



Certified Public Accountants
and Financial Advisors

**THE BERRETT-KOEHLER GROUP, INC.
AND SUBSIDIARY**

Consolidated Financial Statements
December 31, 2018 and 2017

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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, 2018 and 2017, and the related consolidated statements of income, 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, 2018 and 2017, 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.

Report on Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidated statements of income and EBITDA for the years ended December 31, 2018 and 2017, (“supplemental information”), are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such supplemental information is the responsibility of management and was derived from and relates to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

SQUAR MILNER LLP

San Francisco, California
July 18, 2019

**THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017**

	2018	2017
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 147,096	\$ 143,097
Accounts receivable - net of allowances for doubtful accounts of \$76,000 and \$33,500 at December 31, 2018 and 2017, respectively	1,920,482	1,562,323
Inventories - net	2,864,997	2,379,198
Prepublication costs of producing inventories	120,941	363,534
Other current assets	52,298	103,090
Total current assets	5,105,814	4,551,242
NON-CURRENT ASSETS		
Furniture, equipment and leasehold improvements - net	151,871	149,180
Prepublication costs of producing inventories - net	559,267	148,280
Deferred tax assets	454,800	199,600
Deposits and other assets	324,174	340,789
Total non-current assets	1,490,112	837,849
Total assets	\$ 6,595,926	\$ 5,389,091
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 662,960	\$ 449,471
Accrued liabilities	602,127	450,835
Reserve for returns	901,833	175,000
Line of credit - bank	4,845	417,513
Royalties payable, current	1,676,884	1,370,757
Preferred stock dividends payable	19,495	19,019
Deferred revenue	12,267	-
Deferred rent, current	29,154	19,224
Total current liabilities	3,909,565	2,901,819
OTHER LIABILITIES		
Royalties payable	299,020	168,620
Deferred rent	103,801	132,955
Bonds payable - net of unamortized debt issuance costs	46,895	45,955
Total other liabilities	449,716	347,530
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, 43,013 shares issued and outstanding	492,654	492,654
Common stock, 10 million shares authorized, 794,471 and 803,720 shares issued and outstanding at December 31, 2018 and 2017, respectively	1,262,626	1,355,671
Retained earnings	251,465	61,517
Total stockholders' equity	2,236,645	2,139,742
Total liabilities and stockholders' equity	\$ 6,595,926	\$ 5,389,091

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
REVENUES		
Print sales - net	\$ 7,645,378	\$ 6,373,335
Digital sales	2,262,084	1,858,141
Subsidiary rights	654,735	763,572
Other revenues	<u>202,169</u>	<u>358,325</u>
Total revenues	<u>10,764,366</u>	<u>9,353,373</u>
COST OF SALES		
Direct cost of goods sold	1,832,831	1,572,267
Royalties	1,870,228	1,481,325
Amortization of prepublication costs of producing inventories	659,094	575,158
Other	<u>33,689</u>	<u>265,425</u>
Total cost of sales	<u>4,395,842</u>	<u>3,894,175</u>
Gross profit	<u>6,368,524</u>	<u>5,459,198</u>
OPERATING EXPENSES		
Finance and operations	2,012,731	1,704,772
Marketing	1,705,079	1,361,290
Editorial	612,760	707,870
Distribution	962,769	655,654
International sales and business development	559,775	532,977
General production expenses	120,301	89,689
Start-up costs related to BKpedia	908	78,057
Depreciation and amortization	<u>54,614</u>	<u>73,248</u>
Total operating expenses	<u>6,028,937</u>	<u>5,203,557</u>
Income from operations	<u>339,587</u>	<u>255,641</u>
OTHER INCOME (EXPENSES)		
Interest expense	(61,346)	(27,907)
Other income (expense)	<u>19,194</u>	<u>(17,981)</u>
Total other expense	<u>(42,152)</u>	<u>(45,888)</u>
Income before provision for income taxes	297,435	209,753
Provision for income taxes	<u>66,788</u>	<u>154,871</u>
NET INCOME	<u>\$ 230,647</u>	<u>\$ 54,882</u>

**THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2018 and 2017**

	Preferred Stock- Series A		Preferred Stock- Series B		Common Stock		Retained Earnings	Total
	Shares	Amount	Shares	Amount	Shares	Amount		
Balance - December 31, 2016	26,739	\$ 229,900	43,213	\$ 495,054	807,302	\$ 1,387,543	\$ 56,034	\$ 2,168,531
Shares repurchased from current shareholders	-	-	-	-	(4,282)	(34,272)	(8,700)	(42,972)
Preferred stock dividends - Series A	-	-	-	-	-	-	(20,054)	(20,054)
Preferred stock dividends - Series B	-	-	-	-	-	-	(20,645)	(20,645)
Shares converted from Series B to Common Shares	-	-	(200)	(2,400)	200	2,400	-	-
Shares issued in consideration for services provided	-	-	-	-	500	-	-	-
Net income	-	-	-	-	-	-	54,882	54,882
Balance - December 31, 2017	<u>26,739</u>	<u>229,900</u>	<u>43,013</u>	<u>492,654</u>	<u>803,720</u>	<u>1,355,671</u>	<u>61,517</u>	<u>2,139,742</u>
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	<u>26,739</u>	<u>\$ 229,900</u>	<u>43,013</u>	<u>\$ 492,654</u>	<u>794,471</u>	<u>\$ 1,262,626</u>	<u>\$ 251,465</u>	<u>\$ 2,236,645</u>

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 230,647	\$ 54,882
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	712,766	647,464
Amortization of debt issuance costs	942	942
Deferred taxes	(255,200)	51,900
Changes in assets and liabilities:		
Accounts receivable - net	(358,159)	(75,197)
Deferred rent	(19,224)	(9,583)
Deferred revenue	12,267	-
Inventories - net	(485,799)	(334,753)
Prepublication costs of producing inventories	(827,490)	(564,702)
Other current assets	50,792	74,703
Deposits and other assets	16,615	(32,363)
Accounts payable and other liabilities	364,781	10,903
Reserve for returns	726,833	175,000
Royalties payable	436,527	31,219
Net cash provided by operating activities	606,298	30,415
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furniture and equipment	(56,363)	(9,869)
Net cash used in investing activities	(56,363)	(9,869)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Payments on) proceeds from line of credit - net	(412,668)	172,295
Stock repurchase	(93,045)	(42,972)
Dividends to preferred stockholders	(40,223)	(42,474)
Net cash (used in) provided by financing activities	(545,936)	86,849
NET (DECREASE) INCREASE	3,999	107,395
CASH AND CASH EQUIVALENTS - beginning of year	143,097	35,702
CASH AND CASH EQUIVALENTS - end of year	\$ 147,096	\$ 143,097
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	\$ 61,346	\$ 27,907
Taxes	\$ 162,174	\$ -

**THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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 collectability of receivables, allowance for slow and obsolete inventories, allowance 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.

**THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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 82% and 65%, respectively, of its total revenue for the years ended December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, the Company had accounts receivable due from one and two distributors that accounted for 54% and 64%, 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, 2018 and 2017, 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 4).

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.

**THE BERRETT-KOEHLER GROUP, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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:

Machinery and equipment	3 - 7 years
Software	3 years
Furniture and fixtures	7 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

Sales are recorded when merchandise is shipped, net of allowance for estimated returns, which is determined based on the Company's most recent historical experience. Nonrefundable advances received for subsidiary rights are generally recorded as revenue at the time the contract is signed, while ongoing rights revenue is generally recorded when the payments are received. Distributors are permitted to return unsold merchandise, subject to certain limitations. At December 31, 2018 and 2017, the Company had a returns reserve of approximately \$902,000 and \$175,000, respectively. Revenue from seminars is recorded when seminars are provided; payments received in advance are deferred.

Shipping and Handling

Shipping and handling costs of \$277,478 and \$160,250 for the years ended December 31, 2018 and 2017, respectively, were expensed as incurred.

Advertising and Promotion Costs

The Company expenses advertising and promotion costs as incurred.

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. At December 31, 2018 and 2017, royalties payable are presented net of allowance for returns.

THE BERRETT-KOEHLER GROUP, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

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

Debt Issuance Costs

Debt issuance costs consist of origination charges and other fees incurred in connection with issuing the bonds. These costs are netted against bonds payable and amortized over the debt term (refer to Note 7).

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 12). 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 Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). The new standard is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers. The new standard is effective for the Company for the year ending December 31, 2019. The Company is currently evaluating its impact on its consolidated financial statements.

The FASB also 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, 2020, 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 the reserve for returns 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.

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

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

Subsequent Events

The Company has evaluated subsequent events through July 18, 2019 which represents the date the consolidated financial statements were available to be issued.

2. ACCOUNTS RECEIVABLE

Accounts receivable are summarized as follows:

	<u>2018</u>	<u>2017</u>
Accounts receivable	\$ 1,996,482	\$ 1,595,823
Less- allowances for doubtful accounts	<u>(76,000)</u>	<u>(33,500)</u>
Total accounts receivable - net	<u>\$ 1,920,482</u>	<u>\$ 1,562,323</u>

Accounts receivable are pledged as security for certain indebtedness (refer to Note 6).

