

inc.jet Holding, Inc.
CONSOLIDATED
FINANCIAL STATEMENTS

December 31, 2018 and March 31, 2018

inc.jet Holding, Inc.

December 31, 2018 and March 31, 2018

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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. and subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and March 31, 2018, and the related consolidated statements of operations, stockholders' equity and cash flows for the period from April 1, 2018 to December 31, 2018 and the year ended March 31, 2018, 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 December 31, 2018 and March 31, 2018, and the results of their operations and their cash flows for the period from April 1, 2018 to December 31, 2018 and the year ended March 31, 2018 in accordance with accounting principles generally accepted in the United States of America.

Hartford, Connecticut
March 22, 2019

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

	<u>December 31, 2018</u>	<u>March 31, 2018</u>
Assets		
Current assets:		
Cash	\$ 380	\$ 623
Accounts receivable, less allowance of \$42 in December 2018 and March 2018	1,468	1,309
Current portion of receivable from sale of Mail Inserting segment	-	300
Inventories	1,497	985
Prepaid expenses and other assets	117	256
Total current assets	<u>3,462</u>	<u>3,473</u>
Equipment and leasehold improvements:		
Machinery and equipment	585	576
Furniture and fixtures	208	219
Leasehold improvements	380	-
	<u>1,173</u>	<u>795</u>
Accumulated depreciation and amortization	<u>(652)</u>	<u>(633)</u>
	<u>521</u>	<u>162</u>
Patents, net of amortization of \$50 in December 2018 and \$46 in March 2018	24	28
Receivable from sale of Mail Inserting segment, less current portion	1,068	1,150
Deferred income taxes	2,475	2,728
Total assets	<u>\$ 7,550</u>	<u>\$ 7,541</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 1,654	\$ 1,476
Accrued expenses	993	1,439
Current portion of note payable to Gunther Partners LLC – a related party	50	100
Current portion of capital lease obligation	-	5
Total current liabilities	<u>2,697</u>	<u>3,020</u>
Notes payable to Gunther Partners LLC- a related party	<u>2,950</u>	<u>3,200</u>
Total liabilities	<u>5,647</u>	<u>6,220</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	19,984	19,951
Accumulated deficit	(18,101)	(18,650)
Total stockholders' equity	<u>1,903</u>	<u>1,321</u>
Total liabilities and stockholders' equity	<u>\$ 7,550</u>	<u>\$ 7,541</u>

See accompanying notes.

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

	<u>Period from April 1, 2018 to December 31, 2018</u>	<u>Year Ended March 31, 2018</u>
Sales:		
Systems	\$ 4,560	\$ 4,976
Supplies	6,187	6,781
Total sales	<u>10,747</u>	<u>11,757</u>
Cost of sales:		
Systems	2,327	2,251
Supplies	4,574	5,047
Total cost of sales	<u>6,901</u>	<u>7,298</u>
Gross profit	<u>3,846</u>	<u>4,459</u>
Operating expenses:		
Selling and administrative	2,220	2,328
Research and development	796	946
Total operating expenses	<u>3,016</u>	<u>3,274</u>
Operating income	830	1,185
Interest expense	57	48
Income before income taxes	773	1,137
Income taxes	224	1,104
Net income from continuing operations	549	33
Loss from discontinued operations, net of tax	-	(1,951)
Net income (loss)	<u>\$ 549</u>	<u>\$ (1,918)</u>
Basic and diluted net income per share – continuing operations	\$ 0.03	\$ 0.00
Basic and diluted net loss per share – discontinued operations	(0.00)	(0.10)
Basic and diluted net income (loss) per share	<u>\$ 0.03</u>	<u>\$ (0.10)</u>
Weighted-average number of common shares outstanding:		
Basic	<u>19,767,435</u>	<u>19,767,435</u>
Diluted	<u>19,773,544</u>	<u>19,767,435</u>

See accompanying notes.

inc.jet Holding, Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the period from April 1, 2018 to December 31, 2018 and the year ended March 31, 2018
(Dollars in thousands)

	<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Deficit</u>	<u>Total</u>
			<u>Capital</u>		
Balance, April 1, 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
Stock-based compensation expense	-	-	33	-	33
Net income	-	-	-	549	549
Balance, December 31, 2018	19,767,435	\$ 20	\$ 19,984	\$ (18,101)	\$ 1,903

See accompanying notes.

