



## **CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2018**

**DYNTEK, INC. AND SUBSIDIARY**  
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**JUNE 30, 2018**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders  
DynTek, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of DynTek, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years ended June 30, 2018, 2017 and 2016, 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.

### *Auditors' 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 auditors' 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 auditors consider 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 consolidated financial position of the Company as of June 30, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years ended June 30, 2018, 2017 and 2016, in accordance with accounting principles generally accepted in the United States of America.

*Haskell & White LLP*

HASKELL & WHITE LLP

Irvine, California  
September 7, 2018

**DYNTEK, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

	<b>June 30, 2018</b>	<b>June 30, 2017</b>
<i>ASSETS</i>		
CURRENT ASSETS:		
Cash	\$ 2,691	\$ 2,647
Accounts receivable, net	66,536	71,261
Work in process, net	6,898	4,352
Prepaid expenses and other current assets	570	620
Deferred income taxes	1,336	1,563
TOTAL CURRENT ASSETS	<u>78,031</u>	<u>80,443</u>
PROPERTY AND EQUIPMENT, net	1,244	232
DEFERRED INCOME TAXES	1,066	3,548
OTHER NON CURRENT ASSETS	12,345	7,343
TOTAL ASSETS	<u><u>\$ 92,686</u></u>	<u><u>\$ 91,566</u></u>
<i>LIABILITIES AND STOCKHOLDERS' EQUITY</i>		
CURRENT LIABILITIES:		
Revolving line of credit	\$ 7,000	\$ 22,000
Accounts payable	51,714	38,022
Accrued expenses	5,173	3,925
Deferred revenue	1,146	1,587
TOTAL CURRENT LIABILITIES	<u>65,033</u>	<u>65,534</u>
OTHER NON CURRENT LIABILITIES	383	90
TOTAL LIABILITIES	<u>65,416</u>	<u>65,624</u>
COMMITMENTS AND CONTINGENCIES (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.0001 par value, 600,000 shares authorized; 0 and 0 shares issued and outstanding, respectively	-	-
Class A common stock, \$.0001 par value, 5,400,000 shares authorized; 2,288,924 and 2,264,390 shares issued and outstanding as of June 30, 2018 and June 30, 2017, respectively	-	-
Additional paid-in capital	172,599	173,467
Accumulated deficit	(145,329)	(147,525)
TOTAL STOCKHOLDERS' EQUITY	<u>27,270</u>	<u>25,942</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u><u>\$ 92,686</u></u>	<u><u>\$ 91,566</u></u>

See notes to consolidated financial statements

**DYNTEK, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except share and per share data)

	Years Ended June 30,		
	2018	2017	2016
REVENUES			
Product revenues	\$ 138,650	\$ 130,441	\$ 143,255
Service revenues	31,166	31,612	33,677
TOTAL REVENUES	<u>169,816</u>	<u>162,053</u>	<u>176,932</u>
COST OF REVENUES			
Cost of products	111,145	108,895	121,041
Cost of services	27,131	26,095	27,187
TOTAL COST OF REVENUES	<u>138,276</u>	<u>134,990</u>	<u>148,228</u>
GROSS PROFIT	<u>31,540</u>	<u>27,063</u>	<u>28,704</u>
OPERATING EXPENSES:			
Selling	19,282	16,873	17,845
General and administrative	5,875	4,274	5,034
Depreciation and amortization	173	167	180
TOTAL OPERATING EXPENSES	<u>25,330</u>	<u>21,314</u>	<u>23,059</u>
INCOME FROM OPERATIONS	<u>6,210</u>	<u>5,749</u>	<u>5,645</u>
OTHER INCOME (EXPENSE)			
Interest expense, net	(576)	(1,240)	(1,186)
TOTAL OTHER EXPENSE	<u>(576)</u>	<u>(1,240)</u>	<u>(1,186)</u>
INCOME BEFORE INCOME TAXES	5,634	4,510	4,459
INCOME TAX PROVISION	3,438	2,012	1,544
NET INCOME	<u>\$ 2,196</u>	<u>\$ 2,498</u>	<u>\$ 2,915</u>
NET INCOME PER SHARE—BASIC	<u>\$ 0.96</u>	<u>\$ 1.10</u>	<u>\$ 1.31</u>
NET INCOME PER SHARE—DILUTED	<u>\$ 0.93</u>	<u>\$ 1.05</u>	<u>\$ 1.27</u>
WEIGHTED AVERAGE NUMBER OF SHARES - BASIC	<u>2,278,653</u>	<u>2,264,390</u>	<u>2,219,155</u>
WEIGHTED AVERAGE NUMBER OF SHARES - DILUTED	<u>2,368,611</u>	<u>2,384,294</u>	<u>2,296,567</u>

