

inc.jet Holding, Inc.
CONSOLIDATED
FINANCIAL STATEMENTS

Years Ended March 31, 2018 and 2017

inc.jet Holding, Inc.

March 31, 2018 and 2017

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Independent Auditor's Report

To the Board of Directors and Stockholders
inc.jet Holding, Inc.

We have audited the accompanying consolidated financial statements of inc.jet Holding, Inc. (formerly known as Gunther International Ltd.) and subsidiary, which comprise the consolidated balance sheets as of March 31, 2018 and 2017, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended, and the related notes to the 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 audit 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 entity'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 entity'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 inc.jet Holding, Inc. and subsidiary as of March 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.

Hartford, Connecticut
June 22, 2018

inc.jet Holding, Inc
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	<u>March 31, 2018</u>	<u>March 31, 2017</u>
Assets		
Current assets:		
Cash	\$ 623	\$ 573
Accounts receivable, less allowance of \$42 in 2018 and \$88 in 2017	1,309	1,072
Current portion of receivable from sale of Mail Inserting segment	300	-
Inventories	985	897
Assets of discontinued operations	-	7,024
Prepaid expenses	256	301
Total current assets	<u>3,473</u>	<u>9,867</u>
Equipment and leasehold improvements:		
Machinery and equipment	576	575
Furniture and fixtures	219	219
Leasehold improvements	-	4
	<u>795</u>	<u>798</u>
Accumulated depreciation and amortization	<u>(633)</u>	<u>(600)</u>
	<u>162</u>	<u>198</u>
Patents, net of amortization of \$112 in 2018 and \$107 in 2017	28	18
Long term portion of receivable from sale of Mail Inserting segment	1,150	-
Deferred income taxes	2,728	2,781
Total assets	<u>\$ 7,541</u>	<u>\$ 12,864</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 1,476	\$ 854
Accrued expenses	1,426	1,652
Deferred system revenue	13	11
Accrued interest due to Gunther Partners LLC - a related party	-	224
Current portion of note payable to Gunther Partners LLC – a related party	100	-
Current portion of capital lease obligation	5	6
Liabilities of discontinued operations	-	3,473
Total current liabilities	<u>3,020</u>	<u>6,220</u>
Notes payable to Gunther Partners LLC- a related party	3,200	3,400
Capital lease obligation, less current portion	-	5
Total long-term liabilities	<u>3,200</u>	<u>3,405</u>
Total liabilities	<u>6,220</u>	<u>9,625</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred Stock, \$.001 par value: 500,000 shares authorized; none issued	-	-
Common stock, \$.001 par value: 32,000,000 shares authorized; 19,767,435 shares issued and outstanding	20	20
Additional paid-in capital	19,951	19,951
Accumulated deficit	(18,650)	(16,732)
Total stockholders' equity	<u>1,321</u>	<u>3,239</u>
Total liabilities and stockholders' equity	<u>\$ 7,541</u>	<u>\$ 12,864</u>

See accompanying notes.

inc.jet Holding, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)

	Years Ended March 31,	
	2018	2017
Sales:		
Systems	\$ 4,976	\$ 4,987
Supplies	6,781	5,613
Total sales	<u>11,757</u>	<u>10,600</u>
Cost of sales:		
Systems	2,251	2,120
Supplies	<u>5,047</u>	<u>4,189</u>
Total cost of sales	<u>7,298</u>	<u>6,309</u>
Gross profit	<u>4,459</u>	<u>4,291</u>
Operating expenses:		
Selling and administrative	2,328	2,111
Research and development	<u>946</u>	<u>921</u>
Total operating expenses	<u>3,274</u>	<u>3,032</u>
Operating income	1,185	1,259
Interest expense	<u>48</u>	<u>24</u>
Income before income taxes	1,137	1,235
Income taxes	<u>1,104</u>	<u>543</u>
Net income from continuing operations	33	692
Loss from discontinued operations, net of tax	<u>(1,951)</u>	<u>(611)</u>
Net (loss) income	<u>\$ (1,918)</u>	<u>\$ 81</u>
Basic and diluted net income per share – continuing operations	\$ 0.00	\$ 0.04
Basic and diluted net loss per share – discontinued operations	<u>(0.10)</u>	<u>(0.03)</u>
Basic and diluted net (loss) income per share	<u>\$ (0.10)</u>	<u>\$ 0.01</u>
Weighted-average number of common shares outstanding	<u>19,767,435</u>	<u>19,767,435</u>