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

	Period from April 1, 2018 to December 31, 2018	Year Ended March 31, 2018
Operating activities:		
Net income (loss)	\$ 549	\$ (1,918)
Net loss from discontinued operations	-	(1,951)
Net income from continuing operations	549	33
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization	48	52
Loss on disposal of asset	12	-
Deferred income taxes	253	641
Stock-based compensation	33	-
Changes in operating assets and liabilities:		
Accounts receivable	(159)	(237)
Inventories	(512)	(89)
Prepaid expenses and other assets	139	45
Accounts payable	178	622
Accrued expenses	(446)	(224)
Accrued interest due to Gunther Partners LLC - a related party	-	(224)
Net cash provided by operating activities - continued operations	95	619
Net cash used in operating activities - discontinued operations	-	(1,801)
Net cash provided by (used in) operating activities	95	(1,182)
Investing activities:		
Purchase of equipment and leasehold improvements	(415)	(11)
Capitalized patents	-	(15)
Proceeds from sale of discontinued operations	382	1,737
Net cash (used in) provided by investing activities – continuing operations	(33)	1,711
Net cash used in investing activities – discontinued operations	-	(374)
Net cash (used in) provided by investing activities	(33)	1,337
Financing activities:		
Payments on notes payable to Gunther Partners LLC – a related party	(300)	(100)
Payments on capital leases	(5)	(5)
Net cash used in financing activities - continuing operations	(305)	(105)
Change in cash	(243)	50
Cash, beginning of year	623	573
Cash, end of year	\$ 380	\$ 623
Supplemental cash flow information:		
Receivable from sale of Mail Inserting segment	\$ -	\$ 1,450
Cash paid for interest including \$57 for the nine months ended December 31, 2018 and \$271 for the year ended March 31, 2018 to related parties	\$ 57	\$ 272
Cash paid for income taxes	\$ 10	\$ 37

See accompanying notes.

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

1. Business and Operations

The operations of inc.jet Holding, Inc. 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.

The Company changed its year end from March 31 to December 31 for the current reported period and all future periods.

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 recognizes revenues net of applicable sales taxes and related costs. The Company’s revenues result from the sale of goods and reflect the consideration to which the Company expects to be entitled. The Company records revenue based on a five-step model. For its customer contracts, the Company identifies the performance obligations (sale of goods), determines the transaction price, allocates the contract transaction price to the performance obligations, and recognizes the revenue when (or as) the performance obligation is transferred to the customer. A good is transferred when (or as) the customer obtains control of that good. The Company generates revenue from product sales. No contract resulting in recognized revenue exists for a term greater than one year.

The Company had allowances for credit losses of \$42 at December 31, 2018 and March 31, 2018. 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 \$44 in the nine months ended December 2018 and \$47 in the year ended March 2018.

Patents -

Initial patent costs are amortized over 10 years. Renewal and maintenance costs are expensed as incurred. Patent expense was \$4 in the nine months ended December 2018 and \$5 in the year ended March 2018. Future patent amortization is expected to be \$3 for 2019 through 2022 and \$2 for 2023 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, 2017	\$ 148
Accrual	130
Cost incurred	<u>(64)</u>
Balance, March 31, 2018	214
Accrual	92
Cost incurred	<u>(43)</u>
Balance, December 31, 2018	<u>\$ 263</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 income or (loss) per share amounts are determined using the weighted-average outstanding common shares for both years. Diluted earnings per share include the impact of common stock equivalents using the treasury stock method when the effect is dilutive.