See notes to consolidated financial statements.

**DYNTEK, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(in thousands)

	Class A Common Stock		Additional	Accumulated	Total
	Shares	Par Value	Paid-in Capital	Deficit	Stockholders' Equity
<b>Balances- June 30, 2015</b>	<b>2,180</b>	<b>\$ -</b>	<b>\$ 173,082</b>	<b>\$ (152,940)</b>	<b>\$ 20,142</b>
Shares issued under 2005 Stock Plan	36	-	-	-	-
Stock based compensation	-	-	736	-	736
Stock option exercise	5	-	20	-	20
Cash dividends declared and paid	-	-	(222)	-	(222)
Net income	-	-	-	2,915	2,915
<b>Balances- June 30, 2016</b>	<b>2,221</b>	<b>-</b>	<b>173,616</b>	<b>(150,023)</b>	<b>23,593</b>
Shares issued under 2015 Stock Incentive Plan	43	-	-	-	-
Stock based compensation	-	-	191	-	191
Cash dividends declared and paid	-	-	(340)	-	(340)
Net income	-	-	-	2,498	2,498
<b>Balances- June 30, 2017</b>	<b>2,264</b>	<b>-</b>	<b>173,467</b>	<b>(147,525)</b>	<b>25,942</b>
Shares issued under 2015 Stock Incentive Plan	37	-	-	-	-
Shares and options repurchased	(18)	-	(1,626)	-	(1,626)
Stock option exercise	6	-	41	-	41
Stock based compensation	-	-	716	-	716
Net income	-	-	-	2,196	2,196
<b>Balances- June 30, 2018</b>	<b>2,289</b>	<b>\$ -</b>	<b>\$ 172,599</b>	<b>\$ (145,329)</b>	<b>\$ 27,270</b>

See notes to consolidated financial statements.

**DYNTEK, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Years Ended June 30,		
	2018	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 2,196	\$ 2,498	\$ 2,915
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	173	167	180
Non-cash interest	(259)	78	188
Provision for bad debt	833	38	613
Provision for work in process losses	49	-	81
Stock based compensation	716	191	736
Deferred income taxes	2,709	1,746	1,399
Changes in operating assets and liabilities:			
Accounts receivable	3,892	(8,903)	(11,540)
Work in process	(2,594)	3,025	(648)
Prepaid expenses and other current assets	50	1,035	(172)
Other non current assets	(5,005)	2,036	(3,747)
Accounts payable	13,692	305	10,268
Accrued expenses	1,511	(681)	1,110
Deferred revenue	(727)	297	(228)
Other non current liabilities	294	(60)	-
Total adjustments	15,334	(726)	(1,759)
<b>NET CASH PROVIDED BY OPERATIONS</b>	<b>17,530</b>	<b>1,772</b>	<b>1,156</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Capital expenditures	(901)	(11)	(97)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(901)</b>	<b>(11)</b>	<b>(97)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Repayment of prior line of credit	-	(27,120)	-
(Repayment) borrowings under new line of credit, net	(15,000)	25,520	7,600
Repayment of notes payable	-	-	(8,141)
Deferred financing costs paid	-	(15)	(111)
Proceeds from stock option exercise	41	-	20
Repurchase of shares and stock options	(1,626)	-	-
Payment of dividends	-	(340)	(222)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(16,585)</b>	<b>(1,955)</b>	<b>(854)</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>44</b>	<b>(194)</b>	<b>205</b>
<b>CASH AT BEGINNING OF YEAR</b>	<b>2,647</b>	<b>2,841</b>	<b>2,636</b>
<b>CASH AT END OF YEAR</b>	<b>\$ 2,691</b>	<b>\$ 2,647</b>	<b>\$ 2,841</b>