See accompanying notes.

inc.jet Holding, Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended March 31, 2018 and 2017
(Dollars in thousands)

	<u>Common Stock</u>		<u>Additional</u>		<u>Accumulated</u>			
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Capital</u>	<u>Deficit</u>		<u>Total</u>	
Balance, April 1, 2016	19,767,435	\$ 20	\$ 19,951	\$ (16,813)	\$ 3,158			
Net income	-	-	-	81	81			
Balance, March 31, 2017	19,767,435	20	19,951	(16,732)	3,239			
Net loss	-	-	-	(1,918)	(1,918)			
Balance, March 31, 2018	19,767,435	\$ 20	\$ 19,951	\$ (18,650)	\$ 1,321			

See accompanying notes.

inc.jet Holding, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Years Ended March 31,	
	2018	2017
Operating activities:		
Net (loss) income	\$ (1,918)	\$ 81
Net loss from discontinued operations	(1,951)	(611)
Net income from continuing operations	33	692
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	52	37
Deferred income taxes	641	113
Changes in operating assets and liabilities:		
Accounts receivable	(237)	(242)
Inventories	(89)	(91)
Prepaid expenses and other assets	45	23
Accounts payable	622	186
Accrued expenses	(226)	562
Accrued interest due to Gunther Partners LLC - a related party	(224)	(321)
Deferred system revenue	2	8
Net cash provided by operating activities - continued operations	619	967
Net cash used in operating activities - discontinued operations	(1,801)	(1,937)
Net cash used in operating activities	(1,182)	(970)
Investing activities:		
Purchase of equipment and leasehold improvements	(11)	(5)
Capitalized patents	(15)	-
Proceeds from sale of discontinued operations	1,737	-
Net cash provided by (used in) investing activities – continuing operations	1,711	(5)
Net cash used in investing activities – discontinued operations	(374)	(131)
Net cash provided by (used in) investing activities	1,337	(136)
Financing activities:		
Payments on notes payable to Gunther Partners LLC – a related party	(100)	(200)
Payments on capital leases	(5)	(16)
Net cash used in financing activities - continuing operations	(105)	(216)
Change in cash	50	(1,322)
Cash, beginning of year	573	1,895
Cash, end of year	\$ 623	\$ 573
Supplemental cash flow information:		
Receivable from sale of Mail Inserting segment	\$ 1,450	\$ -
Cash paid for interest including \$271 in 2018 and \$346 in 2017 to related parties	\$ 272	\$ 346
Cash paid for income taxes	\$ 37	\$ 26

See accompanying notes.

inc.jet Holding, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2018 AND 2017
(Dollars in thousands, except per share data)

1. Business and Operations

The operations of inc.jet Holding, Inc. (formerly Gunther International, Ltd.) and its wholly-owned subsidiary inc.jet, Inc. (together, the “Company”) consisted of two business segments: Mail Inserting and Ink Jet. The Mail Inserting segment designed, developed, assembled, marketed and serviced high-speed systems that automatically assemble printed documents, fold, staple or bind the documents and insert completed documents into appropriate envelopes for mailing or other distribution. The Ink Jet segment designs, develops, markets and services ink jet imagers as well as sells product into the packaging industry emphasizing product traceability. The Company’s products are dependent upon proprietary technology and require especially skilled engineers and technicians to design, enhance and produce them to meet customer needs. The Company operates from leased facilities located in Norwich, Connecticut.

On December 12, 2017, the Company signed an Asset Purchase Agreement to sell the assets of the Mail Inserting segment. The transaction closed on January 1, 2018. The Mail Inserting segment is classified as discontinued operations for all periods presented.

The sale will allow the Company to focus all its resources on the remaining Ink Jet segment.

2. Accounting Policies

Principles of consolidation -

The accompanying consolidated financial statements include the accounts of inc.jet Holding, Inc. and its wholly-owned subsidiary. All intercompany activity has been eliminated from the consolidated financial statements.

Cash -

Cash represents the amounts the Company has in accounts with a local banking institution. At times, cash deposits exceed federally insured limits.

