or approval by regulatory authorities in other countries or by the FDA.

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A recall of our products, or the discovery of serious safety issues with our products that leads to corrective actions, could have a significant adverse impact on our business, financial condition or results of operations.

The FDA, USDA and similar foreign governmental authorities have the authority to require the recall of commercialized products in the event of material deficiencies or defects in design or manufacture of a product or in the event that a product poses an unacceptable risk to health. Manufacturers may, under their own initiative, recall a product if any material deficiency in a device is found. A government-mandated or voluntary recall by us or one of our distributors could occur as a result of component failures, manufacturing errors, design or labeling defects or other deficiencies and issues. We are required to report to the FDA any incident in which our product may have caused or contributed to a death or serious injury or in which our product malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury. Repeated product malfunctions may result in a voluntary or involuntary product recall. Recalls of any of our products would divert managerial and financial resources and could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands, any of which could have an adverse effect on our business, financial condition and results of operations. Moreover, if we do not adequately address problems associated with our devices, we may face additional regulatory enforcement action, including FDA warning letters, product seizure, injunctions, administrative penalties, or civil or criminal fines. We may also be required to bear other costs or take other actions that may have a negative impact on our sales as well as face significant adverse publicity or regulatory consequences, which could harm our business, financial condition or results of operations.

We may inadvertently design or produce defective products, which may subject us to significant warranty liabilities or product liability claims. We may have insufficient product liability insurance to pay uninsured claims.

Our business exposes us to potential warranty and product liability risks that are inherent in the design, testing, manufacturing and marketing of human and veterinary medical products. Although we have established procedures for quality control on both the raw materials that we receive from suppliers as well as the design and manufacturing of our products, these procedures may prove inadequate to detect a design or manufacturing defect. In addition, our Piccolo and VetScan chemistry analyzers may be unable to detect all errors that could result in the misdiagnosis of human or veterinary patients.

We may be subject to substantial claims for defective products under our warranty policy or product liability laws. In addition, our policy is to credit medical providers for any defective product that we produce, including those reagent discs that are rejected by our Piccolo and VetScan chemistry analyzers. Therefore, even if a mass defect within a lot or lots of reagent discs were detected by our Piccolo and VetScan chemistry analyzers, the replacement of such reagent discs free of charge would be costly and could adversely affect our business, financial condition and results of operations. Further, in the event that a product defect is not detected in our Piccolo chemistry analyzer, our expansion into the human medical market greatly increases the risk that the amount of damages involved with just one product defect would adversely impact our business, financial condition and results of operations. Our product liability insurance and cash may be insufficient to cover potential liabilities. In addition, in the future the coverage that we require may be unavailable on commercially reasonable terms, if at all. Even with our current insurance coverage, a mass product defect, product liability claim or recall could subject us to claims above the amount of our coverage and could adversely affect our business, our financial condition or results of operations.

Acquisitions, strategic investments, partnerships, or alliances could be difficult to identify and integrate, divert the attention of management, disrupt our business, dilute shareholder value, and adversely affect our business, financial condition or results of operations.

We have in the past and may in the future seek to acquire or invest in businesses, products, or technologies that we believe could complement or expand our products, enhance our capabilities, or otherwise offer growth opportunities. For example, we acquired Quality Clinical Reagents Limited ("QCR") and Trio Diagnostics (Ireland) Ltd ("Trio") in

November 2014. Any acquisition may divert the attention of management and cause us to incur various expenses in identifying, investigating, and pursuing suitable acquisitions, whether or not the acquisitions are completed, and may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel, or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their products are not easily adapted to work with ours, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management, or otherwise. Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for development of our existing business. Any acquisitions we are able to complete may not result in any synergies or other benefits we had expected to achieve, which could result in impairment charges that could be substantial. In addition, we may not be able to find and identify desirable acquisition targets or be successful in entering into an agreement with any particular target. Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our financial condition or results of operations. In addition, if an acquired business, including QCR or Trio, fails to meet our expectations, our business, financial condition or results of operations may suffer or we may be exposed to risks or liabilities that were unknown to us at the time of the acquisition.

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Divestitures or other dispositions could negatively impact our business.