See notes to consolidated financial statements.

**DYNTEK, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**  
(in thousands)

	Years Ended June 30,		
	2018	2017	2016
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest	\$ 845	\$ 1,010	\$ 980
Cash paid (refunded) for income taxes	\$ 232	\$ (704)	\$ 183
SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:			
Conversion of accrued interest into notes payable	\$ -	\$ -	\$ 79
Additions to fixed assets and deferred rent for landlord tenant improvement allowance	\$ 285	\$ -	\$ -

See notes to consolidated financial statements.



**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands, except per share amounts)**

**NOTE 1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES**

**The Company**— DynTek, Inc. (the “Company”) was incorporated in Delaware on May 27, 1989 as Universal Self Care, Inc. The Company changed its name to Tadeo Holdings, Inc. in 1998, to TekInsight, Inc. in 1999, and to DynTek, Inc. in December 2001.

The Company is a value-added reseller of hardware and software products and also provides professional information technology (“IT”) services to mid-market commercial businesses, state and local government agencies, and educational institutions.

**Principles of Consolidation**—The consolidated financial statements include the accounts of the Company and its sole wholly-owned subsidiary, DynTek Services, Inc. All significant inter-company transactions have been eliminated.

**Financial Statement Preparation**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company’s consolidated financial statements and the accompanying notes. Critical accounting policies for the Company include revenue recognition, income taxes, and stock based compensation. Actual results with respect to estimates could differ from the outcome of one or more confirming events in future periods. The difference between actual results and management’s estimates could be material.

**Segment Reporting**—The Company operated in a single segment, Information Technology Solutions, during all periods presented.

**Revenue Recognition**—The Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the Company’s fee is fixed or determinable, and (iv) collectability is probable. Revenue transactions are supported by written evidence of a sale transaction, primarily purchase orders and purchase authorization letters, which indicate the selling price, shipping terms, payment terms, and refund policy (if any). Revenue arrangements do not include a general right of return.

**Product Revenues**

Product revenues consist of hardware and software sales, all on a resale basis. All product warranties and upgrades or enhancements to any product are provided exclusively by the manufacturer. The Company does not sell any internally developed software.

For product sales, in a substantial majority of transactions, the Company recognizes revenue on a gross basis as it (i) acts as principal in the transaction because it is the primary obligor in the arrangement; (ii) it assumes inventory risk if the product is lost in transit or is returned by the customer; (iii) it has supplier discretion and sets the price of the product charged to the customer, (iv) it assumes the credit risk for the amounts billed and (v) it works closely with the customer to determine their hardware and software specifications. Freight billed to customers is included in revenue and the related freight costs are in cost of goods sold. Revenues are reported net of any sales based taxes assessed by governmental authorities that are imposed concurrent with sales transactions.

The Company also sells certain products for which it acts as agent. Products in this category include third party manufactured services and third party maintenance on hardware. These sales do not meet the criteria for gross revenue recognition, and thus are recognized on a net basis at the time of sale. The cost paid to the vendor or third party provider is recorded as a reduction to revenue, resulting in net sales being equal to the gross profit on the transaction. For the years ended June 30, 2018, 2017 and 2016, revenues recognized on a net basis totaled approximately \$3,972, \$3,797, and \$1,689, respectively.

