squarmilner

Certified Public Accountants
and Financial Advisors

THE BERRETT-KOEHLER GROUP, INC.
AND SUBSIDIARY

Consolidated Financial Statements
December 31, 2019 and 2018

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders of
The Berrett-Koehler Group, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The Berrett-Koehler Group, Inc. and its wholly-owned subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Berrett-Koehler Group, Inc. and its wholly-owned subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 3 to the consolidated financial statements, the Company had negative cash flows from operations, a net loss for the year ended December 31, 2019, and an accumulated deficit at December 31, 2019. Management's evaluation of these conditions and management's actions and plans to mitigate these matters are also described in Note 3.

As further discussed in Note 16, subsequent to December 31, 2019, the World Health Organization declared an outbreak of novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout the United States. While the Company expects this matter to negatively impact its operations, the related financial impact cannot be reasonably estimated at this time.

Our opinion is not modified with respect to these matters.

SQUAR MILNER LLP

Squar Milner LLP

San Francisco, California
July 28, 2020

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018

	2019	2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 114,469	$ 147,096
Accounts receivable - net	1,469,533	1,920,482
Inventories - net	2,834,424	2,864,997
Prepublication costs of producing inventories - net	700,083	120,941
Other current assets	302,495	52,298
Total current assets	5,421,004	5,105,814
NON-CURRENT ASSETS		
Furniture, equipment and leasehold improvements - net	117,920	151,871
Prepublication costs of producing inventories - net	310,105	559,267
Deferred tax assets	501,000	454,800
Royalty advances and other assets	338,124	304,174
Total non-current assets	1,267,149	1,470,112
Total assets	$ 6,688,153	$ 6,575,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Outstanding checks - not yet cleared	$ 121,079	$ -
Accounts payable	435,523	662,960
Accrued liabilities	434,709	582,127
Reserve for returns - discontinued distributor	-	641,000
Reserve for returns - general	165,000	260,833
Note payable - bank	1,759,945	4,845
Notes payable - related party	200,000	-
Royalties payable, current	1,262,336	1,676,884
Preferred stock dividends payable	25,013	19,495
Deferred revenue	-	12,267
Deferred rent, current	-	29,154
Total current liabilities	4,403,605	3,889,565
OTHER LIABILITIES		
Royalties payable	252,475	299,020
Deferred rent	204,795	103,801
Bonds payable - net of unamortized debt issuance costs	47,837	46,895
Total other liabilities	505,107	449,716
STOCKHOLDERS' EQUITY		
Convertible preferred stock, Series A, 30,000 shares authorized, 26,739 shares issued and outstanding	229,900	229,900
Convertible preferred stock, Series B, 60,000 shares authorized, 59,653 and 43,013 shares issued and outstanding at December 31, 2019 and 2018, respectively	692,334	492,654
Common stock, 10 million shares authorized, 767,608 and 794,471 shares issued and outstanding at December 31, 2019 and 2018, respectively	1,038,292	1,262,626
Retained earnings (accumulated deficit)	(181,085)	251,465
Total stockholders' equity	1,779,441	2,236,645
Total liabilities and stockholders' equity	$ 6,688,153	$ 6,575,926

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

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended December 31, 2019 and 2018

	2019	2018
REVENUES		
Print sales - net	$ 7,694,718	$ 7,645,378
Digital sales	1,644,605	1,807,554
Audio sales	449,280	454,530
Subsidiary rights	697,388	654,735
Other revenues	105,118	202,169
Total revenues	10,591,109	10,764,366
COST OF SALES		
Direct cost of goods sold	2,025,083	1,832,831
Royalties	1,811,721	1,870,228
Amortization of prepublication costs of producing inventories	945,306	659,094
Other	334,639	33,689
Total cost of sales	5,116,749	4,395,842
Gross profit	5,474,360	6,368,524
OPERATING EXPENSES		
Finance and operations	1,960,593	2,012,731
Marketing	1,755,119	1,705,079
Editorial	399,042	613,668
Distribution	977,634	962,769
International sales and business development	526,820	559,775
General production expenses	82,792	120,301
Depreciation and amortization	70,811	54,614
Total operating expenses	5,772,811	6,028,937
(Loss) income from operations	(298,451)	339,587
OTHER INCOME (EXPENSES)		
Interest expense	(84,687)	(61,346)
Other income	-	19,194
Total other expense	(84,687)	(42,152)
(Loss) Income before provision for income taxes	(383,138)	297,435
Provision for income taxes	(24,989)	66,788
NET (LOSS) INCOME	$ (358,149)	$ 230,647