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 \$2,246 as of December 31, 2018 (\$2,298 as of March 31, 2018) 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 \$3,000 as of December 31, 2018 and \$3,300 as of March 31, 2018.

3. Inventories

Inventories consist of:

	December 2018	March 2018
Materials and sub-assemblies	\$ 1,060	\$ 520
Work-in-process	8	51
Finished goods	429	414
	<u>\$ 1,497</u>	<u>\$ 985</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 recorded under capital leases. Related accumulated depreciation was \$20 as of March 31, 2018.

5. Related Party Debt

The Company has notes payable to Gunther Partners LLC, the Company's principal stockholder, aggregating \$3,000 as of December 31, 2018 and \$3,300 as of March 31, 2018. All of the aggregate amounts outstanding as of December 31, 2018 are due December 31, 2021, after an extension on November 12, 2018, and bear interest equal to the short-term Applicable Federal Rate as issued by the Department of the Treasury. 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 to keep interest current. 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 \$25 on January 31, 2019 and February 28, 2019. As such, \$50 of the notes payable to related party has been classified as current at December 31, 2018. No additional principal payments are currently expected to be made through December 31, 2019.

The Company recognized interest expense on the related party debt of \$57 for the nine months ended December 31, 2018 and \$48 for the year ended March 31, 2018. The Company paid interest of \$57 for the nine months ended December 31, 2018 and \$272 for the year ended March 31, 2018.

6. Debt

The Company had a Commercial Revolving Loan Agreement with Citizens Bank through December 26, 2017 that provided for a Demand Note (the "Old Note") of \$1,000. Borrowings under the Old Note bore interest at 3.50% above the LIBOR Advantage Rate, as defined. Proceeds from the Old Note were to be used to finance working capital related to ongoing operations. Collateral for the Old Note was substantially all of the Company's operating assets. The Company obtained a Commercial Revolving Loan Agreement with Citizens Bank, which closed on December 14, 2018, that provides for a Demand Note (the "Note") of \$1,250. Borrowings under the Note bear interest at 3.50% above the LIBOR Advantage Rate, as defined. Proceeds from the Note are to be used to finance working capital related to ongoing operations. Collateral for the Note is substantially all of the Company's operating assets. There was no borrowing outstanding at December 31, 2018 or March 31, 2018.

7. Common Stock Options and Capital Stock

On July 17, 2018, the Company entered into a Non-Qualified Stock Option Award Agreement (the "Agreement") with its President and Chief Executive Officer. Under the Agreement, the Company granted 1,000,000 non-qualified common stock options with an exercise price of \$0.30 a share. The options vest 33% on each of the first three annual anniversaries from the grant date and have a five-year term. The options automatically vest in the event of a change of control, as defined.

7. Common Stock Options and Capital Stock – concluded

The Company recognizes compensation expense related to stock options granted to their employees based on their fair value on the grant date. The fair value of each option is estimated using the Black-Scholes option-pricing model. The Company recognizes expense ratably over the service period.

The weighted average per share fair value of common stock options granted in 2018 was \$0.22. Stock compensation expense was \$33 for the nine months ended December 31, 2018, and is classified with selling and administrative expenses in the accompanying condensed consolidated statements of operations. As of December 31, 2018, there was \$185 of unrecognized stock option expense. This expense will be recognized ratably through July 16, 2021. The fair value of the stock options granted during 2018 was estimated on the date of grant using the Black-Scholes option-pricing model assuming a weighted average stock volatility rate of 105.75%, an expected option life of 4 years, a weighted average risk-free interest rate of 2.72% and a dividend yield of 0.0%. The volatility rate was determined using the historical implied volatilities of the underlying common stock of the Company's common stock. The expected life is based on the vesting period and the option term. The risk-free interest rate approximates the U.S. Treasury yields in effect at the time of the grant for securities with a term equal to the expected stock option term. The dividend rate has been set at 0.0% as the Company does not expect to pay dividends.