Revenue recognition and accounts receivable -

The Company recognized revenues net of applicable sales taxes and related costs under sales contracts for its high-speed assembly equipment upon customer acceptance. Related accounts receivable were recognized as billings and were rendered under the terms of the sales contract. Accounts receivable for service contracts were recognized when billed and related revenue was recognized over the term of the contract; amounts applicable to future periods were deferred. Sales and related accounts receivable of ink jet imagers and consumables are recognized when the products are shipped and ownership transfers. No contract resulting in recognized revenue exists for a term greater than one year.

The Company had allowances for credit losses of \$42 at March 31, 2018 and \$88 at March 31, 2017. The Company evaluates the collectability of accounts receivable on an ongoing basis based on an assessment of the customers’ current financial condition, general economic conditions and past experience. The Company ages its accounts receivable based on the due date. The credit losses have been within management’s expectations.

Inventories -

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or net realizable value.

2. Accounting Policies - continued

Equipment and leasehold improvements -

Equipment and leasehold improvements are stated at cost. Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the respective assets as follows: machinery and equipment - 3 to 7 years; and furniture and fixtures - 7 years. Amortization of leasehold improvements is computed over the useful life of the improvement or lease terms, whichever is shorter. Amortization of production tooling is computed using the straight-line method over the useful life of the product that the tooling was designed to produce. Fully-depreciated assets no longer used in operations are written off. Depreciation of equipment and amortization of leasehold improvements was \$47 in 2018 and \$31 in 2017.

Patents -

Initial patent costs are amortized over 10 years. Renewal and maintenance costs are expensed as incurred. Patent expense was \$5 in 2018 and \$6 in 2017. Future patent amortization is expected to be \$5 for 2019, \$3 for 2020 through 2026 and \$2 for 2027 through 2028.

Shipping and handling costs -

Expenses associated with shipping and handling are included in cost of sales.

Research and development -

Expenses associated with research and development activities are expensed as incurred.

Foreign Exchange –

Some inventory items are purchased internationally from vendors whose financial transactions are accounted for in foreign currency. Increases or decreases in the value of the U.S. dollar compared to foreign currencies may negatively affect the value of these items in the Company's consolidated financial statements, even though their value has not changed in local currency. Expenses associated with foreign exchange are expensed as incurred. Such costs were not material for any period presented.

Sale and advertising costs -

Costs associated with sales, advertising and marketing activities are expensed as incurred. Such costs were not material for any period presented.

Product warranty -

The Company provides a warranty of up to 12 months on standard ink jet imagers or a lifetime warranty on managed ink jet imagers. The warranty expense and reserve follows:

Balance, April 1, 2016	\$	126
Accrual		79
Cost Incurred		<u>(57)</u>
Balance, March 31, 2017		148
Accrual		130
Cost Incurred		<u>(64)</u>
Balance, March 31, 2018	\$	<u>214</u>

2. Accounting Policies - concluded

Income taxes -

Deferred income taxes are provided on temporary differences between the financial statement and income tax basis of assets and liabilities and on net operating loss and research and development tax credit carryforwards using enacted tax rates in effect in the years in which differences are expected to reverse. A valuation allowance is recorded for the amount of deferred income tax assets for which realization is not likely in the near term.

Royalty expense -

The Company has royalty agreements with certain stockholders (see Note 10). Royalties due under these agreements are expensed as incurred.

Income per share -

Basic and diluted (loss) or income per share amounts are determined using the weighted-average outstanding common shares for both years. In all periods presented, there are no outstanding potentially dilutive securities.

Use of estimates -

The preparation of these 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 and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates are those related to the allowances for credit losses, slow moving and obsolete inventories and deferred income tax assets.

Fair value of financial instruments -

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company utilizes a fair value hierarchy which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The fair value hierarchy has three levels of inputs that may be used to measure fair value:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 Quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The Company's financial instruments include cash, accounts receivable, accounts payable, and notes payable. Due to their relative short-term nature, the carrying amounts for accounts receivable, accounts payable and accrued expenses are estimated to approximate fair value. The fair value of notes payable and related accrued interest was estimated at \$2,810 as of March 31, 2018 (\$2,552 as of March 31, 2017) based on Level 3 inputs for expected cash flows and current market conditions. The aggregate carrying value of the notes payable and related accrued interest was \$3,300 as of March 31, 2018 and \$3,624 as of March 31, 2017.