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

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2019 and 2018

	Preferred Stock- Series A		Preferred Stock- Series B		Common Stock		Retained Earnings (Accumulated Deficit)	Total
	Shares	Amount	Shares	Amount	Shares	Amount		
Balance - January 1, 2018	26,739	$ 229,900	43,013	$ 492,654	803,970	$ 1,355,671	$ 61,517	$ 2,139,742
Shares repurchased from current shareholders	-	-	-	-	(9,249)	(93,045)	-	(93,045)
Preferred stock dividends - Series A	-	-	-	-	-	-	(20,054)	(20,054)
Preferred stock dividends - Series B	-	-	-	-	-	-	(20,645)	(20,645)
Net income	-	-	-	-	-	-	230,647	230,647
Balance - December 31, 2018	26,739	229,900	43,013	492,654	794,721	1,262,626	251,465	2,236,645
Shares repurchased from current shareholders	-	-	-	-	(5,529)	(58,612)	-	(58,612)
Shares converted from Common stock to Series B	-	-	16,640	199,680	(24,960)	(199,680)	-	-
Preferred stock dividends - Series A	-	-	-	-	-	-	(20,054)	(20,054)
Preferred stock dividends - Series B	-	-	-	-	-	-	(20,693)	(20,693)
Common stock dividend - Series 2	-	-	-	-	-	-	(33,654)	(33,654)
ESOP contribution	-	-	-	-	3,376	33,958	-	33,958
Net Loss	-	-	-	-	-	-	(358,149)	(358,149)
Balance - December 31, 2019	26,739	$ 229,900	59,653	$ 692,334	767,608	$ 1,038,292	$ (181,085)	$ 1,779,441

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

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (358,149)	$ 230,647
Adjustments to reconcile net (loss) income to net cash from operating activities:		
Depreciation and amortization	1,015,175	712,766
Amortization of debt issuance costs	942	942
Impairment of prepublication costs	-	-
Deferred taxes	(46,200)	(255,200)
Changes in operating assets and liabilities:		
Accounts receivable - net	450,949	(358,159)
Inventories - net	30,573	(485,799)
Prepublication costs of producing inventories	(1,275,286)	(827,490)
Other current assets	(250,197)	50,792
Royalty advances and other assets	(33,950)	16,615
Outstanding checks - not yet cleared	121,079	-
Accounts payable	(193,479)	213,489
Accrued liabilities	(147,418)	151,292
Reserve for returns - discontinued distributor	(641,000)	641,000
Reserve for returns - general	(95,833)	85,833
Deferred revenue	(12,267)	12,267
Royalties payable	(461,093)	436,527
Deferred rent	71,840	(19,224)
Net cash (used in) provided by operating activities	(1,824,314)	606,298
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furniture and equipment	(35,918)	(56,363)
Net cash used in investing activities	(35,918)	(56,363)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments on) note payable - bank	1,755,100	(412,668)
Proceeds from notes payable - related party	200,000	-
Stock repurchase	(58,612)	(93,045)
Dividends to common stockholders	(33,654)	-
Dividends to preferred stockholders	(35,229)	(40,223)
Net cash provided by (used in) financing activities	1,827,605	(545,936)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(32,627)	3,999
CASH AND CASH EQUIVALENTS - beginning of year	147,096	143,097
CASH AND CASH EQUIVALENTS - end of year	$ 114,469	$ 147,096
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	$ 85,557	$ 61,346
Income taxes	$ 8,043	$ 162,174
Non-cash transaction		
Contribution of common stock to ESOP	$ 33,958	$ -
Conversion of common stock to series B preferred stock	$ 199,680	$ -