On an ongoing basis, we assess opportunities for improved operational effectiveness and efficiency and may divest, spin-off, split-off, or otherwise dispose of businesses that are deemed not to fit with our strategic plan or are not achieving the desired return on investment. For example, we sold our AVRL business to Antech in March 2015, and we sold our equity ownership interest in SMB in connection with Zoetis Inc.'s acquisition of SMB in August 2016. These transactions pose risks and challenges that could negatively impact our business. For example, when we decide to sell or otherwise dispose of a business or assets, the sale is typically subject to satisfaction of pre-closing conditions that may not become satisfied. In addition, divestitures or other dispositions may dilute our earnings per share, have other adverse financial and accounting impacts, distract management, disrupt our business, negatively impact market perception of our prospects and involve the loss of key employees, and disputes may arise with buyers. In addition, we may retain responsibility for or agree to indemnify buyers against contingent liabilities, which could have a material effect on our financial statements. Divestitures may also result in significant asset impairment charges, including those related to goodwill and other intangible assets, which could have a material adverse effect on our financial condition and results of operations. We cannot assure you that divestiture or other disposition efforts will be successful in generating improved operating efficiencies. In addition, past disposition activities may not be a good indication of future disposition opportunities, and any divestiture or other disposition of any business may leave us with reduced financial and marketing resources to develop products and services to compete against our competitors.

We may be subject to litigation for a variety of claims, which could adversely affect our business, financial condition or results of operations.

In addition to product liability claims, we and our directors and officers may be subject to claims arising from our normal business activities. These may include claims, suits, and proceedings involving shareholder and fiduciary matters, intellectual property, labor and employment, wage and hour, commercial and other matters. For example, in October 2012, the St. Louis Police Retirement System, a purported shareholder of Abaxis, filed a lawsuit against certain officers and each of the directors of the Company in the United States District Court for the Northern District of California alleging, among other things, that the directors violated Section 14(a) of the Securities Exchange Act of 1934 and breached their fiduciary duties by allegedly failing to disclose material information in our 2010 proxy statement, breached their fiduciary duties by allegedly violating the terms of our 2005 Equity Incentive Plan, and breached their fiduciary duties by failing to disclose alleged material information in our 2012 proxy statement regarding (1) the events leading up to our proposal to amend the 2005 Equity Incentive Plan to eliminate the limit on the number of shares that may be issued pursuant to restricted stock units, and (2) the effects of the proposed amendment on certain settled and outstanding restricted stock units. On August 12, 2014, the Court issued a final judgment order, among other things, approving a settlement of the lawsuit, pursuant to which (a) the parties have agreed that the claims against the defendants will be dismissed with prejudice and will be granted the release of certain known or unknown claims that have been or could have been brought later in the court arising out of the same allegations, (b) we have agreed that we will adopt certain corporate governance measures, such measures to be in effect for at least five years and (c) the court awarded \$579,430 in attorney's fees and costs to plaintiff's counsel, which was paid by our insurance. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation or settlement or other resolution of a legal matter could adversely affect our business, financial condition or results of operations, harm our reputation or otherwise negatively impact our business.

Our stock price is highly volatile and investing in our stock involves a high degree of risk, which could result in substantial losses for investors.

The market price of our common stock, like the securities of many other medical products companies, fluctuates over a wide range, and will continue to be highly volatile in the future. During the quarter ended December 31, 2016, the closing sale prices of our common stock on the NASDAQ Global Select Market ranged from \$45.88 to \$55.02 per share and the closing sale price on December 30, 2016, the last day of trading for the quarter ended December 31, 2016, was \$ 52.77 per share. During the last eight fiscal quarters ended December 31, 2016, our stock price closed at a high of \$66.54 per share on March 30, 2015 and a low of \$ 38.65 per share on February 11, 2016. Many factors may affect the market price of our common stock, including:

- fluctuation in our operating results;
- announcements of technological innovations or new commercial products by us or our competitors;
- changes in governmental regulation in the United States and internationally;
- prospects and proposals for health care reform;

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- governmental or third-party payors' controls on prices that our customers may pay for our products;
- product liability claims and public concern as to the safety of our devices or similar devices developed by our competitors;
- developments or disputes concerning our patents or our other proprietary rights; and
- general market conditions.

In the past, stockholders have filed securities class action litigation following periods of market volatility. If we were to become involved in such securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business, and adversely affect our business, financial condition or results of operations. Because our stock price is so volatile, investing in our common stock is highly risky. A potential investor must be able to withstand the loss of his entire investment in our common stock.

Fluctuations in foreign exchange rates could adversely affect our business, financial condition or results of operations.

For our international sales denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. For our sales denominated in foreign currencies, we are subject to fluctuations in exchange rates between the U.S. dollar and the particular foreign currency and changes in such exchange rates could adversely affect our reported results of operations and distort period to period comparisons. Our business, financial condition or results of operations could also be adversely affected by the seasonality of international sales and the economic conditions of our overseas markets.