**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands, except per share amounts)**

**NOTE 1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Service Revenues***

Service revenues consist of professional IT services based on hours of time spent at defined hourly billing rates. Delivery of these services is recognized as the work is completed and the customer has indicated their acceptance of services. For certain engagements, the Company enters into fixed bid contracts, and recognizes revenue as phases of the project are completed and accepted by the customer. The Company recognizes deferred revenues when customers remit payment to the Company, or the Company has the contractual right to bill its customers, prior to satisfaction of all revenue recognition requirements.

***Multiple Element Arrangements***

Periodically, the Company has multiple element arrangements whereby it is obligated to deliver to its customers multiple products and/or services. These multiple elements may occur at the same time, or within close proximity of one another. The allocation of revenue among the elements is based on the Company's best estimate of the stand-alone sales price, vendor specific objective evidence, or third-party evidence when an item is not sold separately. The Company accounts for each element as a separate unit of accounting and recognizes revenue related to the delivered product or services only if, and immediately upon, the above revenue recognition criteria being met.

***Advertising Costs***—Costs related to advertising and promotion are recorded as selling expenses as incurred. Amounts are immaterial for all periods presented.

***Shipping and Handling Costs***—The Company accounts for shipping and handling costs as a component of Cost of Products. These costs are primarily the direct freight costs related to the drop shipment of products to the Company's customers. Shipping and handling costs amounted to \$176, \$155, and \$196, in fiscal years 2018, 2017 and 2016, respectively.

***Concentration of Risk***—The State of New York and its agencies in the aggregate accounted for 53% of the Company's revenues during the fiscal year 2018, 53% during fiscal year 2017, and 52% during fiscal year 2016. At June 30, 2018, one customer accounted for approximately 36% of the gross accounts receivable balance, and at June 30, 2017, three customers accounted for approximately 36% of the gross accounts receivable balance.

Sales of products manufactured by two manufacturers accounted for approximately 78% of product revenue and 64% of total revenues during fiscal year 2018, 78% of product and 63% of total revenues during fiscal year 2017, and 73% of product and 59% of total revenues during fiscal year 2016. Typically, vendor agreements provide for the Company to be recognized, on a non-exclusive basis, as an authorized reseller of specified products at specified locations. The agreements generally are terminable on 30 to 90 days notice or immediately upon the occurrence of certain events, and are subject to periodic renewal. Substitute products are readily available.

The Company maintains its cash balances at a commercial bank. Balances are insured by the Federal Deposit Insurance Corporation for up to \$250. The Company's cash balances regularly exceed such insured limits. The Company reduces its exposure to credit risk by maintaining its cash at high quality financial institutions.

***Accounts Receivable***—The Company establishes reserves for uncollectible accounts receivable based on its best estimate of the amount of probable credit losses. The Company periodically reviews its accounts receivable to determine whether an allowance is necessary based on an analysis of past due accounts and other factors that may indicate that the realization of an account may be in doubt. Account balances deemed to be uncollectible are charged to the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Information with respect to the Company's allowance for doubtful accounts is presented in Note 2.

**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share amounts)

**NOTE 1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Income Taxes**—The Company accounts for income taxes using the asset and liability method whereby deferred tax assets and liabilities are determined based on temporary differences between the bases used for financial reporting and income tax reporting purposes. Deferred income taxes are provided based on the enacted tax rates in effect at the time such temporary differences are expected to reverse. A valuation allowance is provided for deferred tax assets if it is more likely than not that the Company will not realize those tax assets through future operations.

The Company accounts for uncertain tax positions using the provisions of Accounting Standards Codification (“ASC”) 740, *Income Taxes*, which contains a two step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not, that the position will be sustained on audit by the taxing authorities. The second step is to measure the tax benefit as the largest amount, which is more than 50% likely of being realized upon ultimate settlement. Management considers many factors when evaluating and estimating the Company’s tax positions and tax benefits, which may require periodic adjustment. Interest and penalties related to unrecognized tax benefits are recognized as income tax expense.