3. Inventories

Inventories consist of:

	March 31,	
	2018	2017
Materials and sub-assemblies	\$ 520	\$ 553
Work-in-process	51	41
Finished goods	414	303
	<u>\$ 985</u>	<u>\$ 897</u>

4. Capital Leases

The Company had capital leases for operating equipment, including two automobiles. The lease terms were 48 months and had interest rates ranging from 3.7% to 3.8%, and matured on April 2, 2018. The Company paid the balance of these capital leases on April 2, 2018. Equipment included \$25 as of March 31, 2018 and 2017 recorded under capital leases. Related accumulated depreciation was \$20 as of March 31, 2018 and \$14 as of March 31, 2017.

5. Related Party Debt

The Company has notes payable to Gunther Partners LLC, the Company's principal stockholder, aggregating \$3,300 as of March 31, 2018 and \$3,400 as of March 31, 2017. All of the aggregate amounts outstanding as of March 31, 2018 are due December 31, 2019 and bear interest equal to the short-term Applicable Federal Rate as issued by the Department of the Treasury. The Company has accrued interest due to Gunther Partners LLC aggregating \$0 and \$224 as of March 31, 2018 and March 31, 2017, respectively. Interest is payable at any time on or before the maturity date of the notes without compounding; however the Company intends to continue to make payments against the outstanding accrued interest. Also, early payments of principal and interest are allowed without premium or penalty. Subsequent to the current year end, the Company made principal payments of \$50 on April 30, 2018 and May 30, 2018. As such, \$100 of the notes payable to related party has been classified as current at March 31, 2018. No additional principal payments are currently expected to be made through March 31, 2019.

The Company recognized interest expense on the related party debt of \$47 and \$23 for 2018 and 2017, respectively. The Company paid interest of \$271 and \$345 for 2018 and 2017, respectively.

6. Related Party Transactions

The Company provided a system to a company controlled by a member of the Board of Directors. Labor and materials for repairs and maintenance to the system are billed to the customer and the processing fees for this system are billed on a per job basis. The system was returned resulting in no activity during 2018. The Company recognized revenue of \$11 in 2017 and had a receivable of \$4 as of March 31, 2017 from these transactions.

7. Debt

The Company had a Commercial Revolving Loan Agreement with Citizens Bank, which was closed on December 26, 2017, that provided for a Demand Note (the "Note") of \$1,000. Borrowings under the Note bore interest at 3.50% above the LIBOR Advantage Rate, as defined. Proceeds from the Note were to be used to finance working capital related to ongoing operations. Collateral for the note was substantially all of the Company's operating assets. There was no borrowing outstanding at March 31, 2017.

8. Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act makes broad and complex changes to the U.S. tax code that will affect 2017, including, but not limited to, (1) requiring a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries that is payable over eight years and (2) bonus depreciation that will allow for full expensing of qualified property. The Tax Act also establishes new tax laws that will affect 2018, including, but not limited to, (1) reduction of the U.S. federal corporate tax rate; (2) elimination of the corporate alternative minimum tax (AMT); (3) the creation of the base erosion anti-abuse tax (BEAT), a new minimum tax; (4) a general elimination of U.S. federal income taxes on dividends from foreign subsidiaries; (5) a new provision designed to tax global intangible low-taxed income (GILTI), which allows for the possibility of using foreign tax credits (FTCs) and a deduction of up to 50 percent to offset the income tax liability (subject to some limitations); (6) a new limitation on deductible interest expense; (7) the repeal of the domestic production activity deduction; (8) limitations on the deductibility of certain executive compensation; (9) limitations on the use of FTCs to reduce the U.S. income tax liability; and (10) limitations on net operating losses (NOLs) generated after December 31, 2017, to 80 percent of taxable income.

For certain portions of our deferred tax assets and liabilities, we have recorded a provisional decrease of \$920, with a corresponding net adjustment to deferred income tax expense of \$920 for the year ended March 31, 2018 related to the Tax Act.

Income tax expense (benefit) from continuing operations follows:

	Year Ended March 31,	
	2018	2017
Current:		
Federal	\$ 356	\$ 416
State	107	14
Deferred:		
Federal	669	119
State	(28)	(6)
Total income taxes	<u>\$ 1,104</u>	<u>\$ 543</u>

Income tax benefit from discontinued operations follows:

	Year Ended March 31,	
	2018	2017
Current:		
Federal	\$ (352)	\$ (384)
State	(160)	5
Deferred:		
Federal	(621)	(161)
State	33	11
Total income taxes	<u>\$ (1,100)</u>	<u>\$ (529)</u>

The difference between the income tax expense on the reported income before income taxes at the federal statutory rate, and the actual expense shown in operations is due to the effect of net operating losses, state income taxes, changes in tax rates and effect of Tax Act in 2018, and changes in the deferred income tax valuation allowance.