3. INVENTORIES

Inventories are summarized as follows:

	<u>2018</u>	<u>2017</u>
Finished goods - net	\$ 2,619,600	\$ 2,126,099
Work-in-process	<u>245,397</u>	<u>253,099</u>
Total inventories - net	<u>\$ 2,864,997</u>	<u>\$ 2,379,198</u>

Inventories are pledged as security for certain indebtedness (refer to Note 6). Inventories are presented net of expected write-offs for unsellable items of \$316,635 and \$252,935 at December 31, 2018 and 2017, respectively.

THE BERRETT-KOEHLER GROUP, INC.
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4. PREPUBLICATION COSTS OF PRODUCING INVENTORIES

Prepublication costs of producing inventories are summarized as follows:

	<u>2018</u>	<u>2017</u>
Editorial costs	\$ 2,220,852	\$ 1,658,114
Production costs	1,417,646	1,152,895
	<u>3,638,498</u>	<u>2,811,009</u>
Less: accumulated amortization	<u>(2,958,290)</u>	<u>(2,299,195)</u>
	680,208	511,814
Less: current portion	<u>(120,941)</u>	<u>(363,534)</u>
	<u>\$ 559,267</u>	<u>\$ 148,280</u>

Amortization expense was \$659,094 and \$575,158 for the years ended December 31, 2018 and 2017, respectively, and was included in cost of sales.

5. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2018</u>	<u>2017</u>
Office furniture and equipment	\$ 251,907	\$ 251,907
Computer equipment	578,572	522,209
Computer software	94,753	94,753
Leasehold improvements	98,212	98,212
	<u>1,023,444</u>	<u>967,081</u>
Less: accumulated depreciation	<u>(871,573)</u>	<u>(817,901)</u>
	<u>\$ 151,871</u>	<u>\$ 149,180</u>

Depreciation expense was \$53,672 and \$72,306 for the years ended December 31, 2018 and 2017, respectively. Certain assets are pledged as security for certain indebtedness (refer to Note 6).

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6. LINE OF CREDIT

The Company has a credit line agreement with a financial institution in the amount of \$2,200,000, which matures on November 13, 2019. The line bears interest at the prime rate (5.50% per annum, at December 31, 2018), plus 0.5% per annum. At December 31, 2018 the effective interest rate on the line of credit was 6%. The line is secured by certain assets of the Company and is subject to certain financial covenants, as defined. At December 31, 2018 and 2017, the outstanding balance on the line of credit was \$4,845 and \$417,513, respectively.

7. BONDS PAYABLE

On August 1, 2012, the Company initiated 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 through the date of redemption. The bonds are subordinated to any bank debt.

Bonds payable are as follows at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Bonds payable	\$ 60,000	\$ 60,000
Unamortized debt issuance costs	<u>(13,105)</u>	<u>(14,045)</u>
	<u>\$ 46,895</u>	<u>\$ 45,955</u>

For the years ended December 31, 2018 and 2017, amortization of the debt issuance costs was \$942.

THE BERRETT-KOEHLER GROUP, INC.
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8. 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, respectively, "common stock" and "preferred stock", 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% 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% applied to the original issue price of \$12 per share, subject to adjustments for stock dividends, stock splits, and other similar transactions.

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 2017, 200 series B Preferred Shares were converted to common 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 \$275,167 at December 31, 2018 and 2017. The liquidation value of the Series B preferred stock was \$527,874 and \$527,398 at December 31, 2018 and 2017, respectively.

Stock Repurchase

During 2018 and 2017, the Company repurchased 9,249 and 10,116 shares of common stock at \$10.06 and \$10.03 per share, respectively, from its shareholders. During 2017, the Company contributed 5,834 shares of common stock to the ESOP (refer to Note 9).

**THE BERRETT-KOEHLER GROUP, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017**

9. 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 \$84,838 and \$33,958 to the ESOP for the years ended December 31, 2018 and 2017, respectively. During the years ended December 31, 2018 and 2017, the Company repurchased 9,249 and 4,282 shares of common stock from the ESOP, respectively. During the year ended December 31, 2017, the ESOP purchased 5,834 shares of common stock from the Company. At December 31, 2018 and 2017, the ESOP held 86,634 and 95,883 shares, respectively.

10. 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 \$7,436 and \$2,625 to the 401(k) profit sharing plan for the years ended December 31, 2018 and 2017, respectively.

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

11. 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, 2018 and 2017, the Company contributed \$34,248 and \$24,954 to the Foundation, based on prior year operating results. Such costs are included in the accompanying consolidated statement of income in finance and operations expenses.

In September 2014, the Company entered into an office lease agreement which ends March 31, 2022. 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 \$321,463 and \$331,111 for the years ended December 31, 2018 and 2017, respectively.