**Work in Process**—Work in process consists primarily of unbilled services that have been provided to the Company’s customers, and software licenses and hardware products for which all revenue recognition criteria have not yet been met. These items are recorded at the lower of cost or net realizable value, and as of June 30, 2018 and 2017, related allowances totaled \$49 and \$0, respectively.

**Property and Equipment**—Property and equipment is stated at cost and is depreciated on a straight-line basis over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of their respective leases or service lives of the improvements, whichever is shorter.

**Fair Value of Financial Instruments**—The carrying amounts reported on the consolidated balance sheets for cash, accounts receivable, work in process, prepaid items, accounts payable and accrued expenses approximate fair value based on the short-term maturity of these instruments. The carrying amount of the revolving line of credit approximates fair value as it carries a market-based interest rate.

**Stock Based Compensation**—Stock based compensation expense includes compensation expense for all stock based compensation awards based on the grant date fair value estimated in accordance with the provisions of ASC 718, *Stock-Based Compensation*, and effective July 1, 2017, with the provisions of ASU 2016-09, *Improvements to Employee Share Based Payment Accounting*, with no material impact upon adoption. There were no stock option grants in the years ended June 30, 2018 or 2017. The weighted average fair value of employee stock options granted during fiscal 2016 was \$4.03 per share, using the Black-Scholes option-pricing model with the following weighted average assumptions:

	<b><u>2016</u></b>
Risk-free interest rate	1.53%
Volatility	49.72%
Forfeiture rate	5.00%
Expected life in years	5
Dividend yield	0.00%

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. Historically, the Company has not paid dividends on any regular basis. For all stock option grants in the periods presented above, no dividends were paid preceding the grant date, therefore the dividend yields are zero. Expected volatility and forfeiture rates are principally based on the Company’s historical experience. Beginning with fiscal year 2018, the Company recognizes forfeitures on an actual basis as they occur.

**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share amounts)

**NOTE 1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The Company recorded approximately \$716, \$191, and \$736, in stock based compensation expense as a general and administrative expense for the years ended June 30, 2018, 2017 and 2016, respectively; of which \$102, \$151, and \$216 relates to stock based compensation expense for employee stock options, respectively.

**Comprehensive Income**—Comprehensive income is comprised of net income and all changes to stockholders' equity, except for changes that relate to investments made by stockholders, changes in paid-in capital and dividends. There are no elements of comprehensive income for the years ended June 30, 2018, 2017 or 2016, and the Company has no elements of accumulated other comprehensive income as of June 30, 2018 or 2017.

**Net Income Per Share**—The computation of net income per share excludes the effect of potentially dilutive securities that would be issuable upon the exercise of stock options, because their effect would be anti-dilutive. Basic and diluted weighted average shares for the periods presented are as follows:

	<b>For the Year Ended June 30,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Weighted average shares- basic	2,278,653	2,264,390	2,219,155
Dilutive options	89,958	119,904	77,412
Weighted average shares- diluted	2,368,611	2,384,294	2,296,567

**Recent Accounting Pronouncements**—In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*, which when effective will supersede existing revenue recognition requirements and will eliminate most industry-specific guidance from generally accepted accounting principles. The core principle of the new guidance is to require an entity to recognize as revenue the amount that reflects the consideration to which it expects to be entitled in exchange for goods or services as it transfers control to its customers. The new guidance requires additional disclosures including those that are qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. An entity can apply the new guidance retrospectively to each prior reporting period presented (i.e., the full retrospective method) or retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application in retained earnings. In August 2015, the FASB issued a standards update for a delay of the effective date of this new revenue recognition standard. The guidance now becomes effective for the Company in fiscal year 2020. Management is currently evaluating the appropriate transition method and any further impact of this guidance on its consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes- Balance Sheet Classification of Deferred Taxes*. This ASU simplifies the presentation of deferred taxes by requiring that deferred tax assets and liabilities be presented as noncurrent on the balance sheet. ASU 2015-17 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017, with early adoption permitted. Management does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements; however the current portion of the Company's net current deferred income tax assets will be reclassified to non-current assets.