Components of the Company’s deferred income tax assets (liabilities) follows:

8. Income Taxes – concluded

	March 31,	
	2018	2017
Deferred income tax assets:		
Allowance for credit losses	\$ 11	\$ 35
Accrued liabilities	128	479
Deferred revenue	-	47
Inventories	20	582
Research credits	850	872
Other credits	241	78
Net operating loss carryforwards	1,506	1,096
	<u>2,756</u>	<u>3,189</u>
Deferred income tax liabilities:		
Property and equipment	(28)	(158)
Net deferred income tax assets before		
Valuation allowance	2,728	3,031
Valuation allowance	-	(250)
Net deferred income tax assets	<u>\$ 2,728</u>	<u>\$ 2,781</u>

As of March 31, 2018, the Company reduced its previously recorded valuation allowance for certain tax credits as it is now more likely than not that the Company will receive the benefit of those assets. The valuation allowance decreased \$250 in 2018 and increased \$150 in 2017.

At March 31, 2018, the Company had federal net operating loss carryforwards of \$7,504 that begin to expire in 2022. At March 31, 2018, the Company had state net operating loss carryforwards in various states of \$2,157 that expire in varying amounts to 2022. As defined in Section 382 of the Internal Revenue Code, certain ownership changes limit the annual utilization of federal net operating losses and tax credit carryforwards. The Company believes that the Section 382 limitation from its previous ownership changes will result in the loss of \$941 of the net operating losses resulting in net usable losses of \$6,563 against future federal taxable income. The Company has not recognized any tax benefits associated with the net operating losses expected to be lost due to the Section 382 limitation. Research and development and other credit carryforwards of \$843 are scheduled to expire in varying amounts to 2027.

The Company files income tax returns in the U.S. federal jurisdiction, and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2015. The Company has no significant uncertain income tax positions. The Company recognizes interest and penalties associated with tax matters as part of the income tax provision and includes accrued interest and penalties with the related tax liability in the consolidated balance sheets.

9. Preferred Stock

The Board of Directors is authorized to determine the powers, preferences, rights and restrictions of the Company's Preferred Stock. At March 31, 2018 and 2017, there were no issued and outstanding shares of Preferred Stock.

10. Commitments and Contingencies

Leases -

The Company leases its office and manufacturing facility under an operating lease that provided for monthly rental, as renewed in 2012, of \$23 through July 2016. In August 2016, the Company began utilizing a holdover provision under the current lease allowing for month-to-month occupancy at 150% of the current rental rate, or \$35 monthly. In March 2018, the Company signed a lease agreement reverting the terms to the 2012 renewal at \$23 per month through June 2018. Under this agreement, the Company is responsible for all operating costs including real estate taxes and maintenance. In May 2018, the Company signed a lease in a new building. The terms of this lease are seven years at approximately \$60 per year. The Company also leases certain office equipment under operating lease agreements. Lease expense was \$458 and \$422 for 2018 and 2017, respectively.

10. Commitments and Contingencies - concluded

As of March 31, 2018, future minimum payments under non-cancelable operating leases are \$74 in 2019.

Unconditional purchase obligations –

As of March 31, 2018, the Company has contracted to purchase goods from various vendors in the amount of \$803 in 2019.

Other commitments -

As of April 1, 2016, the Company had agreements with two founding stockholders whereby the Company was obligated to pay these individuals an annual royalty equal to 0.24% of total revenues up to an aggregate total of \$2,920. On December 8, 2017, one of these stockholders settled all future royalties for a lump payment of \$50. The remaining stockholder accounts for 0.15% of total revenues up to an aggregate total of \$1,820. For 2018 and 2017, royalty expense under these agreements was \$87 and \$66, respectively. The maximum remaining royalty that may be required to be paid to the founding stockholder, contingent upon the Company attaining certain revenues, is \$918 at March 31, 2018.

Contingencies -

The Company is a party to legal proceedings arising in the ordinary course of business. Management believes that the ultimate outcome of these matters will not have a material adverse effect on the Company's financial position, operating results or cash flows.