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

<u>Year ending December 31,</u>	
2019	\$ 340,951
2020	351,180
2021	361,715
2022	<u>92,448</u>
	<u>\$ 1,146,294</u>

12. INCOME TAXES

At December 31, 2018 and 2017, deferred tax assets were comprised mostly of temporary differences related to various accrued liabilities and foreign tax credits.

At December 31, 2018 and 2017, the Company has foreign tax credits available of approximately \$133,500 and \$85,000, respectively, which are included in the deferred tax asset and expire over a period from 2017 to 2023. The Company has determined that there is no need for a valuation allowance at December 31, 2018 or 2017.

THE BERRETT-KOEHLER GROUP, INC.
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12. INCOME TAXES (continued)

Income tax expense for the years ended December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Current income tax expense		
Federal	\$ 234,304	\$ 38,395
State	51,390	10,472
Foreign	36,794	(2,896)
	<u>322,488</u>	<u>45,971</u>
Deferred income tax expense		
Federal	(191,548)	72,300
State	(35,900)	21,600
Foreign	(28,252)	15,000
	<u>(255,700)</u>	<u>108,900</u>
Provision for income tax expense	<u>\$ 66,788</u>	<u>\$ 154,871</u>

On December 22, 2017, Tax Cuts and Jobs Act tax reform legislation was signed into law. This legislation makes significant changes in U.S. tax law, including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks, and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 34% to 21%. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the rate in effect during their scheduled reversal. This revaluation resulted in an increase in the 2017 income tax provision of \$57,000 from continuing operations and a corresponding reduction in the deferred tax asset. The other provisions of the Tax Cuts and Jobs Act did not have a material impact on the financial statements.

THE BERRETT-KOEHLER GROUP, INC.
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December 31, 2018 and 2017

13. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2018 and 2017, the Company recognized sales of \$1.8 million and \$1.9 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 and \$204,692 at December 31, 2018 and 2017, respectively, are included in the accounts receivable balances in the accompanying consolidated balance sheets. Accounts payable to this related party totaling \$2,000 and \$4,500 at December 31, 2018 and 2017, respectively, are included in the accounts payable balances in the accompanying consolidated balance sheets.

During the year ended December 31, 2017, the Company incurred IT support costs of \$57,288, from another company in which an officer of that company is a member of the Company's Board of Directors. There were no such IT support costs incurred during the year ended December 31, 2018.

During the year ended December 31, 2018 and 2017, the Company incurred printing costs of \$189,309 and \$588,649, respectively, from another company in which an officer of that company is a member of the Company's Board of Directors. Accounts payable to this related party totaling \$41,312 at December 31, 2017, are included in the accounts payable balances in the accompanying consolidated balance sheets. There were no such accounts payable to the member at December 31, 2018.

During the years ended December 31, 2018 and 2017, the Company incurred office supply costs of \$5,796 and \$5,743, respectively, from another company in which an officer of that company is a member of the Company's Board of Directors. Accounts payable to this related party totaling \$2,000 and \$106 at December 31, 2018 and 2017, respectively, are included in the accounts payable balances in the accompanying consolidated balance sheets.

The Company has bonds payable totaling \$20,000 to the President of the Company at December 31, 2018 and 2017.

SUPPLEMENTAL INFORMATION

THE BERRETT-KOEHLER GROUP, INC.
AND ITS WHOLLY-OWNED SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME AND EBITDA
For the Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
REVENUES		
Print sales - net	\$ 7,645,378	\$ 6,373,335
Digital sales	2,262,084	1,858,141
Subsidiary rights	654,735	763,572
Other revenues	202,169	358,325
Total revenues	<u>10,764,366</u>	<u>9,353,373</u>
COST OF SALES		
Direct cost of goods sold	1,832,831	1,572,267
Royalties	1,870,228	1,481,325
Amortization of prepublication costs of producing inventories	659,094	575,158
Other cost of sales	33,689	265,425
Total cost of sales (excluding amortization)	<u>4,395,842</u>	<u>3,894,175</u>
Gross profit	<u>6,368,524</u>	<u>5,459,198</u>
OPERATING EXPENSES		
Finance and operations	2,012,731	1,704,772
Marketing	1,705,079	1,361,290
Editorial	612,760	707,870
Distribution	962,769	655,654
International sales and business development	559,775	532,977
General production expenses	120,301	89,689
Start-up costs related to Bkpedia	908	78,057
Total operating expenses (excluding depreciation)	<u>5,974,323</u>	<u>5,130,309</u>
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	394,201	328,889
Depreciation	54,614	73,248
Interest and other expenses	<u>42,152</u>	<u>45,888</u>
Income before provision for income taxes	297,435	209,753
Provision for income taxes	<u>66,788</u>	<u>154,871</u>
NET INCOME	<u>\$ 230,647</u>	<u>\$ 54,882</u>