**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share amounts)

**NOTE 1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which changes the accounting for leases, requiring lessees to recognize the assets and liabilities that arise from all leases. Lessor accounting, however, has remained largely unchanged, with certain exceptions to allow for better alignment of lessee and lessor accounting as well as key aspects of revenue recognition guidance. The new lease standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with adoption to use certain transition relief. The new standard will be effective for reporting periods beginning after December 15, 2019 with early application permitted. The Company is currently evaluating the impact of the adoption of the updated standard.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting*. This ASU provides additional guidance for when a company should apply modification accounting when there is a change in either the terms or conditions of a share-based payment award. Specifically, a company should not apply modification accounting if the fair value, vesting conditions, and classification of the award remains the same immediately before and after the modification. The amendments in this update must be applied on a prospective basis and are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. Management does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

**NOTE 2. COMPOSITION OF CERTAIN FINANCIAL STATEMENT CAPTIONS**

***Accounts Receivable:***

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Accounts receivable	\$ 67,052	\$ 71,706
Less: allowance for doubtful accounts	(516)	(445)
	<u>\$ 66,536</u>	<u>\$ 71,261</u>

As of June 30, 2018, and 2017, the Company performed an analysis of the allowance for doubtful accounts based on periodic reviews of its receivables, taking into consideration historical write-offs and future payment expectations. During the year ended June 30, 2018, the Company wrote off accounts receivable of \$761 and increased the reserve by \$833 based on management's periodic review. During the year ended June 30, 2017, the Company wrote off and collected accounts previously deemed uncollectible of \$588, decreased the reserve by \$328 for accounts previously deemed uncollectible, and increased the reserve by \$366 based on management's periodic review.

**DYNTEK, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share amounts)

**NOTE 2. COMPOSITION OF CERTAIN FINANCIAL STATEMENT CAPTIONS (CONTINUED)**

***Property and Equipment:***

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Furniture and fixtures	\$ 322	\$ 295
Computer equipment	514	556
Leasehold improvements	994	233
Construction in progress	139	-
	1,969	1,084
Less: accumulated depreciation	(725)	(852)
	<u>\$ 1,244</u>	<u>\$ 232</u>

During the year ended June 30, 2018, the Company wrote off fully depreciated assets which were no longer in-service totaling \$299. Construction in progress assets relate to the Company's newly leased headquarters location in California which began in May 2018. These improvements are expected to be complete by the end of the 2018 calendar year.

Depreciation expense for the years ended June 30, 2018, 2017 and 2016 amounted to approximately \$173, \$167, and \$180, respectively.

***Other Non-Current Assets:***

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Long-term accounts receivable, net	\$ 12,175	\$ 7,176
Other	170	167
	<u>\$ 12,345</u>	<u>\$ 7,343</u>

Long-term accounts receivable do not bear interest, are not collateralized, and at June 30, 2018, are due between July 2019 and October 2020. At June 30, 2018 and June 30, 2017, imputed interest of \$305 and \$156, respectively, was recorded against the long-term accounts receivable, and such amounts are amortized to interest income over the terms of the accounts receivable.