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

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company

The Berrett-Koehler Group, Inc. (BKG) is a holding company whose wholly-owned subsidiary is Berrett-Koehler Publishers, Inc. (BKP) (collectively "the Company"). Both BKG and BKP Corporations were formed in the state of California. The Company publishes resource materials (primarily hardcover books, paperback books, digital books, and other digital resources) in a range of areas, including business, economics, leadership, management, organizational change, human resource development, work and careers, personal development, self-help, current affairs, societal change, and sustainable development. The Company sells its products to customers primarily through domestic and international distributors, bookstores, internet sales, conference and meeting displays, promotions by authors, catalog marketers, direct corporate sales, direct mail and email marketing to customers, other online and digital marketing, subsidiary rights sales, and other similar means.

Principles of Consolidation

The consolidated financial statements include the accounts of BKG and its wholly-owned subsidiary, BKP. All material intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses in the consolidated financial statements and accompanying notes. Significant estimates in the accompanying consolidated financial statements include the allowance for doubtful accounts, allowance for slow and obsolete inventories, reserve for returns, and the amortization of prepublication costs. Actual results could differ from those estimates.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and receivables. Risks associated with cash and cash equivalents are mitigated by banking with creditworthy institutions. Such balances with any one institution may, at times, be in excess of federally insured amounts (currently $250,000 per depositor). The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Concentrations of Credit Risk (continued)

The Company performs ongoing credit evaluations of its distributors and customers and generally does not require collateral. The Company maintains reserves for potential credit losses and such losses have been within management's expectations. The Company had sales through two distributors that generated 61% and 82%, respectively, of its total revenue for the years ended December 31, 2019 and 2018, respectively. At December 31, 2019 and 2018, the Company had accounts receivable due from one distributor that accounted for 55% and 54%, respectively, of its total accounts receivable.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all short-term highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents. At December 31, 2019 and 2018, there were no cash equivalents.

Prepublication Costs of Producing Inventories

Prepublication costs of producing inventories include certain expenditures for the development of print products, including editorial development of publications and design and production management. The prepublication costs are assigned to each individual publication by effort expended, based on management's assessment. These costs are incurred and capitalized prior to the commencement of printing, and are amortized over three years using the double-declining balance method of amortization (refer to Note 6).

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at net realizable value. An allowance for uncollectible accounts reflects management's estimate of probable losses inherent in the accounts receivable balance. Management primarily determines the allowance based on the aging of accounts receivable balances and historical experience. Delinquent accounts are written-off when it is determined that the amounts are uncollectible. Finance charges are recorded as income when received. The Company generally does not require collateral, but has the ability to file liens for outstanding receivables.

Inventories

Inventories are stated at the lower of cost (on the average cost basis) or net realizable value and include finished books and work-in-process.

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment

Property and equipment acquisitions in excess of $500 are recorded at cost, less accumulated depreciation. Leasehold improvements are recorded at cost and amortized over the improvements' estimated useful lives or the life of the lease, whichever is shorter. Repairs and maintenance are expensed as incurred. Depreciation is provided using the straight-line method over the following estimated useful lives:

Office furniture and equipment	3 - 7 years
Computer equipment	3 years
Computer software	3 years
Leasehold improvements	7 years

Deferred Rent

The Company's office lease contains predetermined fixed increases of the minimum rental rate over the term of the lease. The Company recognizes the related rental expense on a straight-line basis over the life of the lease and records the difference between rent expense and the amount paid as deferred rent.

Revenue Recognition

In the year ended December 31, 2019, the Company adopted the provisions of ASC 606 "Revenue from Contracts with Customers" issued by the Financial Accounting Standards Board using the modified retrospective method (refer to Note 2).

Revenues primarily result from the Company's sales of print books, subsidiary rights, digital products and events. Revenue recognition is evaluated through the following five steps: (i) identification of the contract or contracts with a customer; (ii) identification of the performance obligations in the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price in the contract; and (v) recognition of revenue when or as a performance obligation is satisfied.

Revenues from print and digital products are recognized at a point in time, upon transfer of control of promised products and/or services to customers in amounts that reflect the consideration the Company expects to receive in exchange for those products and services.