11. Employee Benefit Plans

The Company has a defined contribution benefit plan (the "Plan") covering substantially all employees. The Plan is intended to comply with Section 401(k) of the Internal Revenue Code. Each year, eligible participants may elect to make salary reduction contributions on their behalf up to a maximum of 100% of pre-tax compensation or the annual maximum established by the Internal Revenue Service. Participants may also make voluntary after-tax contributions to the Plan. The Company can make contributions to the Plan at its sole discretion. There was no Company contribution expense in 2018 or 2017. The Company pays certain expenses of the Plan which are not material for any period presented.

12. Economic Dependence and Significant Customers

The Company's ink jet technology is based on a cross licensing agreement with a significant vendor. That agreement allows the Company and the vendor to use each other's ink jet technology. If that vendor changed the technology or this licensing relationship, it would significantly affect the Company's business. Vendors utilizing this technology are also the primary providers of ink purchases that are sold to customers. These purchases from two key vendors accounted for 65% of cost of sales in fiscal year 2018 and 67% in 2017.

Additionally, due to the nature of the Company's products, a significant portion of the Company's revenues are generally derived from a few customers, the majority of which are OEMs. In 2018 and 2017, two customers accounted for 34% and 31% of total revenues, respectively. No other customers accounted for 10% or more of the total Company revenues.

13. Discontinued Operations

On December 12, 2017, the Company signed an Asset Purchase Agreement to sell the assets of the Mail Inserting segment of the business. The transaction was completed and effective on January 1, 2018. The sales price was \$2,500, \$1,500 of which was payable at closing and \$1,000 that is payable in six monthly installments beginning one month after the closing. The sale price also included a working capital adjustment that is currently estimated to increase the sales price by \$687. The working capital adjustment was computed based on the change between the working capital provided at the closing with the average working capital for the twelve monthly periods ended October 31, 2017.

13. Discontinued Operations - continued

In addition to the sales price, there is a provision for two contingent payments of up to \$500 each, payable after the twelfth and eighteenth month anniversaries of the closing. The contingent payments will be computed by comparing the monthly service revenue the business had for the month prior to the closing (the "Base Revenue") to the monthly service revenues the buyer has retained by the twelfth and eighteenth month anniversaries of the sale for the month prior to the anniversaries (the "Future Revenue"). The computation of the contingent payments will be computed as follows: (1) if the Future Revenue equals or exceeds the Base Revenue, the full \$500 payment(s) will be earned, (2) if the Future Revenue exceeds 95% of the Base Revenue, a proration between \$300 and \$500 will be earned, (3) if the Future Revenue exceeds 94% of the Base Revenue, a \$100 payment will be earned, (4) if the Future Revenue exceeds 93% of the Base Revenue, a \$50 payment will be earned, and (5) if the Future Revenue exceeds 92% of the Base Revenue, a \$10 payment will be earned. Since these contingent payments are tied to future events and can be influenced by many factors, the Company will not recognize any of the potential payments until it is likely such amounts will be received.

Under the Asset Purchase Agreement, the Company transferred substantially all the assets and certain liabilities of the Mail Inserting segment to the buyer. The net value of the assets and liabilities transferred to the buyer was \$3,928.

As of March 31, 2018, the Company has \$1,450 classified of the gross proceeds of the sale as receivables for contractual payments due to the Company resulting from the sale of the assets of the Mail Inserting segment. Management believes this full amount to be collectable in future periods. The entire receivable is funded by the buyer of the Mail Inserting segment and is held in escrow until certain conditions are met. The Company has classified \$300 of this receivable as current because it is due to the Company in the first quarter of next fiscal year. The remaining \$1,150 has been classified as long term because these funds are due in greater than one year.

The Company incurred \$93 of professional fees and other costs to complete the transaction. In addition, the Company incurred \$1,776 of personnel and other related costs as a result of the transaction.

The Mail Inserting segment is classified as discontinued operations for all periods presented. The Company has significant continuing involvement in the discontinued operations.

The following is a summary of the major classes of line items constituting the loss on the sale of the discontinued operations.

Proceeds

Contract Price	
Proceeds at closing	\$ 1,500
Future payments	1,000
Working capital adjustment	<u>687</u>
Gross proceeds	3,187

Basis given

Assets	5,795
Liabilities	<u>1,867</u>
Net basis	<u>3,928</u>
Gross loss on sale	(741)

Related Expenses

Professional fees	<u>93</u>
Net loss on sale	<u><u>\$ (834)</u></u>

13. Discontinued Operations - continued

The following is a reconciliation of the carrying amounts of major classes of assets and liabilities of the discontinued operation).