***Accrued Expenses:***

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Compensation and benefits	\$ 4,297	\$ 3,609
Sales and use taxes	255	174
Income taxes	400	-
Other	221	142
	<u>\$ 5,173</u>	<u>\$ 3,925</u>

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**NOTE 3. REVOLVING LINES OF CREDIT**

On June 30, 2014, the Company entered into a \$20,000 revolving line of credit agreement (the “2014 Facility”) with a bank. Borrowings under the 2014 Facility accrued interest at the higher of the Wall Street Journal Prime Rate plus 0.75%, or 4.0% (an effective rate of 4.25% at June 30, 2016). Interest was payable monthly in arrears. An unused commitment fee of 0.25% was calculated quarterly and payable quarterly in arrears. Borrowings were based on 85% of eligible accounts receivable, plus 40% of eligible long-term accounts receivable, as defined. Borrowings under this 2014 Facility were subject to compliance with operational, financial and collateral reporting requirements, including a financial covenant. The 2014 Facility was collateralized by substantially all the assets of the Company. On July 1, 2014, the 2014 Facility closed and funded, and the Company borrowed \$16,740 to repay in full the prior credit facility and \$5,133 principal and interest due on the Subordinated Promissory Note (Note 4).

On September 30, 2015, the Company and the bank amended and restated the 2014 Facility to increase the revolving line of credit to \$30,000 and to concurrently permit the use of funds to pay in full the then outstanding Senior Notes (Note 4). On September 30, 2015, the Company borrowed \$10,000 to repay in full the principal and interest outstanding on the Senior Notes which totaled \$7,641. The maturity date of the 2014 Facility was extended to September 30, 2018. All other terms of the 2014 Facility remained unchanged. All amounts due totaling \$27,120 under the 2014 Facility were paid in full and the 2014 Facility was terminated concurrent with the March 31, 2017 funding of the new line of credit agreement with a new bank as described below.

On March 31, 2017, the Company entered into a \$50,000 revolving line of credit agreement (the “2017 Facility”) with a new bank. Borrowings under the 2017 Facility accrue interest at the one-month LIBOR plus 2.75% (an effective rate of 4.84% at June 30, 2018 and 3.8% at June 30, 2017). Interest is payable monthly in arrears. Borrowings are based on 85% of eligible accounts receivable, plus 50% to 75% of eligible long term and other assets, as defined. Borrowings under this 2017 Facility are subject to compliance with operational, financial and collateral reporting requirements, including two financial covenants. The 2017 Facility is collateralized by substantially all the assets of the Company. The initial borrowing on the 2017 Facility on March 31, 2017 was \$27,120 and proceeds were used to repay in full the 2014 Facility.

At June 30, 2018 and June 30, 2017, the outstanding balance of the credit facility was \$7,000 and \$22,000, respectively. At June 30, 2018, \$43,000 was available. The Company is in compliance with all requirements and covenants at June 30, 2018. Interest expense on the revolving line of credit for the years ended June 30, 2018, 2017 and 2016 was \$835, \$1,163, and \$998, respectively.

**NOTE 4. NOTES PAYABLE**

There are no notes payable outstanding at June 30, 2018 and 2017.

***Senior Secured Notes Payable to Related Party and Others***

Reference is made to Note 3, Revolving Lines of Credit, in that the notes described below as the “Senior Notes” were subordinate to the 2014 Facility.

On March 8, 2006, the Company entered into a Note Purchase Agreement (the “Note Purchase Agreement”) with SACC Partners, L.P. and Lloyd I. Miller, III (who is the majority shareholder) (the “Senior Lenders”), pursuant to which the Company issued Senior Secured Notes (the “Senior Notes”) in principal amounts of \$1,400 and \$5,300 respectively, with warrants to purchase up to 4.09% and 15.81% respectively, of the Company’s outstanding common stock on a fully diluted basis at the time of exercise. The Senior Notes initially bore interest at the rate of 8% per annum if paid in cash, or 11% per annum if paid in kind, at the Company’s discretion, and are collateralized by substantially all the Company’s assets. Effective January 1, 2009, the Senior Notes were amended (“Fifth Amendment”) to accrue interest at 4% per annum regardless of whether paid in cash or in kind. On November 23, 2009, the ownership of the \$1,400 Senior Secured Note was transferred to Marli Bryant Miller, a related party.