Our subsidiaries in Europe and the United Kingdom increase our exposure to foreign currency fluctuation risks. These risks include uncertainty regarding the Euro and the British pound sterling, that could adversely impact our results of operations based on the movements of the applicable foreign currency exchange rates in relation to the U.S. dollar. Fluctuating exchange rates cause the value of items on both the assets and liabilities side of the balance sheet to change, which could also negatively impact our results of operations. Our financial results will therefore be sensitive to movements in foreign exchange rates. A depreciation of non-U.S. dollar currencies relative to the U.S. dollar could have a material adverse impact on our results of operations and could cause our results of operations to differ from our expectations and the expectations of our investors. For example, in June 2016, the United Kingdom held a referendum in which voters approved an exit from the European Union, which caused significant volatility in global stock markets and currency exchange rate fluctuations that resulted in the strengthening of the U.S. dollar against foreign currencies in which we conduct business. Additionally, such foreign currency exchange rate fluctuations could make it more difficult to detect underlying trends in our business and results of operations. We do not currently engage in hedging transactions to mitigate foreign currency exchange risks.

Our international operations subject us to unique risks different than those faced by us in the United States and we may not be able to effectively manage our international business.

We have operations outside of the United States. We expect that we will continue to expand our international operations in the future. International operations inherently subject us to a number of risks and uncertainties, including:

- the increased complexity and costs inherent in managing international operations;
- diverse regulatory and compliance requirements, and changes in those requirements that could restrict our or our distributors' ability to manufacture, market or sell our products;

- our limited knowledge of and relationships with distributors, contractors, suppliers or other parties in these areas;
- political and economic instability;
- diminished protection of intellectual property in some countries outside of the United States;
- trade protection measures and import or export licensing requirements;
- complexity and costs associated with staffing and managing international development and operations;
- differing labor regulations and business practices;

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- potentially negative consequences from changes in or interpretations of tax laws;
- changes in international medical reimbursement policies and programs;
- financial risks such as longer payment cycles, difficulty collecting accounts receivable and exposure to fluctuations in foreign currency exchange rates;
- regulatory and compliance risks that relate to maintaining accurate information and control over sales and distributors' and service providers' activities that may fall within the purview of the Foreign Corrupt Practices Act (the FCPA); and
- regulations relating to data security and the unauthorized use of, or access to, commercial and personal information.

Any of these factors may, individually or as a group, have a material adverse effect on our business and results of operations. As our international operations grow, we may encounter new risks. For example, to build our international sales and distribution networks in new geographic regions, we must continue to develop relationships with qualified local distributors. If we are not successful in developing and maintaining these relationships, we may not be able to grow sales in these geographic regions. These or other similar risks could adversely affect our revenue and profitability.

We are dependent on information technology systems, infrastructure and data.

We are dependent upon information technology systems, infrastructure and data. We operate and manage our business by relying on several information systems to maintain financial records, process customer orders, manage inventory, process shipments to customers and operate other critical functions. Information technology system failures, network disruptions and breaches of data security could disrupt our operations. If we were to experience a system disruption in the information technology systems that enable us to interact with customers and suppliers, it could result in the loss of sales and customers, delays or cancellation of orders, impeding the manufacture or shipment of products, processing transactions and reporting financial results and significant incremental costs.

The multitude and complexity of our computer systems make them inherently vulnerable to service interruption or destruction, malicious intrusion and random attack. Likewise, data privacy or security breaches by employees or others may pose a risk that sensitive data, including our intellectual property, trade secrets or personal information of our employees, customers or other business partners and any patient information may be exposed to unauthorized persons or to the public. Cyberattacks are increasing in their frequency, sophistication and intensity. Cyberattacks could include the deployment of harmful malware, denial-of-service, social engineering and other means to affect service reliability and threaten data confidentiality, integrity and availability. Our business partners face similar risks and any security breach of their systems could adversely affect our security posture.

Management has taken steps to address these concerns by implementing network security and internal control measures. While we have invested, and continue to invest, in the protection of our data and information technology infrastructure, there can be no assurance that our efforts will prevent service interruptions, or identify breaches in our systems, that could adversely affect our business and operations and/or result in the loss of critical or sensitive information, which could result in financial, legal, business or reputational harm to us. In addition, our liability insurance may not be sufficient in type or amount to cover us against claims related to security breaches, cyberattacks and other related breaches.

We are subject to complex requirements from legislation requiring companies to evaluate internal control over financial reporting.

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of internal control over financial reporting by our management and an attestation of the effectiveness of our internal control over financial reporting by an independent registered public accounting firm. We have an ongoing program to perform the assessment, testing and evaluation to comply with these requirements and we expect to continue to incur significant expenses for Section 404 compliance on an ongoing basis.

We cannot predict the outcome of our testing in future periods. In the event that our internal control over financial reporting is not effective as defined under Section 404, or any failure to implement required new or improved controls, or difficulties encountered in implementation could harm results of operations or prevent us from accurately reporting financial results or cause a failure to meet our reporting obligations in the future. If management cannot assess internal control over financial reporting is effective, or our independent registered public accounting firm is unable to provide an unqualified attestation report on such assessment, investor confidence and our share value may be negatively impacted.