Sales of print products are recorded when merchandise is shipped to customers by the Company or its distributors, net of an allowance for estimated returns (see Policy for Reserves for Returns below).

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition (continued)

Sales of digital products are recorded when digital files are delivered to customers by the Company or its distributors. Sales of audio products are recorded when digital files or merchandise are delivered to customers by the Company or its distributors. There are no variable considerations related to sales of print, audio, or digital products.

Subsidiary rights revenues are recorded over time when the Company becomes entitled to consideration as a result of usage of such rights by the Company's subsidiary rights customers. Nonrefundable advances received for subsidiary rights are generally recorded as revenue at the time the contract is signed.

Revenue from seminars, which is presented as other income on the statement of operations, are recorded when seminars are provided. Payments received in advance are deferred.

Payment terms vary depending on the customer's risk profile to the Company and are typically due in 30 days. There were no significant financing components in contracts for the years ended December 31, 2019 and 2018.

Reserve for Returns

Estimated returns are determined based on actual returns that are known and those reasonably estimated by Company based on the most recent historical experience. At December 31, 2019 and 2018, the Company had a returns reserve of approximately $165,000 and $902,000, respectively. At December 31, 2019 and 2018, the reserve consisted entirely of print sales.

The Company discontinued its relationship with its primary trade distributor (Ingram Publishers Services) in 2018 as part of a long-planned transition to distribution by Penguin Random House Publishers Services. The Company incurred significant, expected returns as a result of this transition and planned for those returns by establishing an appropriate reserve for returns at December 31, 2018. Such returns were completed in 2019, and no remaining returns from the discontinued distributor are expected.

Shipping and Handling

For the years ended December 31, 2019 and 2018, shipping and handling costs of $201,791 and $277,478, respectively, were expensed as incurred.

Advertising and Promotion Costs

The Company expenses advertising and promotion costs as incurred.

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Royalty Costs

Royalties are charged to cost of sales when the sale of a book occurs. These costs are predetermined by the arrangements made between the Company and the author. Royalties payable are presented net of allowance for returns.

Debt Issuance Costs

Debt issuance costs consist of origination charges and other fees incurred in connection with issuing bonds. These costs are netted against bonds payable and amortized over the debt term (refer to Note 9).

Income Taxes

The Company recognizes deferred tax assets and liabilities for future tax consequences of events that have been previously recognized in the Company's consolidated financial statements or tax returns. Deferred tax assets are recognized for deductible temporary differences, with a valuation allowance established against the resulting assets to the extent it is more likely than not that the related tax benefit will not be realized. Foreign amounts relate to taxes paid on international sales which created federal deferred tax assets (refer to Note 14). The measurement of deferred tax assets and liabilities is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The Company classifies all the deferred tax assets and liabilities as noncurrent on the Company's consolidated balance sheets.

Each year, management considers whether any material tax position the Company has taken is more likely than not to be sustained upon examination by the applicable taxing authority. Management believes that any positions the Company has taken are supported by substantial authority and, hence, do not need to be measured or disclosed in the attached consolidated financial statements.

Recent Accounting Pronouncements

The FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02") for lease accounting to increase transparency and comparability among companies by requiring the recognition of lease assets and lease liabilities by lessees. The new standard will be effective for the Company for the year ending December 31, 2022, and early adoption is permitted. The Company is currently evaluating the timing of its adoption and its impact on its consolidated financial statements.

Reclassification of Prior Year Presentation

Certain amounts related to royalty advances and accrued liabilities have been reclassified to conform to the presentation of the current period consolidated financial statements. These reclassifications had no effect on the previously reported net income.

1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsequent Events

The Company has evaluated subsequent events through July 28, 2020 which represents the date the consolidated financial statements were available to be issued.

2. NEW ACCOUNTING PRONOUNCEMENT

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which replaces most existing revenue recognition guidance in U.S. GAAP. The Company has adjusted the presentation of its consolidated financial statements accordingly (refer to Note 1, Revenue Recognition).