	<u>March 31, 2017</u>
Carrying amounts of the major classes of assets included in discontinued operations:	
Accounts receivable	\$ 1,591
Inventories	4,964
Other current assets	63
Plant, property, and equipment	406
Total assets of discontinued operations	<u>\$ 7,024</u>
Carrying amounts of the major classes of liabilities included in discontinued operations:	
Accounts payable	\$ 841
Accrued expenses	102
Deposits on systems contracts	803
Deferred service contract revenue	1,727
Total liabilities of discontinued operations	<u>\$ 3,473</u>

The following is a reconciliation of the major classes of lines items constituting pretax loss of discontinued operations.

	<u>Year Ending March 31,</u>	
	<u>2018</u>	<u>2017</u>
Net sales	\$ 12,824	\$ 16,436
Cost of sales	11,190	13,976
Gross profit	1,634	2,460
Selling and administrative	3,580	3,111
Research and development	271	489
	(2,217)	(1,140)
Loss from sale of discontinued operations	(834)	-
Income tax benefit	(1,100)	(529)
Net loss on discontinued operations	<u>\$ (1,951)</u>	<u>\$ (611)</u>

13. Discontinued Operations – concluded

The following is a reconciliation of the major classes of line items constituting changes in cash flows of discontinued operations.

	Year Ending March 31,	
	2018	2017
Major classes of line items constituting changes in cash flow on discontinued operations		
Loss from discontinued operations	\$ (1,951)	\$ (611)
Depreciation and amortization	73	149
Loss on disposal of asset	397	46
Deferred income taxes	(588)	(150)
Accounts receivable	141	304
Inventories	3,699	(779)
Prepaid expenses and other assets	64	(53)
Accounts payable	(842)	415
Accrued expenses	(102)	(360)
Deferred service contract revenue	(2,194)	(1,079)
Deposits on systems contracts	(498)	179
Net cash used in discontinued operating activities	<u>(1,801)</u>	<u>(1,937)</u>
Investing activities of discontinued operations:		
Purchase of equipment and leasehold improvements	(374)	(131)
Net cash used in investing activities of discontinued operation	<u>(374)</u>	<u>(131)</u>
Change in cash on discontinued operations	<u>\$ (2,175)</u>	<u>\$ (2,068)</u>

14. Recent Accounting Pronouncements

The Company continually assesses any new accounting pronouncements to determine their applicability to the Company. In the case where it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its financial reporting, and assures that there are proper controls in place to ascertain that the Company's financial statements properly reflect the change.

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue From Contracts with Customers*. ASU No. 2014-09 was updated by ASU No. 2015-14 in August 2015, which deferred the effective date of the new standard to fiscal years beginning after December 15, 2017. The purpose of this new standard is to clarify the principles for recognizing revenue so that the standard can be applied consistently across various transactions, industries and capital markets. ASU No. 2014-09 was updated by ASU No. 2016-08, *Principal versus Agent Considerations*, in March 2016, by ASU No. 2016-10, *Identifying Performance Obligations and Licensing*, as well as other updates that address certain narrow-scope matters and practical expedients. The Company adopted the new revenue standard effective April 1, 2018, using the Modified Retrospective method, under which prior-year results are not restated; however, supplemental information regarding the impact of the new standard must be provided for 2018 results, if material. The adoption of ASU No. 2014-09, including the cumulative effect of its adoption, did not have a material impact on the Company's financial statements.

14. Recent Accounting Pronouncements - concluded

In February 2016, the Financial Accounting Standards Board issued ASU No. 2016-02, *Leases*. The purpose of this standard is to mandate that lessees recognize the assets and liabilities that arise from leases.

For finance leases, a lessee is required to do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
2. Recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income
3. Classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows.

For operating leases, a lessee is required to do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position
2. Recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis
3. Classify all cash payments within operating activities in the statement of cash flows.

The Company is required to adopt ASU No. 2016-02 in its interim period beginning April 1, 2019. Upon adoption, the Company will recognize the asset and liability associated with each lease on its consolidated balance sheet and reflect payments on the consolidated statement of cash flows. The Company has not completed its assessment of ASU No. 2016-02.