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Regulations related to conflict minerals could adversely impact our business, financial condition or results of operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of tin, tantalum, tungsten and gold, known as conflict minerals, originating from the Democratic Republic of Congo, (“ the DRC”), and adjoining countries. As a result, in August 2012 the SEC adopted annual disclosure and reporting requirements for public companies that use conflict minerals mined from the DRC and adjoining countries in their products. We have determined that we use at least one of these conflict minerals in the manufacture of our products, although we have been unable to determine the source of the conflict minerals that we use. These disclosure requirements require us to use diligent efforts to determine which conflict minerals we use and the source of those conflict minerals, and disclose the results of our findings annually. There are and will be costs associated with complying with these disclosure requirements, including those costs incurred in conducting diligent efforts to determine which conflict minerals we use and the sources of conflict minerals used in our products. Further, the implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering conflict free conflict minerals, we cannot be sure that we will be able to obtain necessary conflict free conflict minerals in sufficient quantities or at competitive prices. In addition, we may face reputational challenges if we determine that our products contain minerals not determined to be conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we may implement. If we determine to redesign our products to not use conflict minerals, our business, financial condition and results of operations could be adversely affected.

We must comply with strict and potentially costly environmental regulations or we could pay significant fines.

We are subject to stringent federal, state and local laws, rules, regulations and policies that govern the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials and wastes. In particular, we are subject to laws, rules and regulations governing the handling and disposal of biohazardous materials used in the development and testing of our products. Our costs to comply with applicable environmental regulations consist primarily of handling and disposing of human and veterinary blood samples for testing (whole blood, plasma and serum). Although we believe that we have complied with applicable laws and regulations in all material respects and have not been required to take any action to correct any noncompliance, we may have to incur significant costs to comply with environmental regulations if our manufacturing to commercial levels continues to increase. In addition, if a government agency determines that we have not complied with these laws, rules and regulations, we may have to pay significant fines and/or take remedial action that would be expensive and we do not carry environmental-related insurance coverage.

We are subject to taxation in multiple jurisdictions. Our financial condition and results of operations could be adversely affected by unanticipated changes in our tax provisions or exposure to additional income tax liabilities.

We are subject to taxation in, and to the tax laws and regulations of, multiple jurisdictions as a result of the international scope of our operations and our corporate and financing structure. We are also subject to transfer pricing laws with respect to our intercompany transactions, including those relating to the flow of funds among our companies. Adverse developments in these laws or regulations, or any change in position regarding the application, administration or interpretation thereof, in any applicable jurisdiction, could have a material adverse effect on our business, consolidated financial condition or results of our operations. Our determination of our tax liability is subject to review by tax authorities in any applicable jurisdiction, including the United States, who may disagree with the positions we have taken or intend to take regarding the tax treatment or characterization of any of our transactions. Any adverse outcome of such a review could have an adverse effect on our results of operations and financial condition. In addition, the determination of our provision for income taxes and other tax liabilities requires significant judgment including our determination of whether a valuation allowance against deferred tax assets is required. Our ultimate tax liability may differ from the amounts recorded in our condensed consolidated financial statements and

may adversely affect our financial condition and results of operations.

Our ability to issue preferred stock may delay or prevent a change of control of Abaxis.

Our board of directors has the authority to issue up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the shareholders, except to the extent required by NASDAQ rules. The issuance of preferred stock, while providing flexibility in connection with possible financings or acquisitions or other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock and, consequently, negatively affect our stock price.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

Exhibit No.	Description of Document
3.1	Amended and Restated Articles of Incorporation, as amended (filed with the Securities and Exchange Commission on May 30, 2014 as Exhibit 3.1 to our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 and incorporated herein by reference).
3.2	Amended and Restated Bylaws (filed with the Securities and Exchange Commission on July 10, 2015 as Exhibit 3.2 to our Current Report on Form 8-K and incorporated herein by reference).
10.1	2014 Equity Incentive Plan, as amended (filed with the Securities and Exchange Commission on November 1, 2016 as Exhibit 10.1 to our Current Report on Form 8-K and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1#	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2#	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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These exhibits are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Abaxis, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q and irrespective of any general incorporation language contained in any such filing.

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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.

ABAXIS, INC.  
(Registrant)

Date: February 9, 2017 BY: /s/ Clinton H. Severson  
Clinton H. Severson  
Chief Executive Officer  
and Director  
(Principal Executive  
Officer)

Date: February 9, 2017 BY: /s/ Ross Taylor  
Ross Taylor  
Chief Financial  
Officer and  
Vice  
President of  
Finance  
(Principal  
Financial and  
Accounting  
Officer)

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