The core principle of ASC 606 is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. Revenue is recognized when control of the promised goods or services is transferred to customers. ASC 606 also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments used (refer to Note 1). The Company adopted ASC 606 effective January 1, 2019, using the modified retrospective method. The adoption of ASC 606 did not have a material effect on the Company's consolidated financial position or results of operations and there was no cumulative effect adjustment to the opening balance of retained earnings as of January 1, 2019 and 2018 as a result of ASC 606 implementation.

3. LIQUIDITY AND MANAGEMENT'S PLANS

Pursuant to Accounting Standards Update No. 2014-15, Presentation of Financial Statement Going Concern (Subtopic 205-40), management evaluates the Company's ability to continue as a going concern for one year after the date of the financial statements are available for issuance.

For the year ended December 31, 2019, the Company had negative operating cash flows of approximately $1,824,000, including $641,000 non-recurring effect of expected sales returns from a discontinued distributor as described in Note 1, Reserve for Returns. This amount was accrued at December 31, 2018 and was reflected in the results of operations in 2018; it was fully settled in 2019. At December 31, 2019, the accumulated deficit was approximately $181,000 and there was a net loss of approximately $358,000. The Company relies on its line of credit to finance its operations; the line of credit is subject to various covenants and matures in February 2021 (refer to Note 8). In addition, the Company has been adversely affected by the global pandemic from COVID 19 (refer to Note 16).

3. LIQUIDITY AND MANAGEMENT'S PLANS (continued)

Management considered these conditions and events to be significant and has implemented the following plans to mitigate the impact of the loss and COVID-19:

1. In 2020, the Company raised $858,500 in cash in a Series C Preferred Stock offering and is planning to issue additional stock to accommodate several purchasing offers it has already fielded from additional investors (refer to Note 16).
2. The Company received $10,000 (fully forgiven) and expects to receive an additional $140,000 from the Federal Economic Injury and Disaster Loan program.
3. The Company received a Paycheck Protection Program ("PPP") loan, in the amount of $691,883, under the CARES ACT. Management expects the entire amount of the loan to be forgiven.
4. Salaries of 33 full-time and part-time employees were reduced by 5-10% as of January 1, 2020.
5. The Company has been approved for the California Work Sharing Program, designed to reduce payroll expenses, avoid layoffs, and speed recovery. It launched participation in this program in July, 2020.
6. Inventory processes were modified to reduce excessive inventory purchases in an effort to improve cash flow.

Management believes the above actions and plans to be effective and expects to have sufficient availability under its line of credit and sufficient liquidity for the period of at least twelve months from July 28, 2020. Whereas management has been successful to date in carrying out its plan to improve its liquidity position, the Company's ability to continue improving its financial position significantly depends on its ability to meet sales forecast, obtain PPP loan forgiveness, and renew its line of credit when it becomes due in February 2021 (refer to Note 8), and there can be no assurance that the Company will be successful in accomplishing these objectives.

4. ACCOUNTS RECEIVABLE

At December 31, 2019 and 2018 accounts receivable were as follows:

	2019	2018
Accounts receivable	$ 1,543,533	$ 1,996,482
Less- allowance for doubtful accounts	(74,000)	(76,000)
Accounts receivable - net	$ 1,469,533	$ 1,920,482

Accounts receivable are pledged as security for certain indebtedness (refer to Note 8).

5. INVENTORIES

At December 31, 2019 and 2018 inventories consisted of the following:

	2019	2018
Finished goods - net	2,578,574	2,619,600
Work-in-process	255,850	245,397
Total inventories - net	2,834,424	2,864,997

Inventories are pledged as security for certain indebtedness (refer to Note 8) and are presented net of expected write-offs for unsellable items of $199,447 and $107,000 at December 31, 2019 and 2018, respectively.

6. PREPUBLICATION COSTS OF PRODUCING INVENTORIES

At December 31, 2019 and 2018, prepublication costs of producing inventories were as follows:

	2019	2018
Editorial costs	$ 3,133,955	$ 2,220,852
Production costs	1,779,829	1,417,646
	4,913,784	3,638,498
Less: accumulated amortization	(3,903,596)	(2,958,290)
	1,010,188	680,208
Less: current portion	(700,083)	(120,941)
	$ 310,105	$ 559,267

For the years ended December 31, 2019 and 2018, amortization expense was $945,306 and $659,094, respectively, and was included in cost of sales.