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:

	Period from April 1, 2018 to December 31, 2018	Year ended March 31, 2018
Current:		
Federal	\$ (47)	\$ 356
State	18	107
Deferred:		
Federal	144	669
State	109	(28)
Total income taxes	<u>\$ 224</u>	<u>\$ 1,104</u>

8. Income Taxes – concluded

Income tax benefit from discontinued operations follows:

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

	December 31, 2018	March 31, 2018
Deferred income tax assets:		
Allowance for credit losses	\$ 11	\$ 11
Accrued liabilities	155	128
Deferred revenue	269	-
Inventories	20	20
Research credits	874	850
Other credits	206	241
Net operating loss carryforwards	970	1,506
	<u>2,505</u>	<u>2,756</u>
Deferred income tax liabilities:		
Property and equipment	(30)	(28)
Net deferred income tax assets	<u>\$ 2,475</u>	<u>\$ 2,728</u>

At December 31, 2018, the Company had federal net operating loss carryforwards of \$5,495 that begin to expire in 2022. At December 31, 2018, the Company had state net operating loss carryforwards in various states of \$234 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 \$4,554 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 \$874 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 2016. 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 December 31, 2018 and March 31, 2018, there were no issued and outstanding shares of Preferred Stock.

10. Commitments and Contingencies

Leases -

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 \$140 for the nine months ended December 31, 2018 and \$458 for the year ended March 31, 2018.

As of December 31, 2018, future minimum payments under non-cancelable operating leases follow:

2019	\$	62
2020		63
2021		63
2022		65
2023		64
2024 and thereafter		92
	\$	<u>409</u>

Unconditional purchase obligations –

As of December 31, 2018, the Company has contracted to purchase goods from various vendors as follows:

2019	\$	1,152
2020		43
	\$	<u>1,195</u>

Other commitments -

As of April 1, 2017, 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. Royalty expense under these agreements was \$16 and \$87 for the nine months ended December 31, 2018 and the year ended March 31, 2018, respectively. The maximum remaining royalty that may be required to be paid to the founding stockholder, contingent upon the Company attaining certain revenues, is \$902 at December 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 the nine months ended December 2018 or the year ended March 31, 2018. 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 61% of cost of sales in the nine months ended December 31, 2018 and 63% in year ended March 31, 2018.

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 the nine months ended December 31, 2018, two customers accounted for 35% of total revenues and 34% in the year ended March 31, 2018. 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 of \$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.

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 revenue 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. On January 25, 2019, the Company received the first contingent payment \$300 for the twelfth month anniversary.

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 December 31, 2018, the Company has \$1,068 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. A portion of the escrow, classified as an indemnity escrow, total \$150 will be release January 1, 2020. The remaining balance will be released to the Company as the aforementioned royalty amount decreases or the earlier of the dissolution of the royalty agreement or five years. The receivable has been classified as long term because these funds are due in greater than one year.

The Mail Inserting segment is classified as discontinued operations for all periods presented.

13. Discontinued Operations - concluded

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

	Year ended March 31,
	2018
Net sales	\$ 12,824
Cost of sales	11,190
Gross profit	1,634
Selling and administrative	3,580
Research and development	271
	(2,217)
Loss from sale of discontinued operations	(834)
Income tax benefit	(1,100)
Net loss on discontinued operations	<u>\$ (1,951)</u>

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

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

14. Recent Accounting Pronouncements - concluded

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“new revenue standard”). The new revenue standard outlines a comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new model provides a five-step analysis in determining when and how revenue is recognized. The core principle of the new guidance is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard allows for initial application to be performed retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. During 2016, the FASB clarified the implementation guidance on principal versus agent, identifying performance obligations, licensing, collectability and made technical corrections on various topics.

The Company adopted the new revenue recognition standard April 1, 2018 using the modified retrospective method. The standard had no material effect on prior year results.

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 January 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.