7. PROPERTY AND EQUIPMENT

At December 31, 2019 and 2018, property and equipment consisted of the following:

	2019	2018
Office furniture and equipment	$ 251,907	$ 251,907
Computer equipment	592,176	578,572
Computer software	94,753	94,753
Leasehold improvements	120,527	98,212
	1,059,363	1,023,444
Less: accumulated depreciation	(941,443)	(871,573)
	$ 117,920	$ 151,871

For the years ended December 31, 2019 and 2018 depreciation expense was $69,869 and $53,672, respectively. Certain assets are pledged as security for certain indebtedness (refer to Note 8).

8. NOTE PAYABLE - BANK

The Company has a credit line agreement with a financial institution in the amount of $2,200,000, which matures on February 10, 2021. The line bears interest at the prime rate (4.750% per annum at December 31, 2019), plus 0.5% per annum. At December 31, 2019 the effective interest rate on the line of credit was 5.25%. The line is secured by certain assets of the Company and is subject to certain financial covenants, as defined. At December 31, 2019, the Company was not in compliance with the current ratio covenant, and the bank waived this event of noncompliance. At December 31, 2019 and 2018, the outstanding balance on the line of credit was $1,759,945 and $4,845, respectively.

Towards the end of the 2018 year, the Company received approximately $1,190,000 from its discontinued distributor; therefore, its borrowings under the line amounted to only $4,845. The amount received from the former distributor was spent in its entirety during 2019 as returns from that distributor were applied against the payment from the new distributor. At December 31, 2019, the increase in the line of credit amount of $1,759,945 resulted from the Company funding its operations along with starting to make semi-annual royalty payments in the fall of 2019, which accelerated its payments of approximately $300,000 in royalties into the 2019 year. At December 31, 2019, and at July 28, 2020, $440,055 and approximately $200,000 was available to borrow on the line respectively.

9. BONDS PAYABLE

In 2012, the Company conducted a private offering in which it offered to its stockholders and other defined groups up to $475,000 in unsecured, interest-bearing corporate bonds of the Company. The interest rate on the bonds is 4% per annum, and provides for interest only payments on January 15 of each year, covering the interest accrued during the previous calendar year. All outstanding principal, and interest accrued from the previous payment through December 31, 2032, will be due and payable no later than January 15, 2033.

The bonds may be redeemed without penalty at any time after December 31, 2017 by the Company paying the bondholder the principal amount of the bond plus interest accrued though the date of redemption. The bonds are subordinated to any bank debt.

At December 31, 2019 and 2018, bonds payable are as follows:

	2019	2018
Bonds payable	$ 60,000	$ 60,000
Unamortized debt issuance costs	(12,163)	(13,105)
	$ 47,837	$ 46,895

For the years ended December 31, 2019 and 2018, amortization of the debt issuance costs was $942.

10. CAPITAL STOCK

In July 2012, the Company amended and restated its Articles of Incorporation which authorized the Company to issue two classes of stock designated as “common stock” and “preferred stock”, respectively, with total authorized shares of 10,000,000 and 90,000, respectively. Of the preferred stock, 30,000 shares are designated Series A and 60,000 shares are designated Series B.

Each share of preferred stock is entitled to receive on July 1 of each year, in preference to holders of any other stock of the Company, out of legally available funds, cumulative cash dividends. The Series A preferred stockholders are entitled to dividends at a per annum rate of the prime interest rate, as defined, plus 3.25%, subject to a minimum rate of 7.5% and a maximum rate of 15% per annum applied to the original issue price of $10 per share, subject to adjustments for stock dividends, stock splits, and other similar transactions. The Series B preferred stockholders are entitled to dividends at a per annum rate of 4% per annum applied to the original issue price of $12 per share, subject to adjustments for stock dividends, stock splits, and other similar transactions.

10. CAPITAL STOCK (continued)

The preferred stock is convertible, at the option of the holder, into common stock, and each preferred stockholder shall be entitled to one vote for each share of common stock into which such preferred stock is converted. Each share of preferred stock shall be automatically converted into shares of common stock upon the election of at least 60% of the holders of the stock, or upon the closing of a public offering, which results in aggregate gross proceeds of at least $30 million. At any time after two years from the original issue date of the preferred stock, the Company may redeem such stock by paying the original issue price (adjusted for stock dividends, combinations, splits, recapitalizations and the like) plus any accrued but unpaid dividends. No shares of preferred stock acquired by the Company may be reissued.

In 2019, 24,960 common shares were converted to 16,640 series B Preferred Shares.

Upon liquidation of the Company, the preferred stockholders are entitled to receive an amount equal to the original issuance price per share plus all accrued and unpaid dividends on such shares. The preferred stock has preference as to dividends and liquidation value upon dissolution or winding up of the Company. Liquidation value of the Series A preferred stock was $278,086 and $275,167 at December 31, 2019 and 2018, respectively. The liquidation value of the Series B preferred stock was $730,153 and $527,874 at December 31, 2019 and 2018, respectively.

Subsequent to year end the Company authorized and issued 100,000 shares of Series C preferred stock (refer to Note 16).

Stock Repurchase

During 2019 and 2018, the Company repurchased 5,529 and 9,249 shares of common stock at $10.60 and $10.06 per share, respectively, from its shareholders (refer to Note 11).

ESOP Contribution

During 2019, the Company contributed 3,376 shares of common stock to the ESOP.

Series 2 Stock Issuance

In December 2017, Common stockholders were provided the option to convert shares to Series 2 Common Stock. Effective January 2018, 142,537 shares of Common stock were converted into Series 2. In June 2019, all shares of Series 2 common stock were rescinded and converted back to Common stock. The Company paid dividends of $33,654 to Series 2 Common Stockholders for the period between January 2018 and June 2019.

11. EMPLOYEE STOCK OWNERSHIP PLAN

The Company established an employee stock ownership plan ("ESOP") effective January 1, 1996. The ESOP was designed to qualify for preferred tax treatment under Section 401 (a) of the Internal Revenue Code and to enable participating employees to share in the growth and prosperity of the Company. Under the ESOP, an Employee Stock Ownership Trust holds the investments of the Plan.

Upon termination, death, or retirement, distributions may be made in cash or shares of Company common stock. Under Federal income tax regulations, Company stock that is held by the ESOP and its participants and is not readily tradable on an established market, or is subject to trading limitations, includes a put option. The put option is a right to demand the Company to buy any shares of its stock distributed to participants for which there is no market. The put price is representative of the fair market value of the stock. The purpose of the put option is to ensure the participant has the ability to ultimately obtain cash.

Employer contributions to the ESOP are at the discretion of the Board of Directors. The Company contributed $33,958 to the ESOP for the year ended December 31, 2018. There was no contribution expense to the ESOP for the year ended December 31, 2019. During the years ended December 31, 2019 and 2018, the Company repurchased 5,529 and 9,249 shares of common stock from the ESOP, respectively. At December 31, 2019 and 2018, the ESOP held 81,105 and 86,634 shares, respectively.

12. 401(K) PROFIT SHARING PLAN

The Company has a 401(k) profit-sharing plan that is available to eligible employees. Employer contributions to the plan are at the discretion of the Board of Directors. The Company contributed $10,689 and $7,436 to the 401(k) profit sharing plan for the years ended December 31, 2019 and 2018, respectively.

13. COMMITMENTS AND CONTINGENCIES

In 2013, a group of the Company's authors, customers, employees, and other community members, including the Company's President, founded the Berrett-Koehler Foundation ("Foundation"), a non-profit organization. The Company's Board of Directors agreed to fund the Foundation with contributions determined at their discretion. For the years ended December 31, 2019 and 2018, the Company contributed $29,744 and $34,248 to the Foundation, based on prior year operating results. Such costs are included in the accompanying consolidated statement of income in finance and operations expense.

In September 2019, the Company entered into an office lease agreement which ends October 31, 2026. On each lease anniversary date, there is an annual 3% increase in rent until the end of the lease term. Total rent expense under the Company's operating lease was $355,887 and $321,463 for the years ended December 31, 2019 and 2018, respectively.

13. COMMITMENTS AND CONTINGENCIES (continued)

Future minimum lease commitments the under non-cancelable operating lease are as follows:

Year ending December 31,		
2020	$	275,030
2021		312,467
2022		639,013
2023		717,693
2024		739,224
Thereafter		1,411,684
	$	4,095,111

14. INCOME TAXES

At December 31, 2019 and 2018, deferred tax assets were comprised mostly of temporary differences related to various accrued liabilities, net operating loss carry-forwards and foreign tax credits.

At December 31, 2019 and 2018, the Company has foreign tax credits available of approximately $192,400 and $133,500, respectively, which are included in the deferred tax asset and expire over the period from 2018 to 2024. The Company has determined that there is no need for a valuation allowance at December 31, 2019 or 2018.

14. INCOME TAXES (continued)

For the years ended December 31, 2019 and 2018, the income tax (benefit) expense is as follows:

	2019	2018
Current income tax expense:		
Federal	$ 5,761	$ 234,304
State	(34,047)	51,390
Foreign	49,497	36,794
	21,211	322,488
Deferred income tax expense:		
Federal	(65,800)	(191,548)
State	34,200	(35,900)
Foreign	(14,600)	(28,252)
	(46,200)	(255,700)
Provision for income taxes	$ (24,989)	$ 66,788

15. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2019 and 2018, the Company recognized sales of $1.7 million and $1.8 million, respectively, from a company in which an officer of that company is a member of the Company's Board of Directors. Accounts receivable from this related party totaling $16,463 at December 31, 2018, are included in the accounts receivable balance in the accompanying consolidated balance sheets. There were no receivables from this related party as of December 31, 2019. Accounts payable to this related party totaling $1,000 and $2,000 at December 31, 2019 and 2018, respectively, are included in the accounts payable balances in the accompanying consolidated balance sheets.

During the year ended December 31, 2018, the Company incurred printing costs of $189,309 from another company in which an officer of that company is a member of the Company's Board of Directors. There were no printing costs for the year ended December 31, 2019.

During the years ended December 31, 2019 and 2018, the Company incurred office supply costs of $16,952 and $5,796, respectively from another company in which an officer of that company was formerly a member of the Company's Board of Directors. Accounts payable to this related party totaling $1,133 and $2,000 at December 31, 2019 and 2018, respectively, and are included in the accounts payable balances in the accompanying consolidated balance sheets.

15. RELATED PARTY TRANSACTIONS (continued)

The Company has bonds payable totaling $20,000 to the senior editor of the Company at December 31, 2019 and 2018.

On September 30, 2019 and October 11, 2019 the Company received two loans of $100,000 each from an individual serving on one of the Company's committees. The loans, which bear interest at 2.4% per annum, were due September 2020; however, subsequent to year end, one of the loans was converted into Series C preferred stock (refer to Note 16) and the due date of the other loan was changed to September 2021.

16. SUBSEQUENT EVENTS

Subsequent to December 31, 2019, the Company authorized and issued 100,000 shares of Series C Preferred Stock (refer to Note 10). The board also approved an additional 60,000 shares on July 14, 2020, which are pending shareholder approval. Consideration consisted of $858,500 in cash, $41,500 in lieu of services and royalties and $100,000 in lieu of principal from a note outstanding.

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout the United States. As a result, the Company has experienced a decline in sales, resulting in a negative impact to the results of its operations and its financial position. While the disruption is currently expected to be temporary, there is an uncertainty around the duration. It is reasonably possible that estimates made in the financial statements have been, or will be, materially and adversely impacted in the near term as a result of these conditions, such as expected credit losses on receivables.

While the Company expects this matter to negatively impact its business, results of operations, and financial position, the related financial impact cannot be reasonably estimated at this time. The Company applied for and received a loan under the Paycheck Protection Program, took significant cost cutting measures, filed a claim under its business interruption insurance to cover lease costs, and is seeking rent abatement or forbearance from its landlord (refer to Note 3). Management will continue to closely monitor the development and the effect of COVID-19 on the Company's operations and adjust its plans as necessary.