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**NOTE 4. NOTES PAYABLE (CONTINUED)**

In accordance with the Sixth Amendment of the Senior Notes dated March 11, 2011 ("Sixth Amendment"), the principal amount of the Senior Notes was to be payable in equal monthly installments on the last day of each month beginning on March 31, 2013, with the balance to be paid in full on March 1, 2014. Interest was payable quarterly in arrears, unless the Company chose to make its payments in kind, in which case such interest is added to the principal amount of the Senior Notes. Concurrent with the Sixth Amendment, the Company prepaid, without penalty, \$2,000 of principal on the Senior Notes.

Concurrent with the closing of a prior line of credit arrangement in December 2011, to establish the subordination of the Senior Notes to the bank, the Senior Notes were amended and restated for the then outstanding balance of each note, including paid in kind interest to that date. Accordingly, the Senior Note to Lloyd I. Miller, III is in the amount of \$6,166 and the Senior Note to Marli Bryant Miller is in the amount of \$1,653. The principal amount of the Senior Notes was payable in equal monthly installments on the last day of each month beginning on March 31, 2015, with the balance due on March 31, 2016. The interest rate on the Senior Notes remained at 4% per annum, compounding quarterly, regardless of whether paid in cash or in kind. During the year ended June 30, 2015, the Company made scheduled payments of \$996 on the Senior Notes. During the year ended June 30, 2016, the Company made scheduled payments of \$500 on the Senior Notes, and then on September 30, 2015 in conjunction with the expansion and amendment of the 2014 Facility (Note 3), the Company repaid in full, without penalty, the balance on the Senior Notes in the amount of \$7,641.

The Company elected to pay contractual interest on the Senior Notes in kind and recorded an aggregate interest charge of \$79 for the year ended June 30, 2016, of which, \$62 is related to the interest on the note payable to Lloyd I. Miller, III.

In connection with the early full repayment of the Senior Notes on September 30, 2015, the remaining unamortized balance of \$51 of the debt discount was accelerated and expensed. For the year ended June 30, 2016, \$66 of interest expense was recognized in the accompanying consolidated statements of income related to the Senior Note discount.

**NOTE 5. COMMITMENTS AND CONTINGENCIES**

***Lease Commitments***

The Company is obligated under non-cancelable leases for its corporate headquarters and its Southwest region in California through April 2024, and for several separate direct sales offices and other facilities under lease terms expiring at various times through September 2020. Total rent expense for the fiscal years ended June 30, 2018, 2017, and 2016 amounted to \$760, \$826, and \$830, respectively. At June 30, 2018, future minimum rental payments under non-cancelable operating leases are as follows:



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**NOTE 5. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

<u>Year Ending June 30,</u>	
2019	\$672
2020	493
2021	338
2022	344
2023	359
Thereafter	310
	<u>\$2,516</u>

***Legal Proceedings***

From time to time the Company is involved in various legal proceedings and disputes that arise in the normal course of business. These matters have included intellectual property disputes, contract disputes, employment disputes and other matters.

***Employment Agreements***

The Company has entered into employment agreements with two officers of the Company. Upon a change in control (as defined), the executives would be paid up to a total of \$502 in cash or an unrestricted stock grant at the executive's discretion. Upon termination without cause, the executives will receive up to \$583, payable in equal payments over one year, in accordance with the Company's regular practice.

**NOTE 6. STOCKHOLDERS' EQUITY**

As of June 30, 2018, the Company had authorized capital consisting of the following:

- 600,000 shares of Preferred stock, \$.0001 par value, with no shares issued and outstanding, and;
- 5,400,000 shares of Class A Common stock, \$.0001 par value, with 2,288,924 shares issued and outstanding.

***Equity Transactions Completed During the Year Ended June 30, 2016***

On June 30, 2016, the Company granted 43,334 shares of restricted stock to certain employees and non-employee directors under the 2015 Plan (Note 7), all of which have been earned as of June 30, 2016. 40,000 of the shares granted to employees were valued at \$480 and issuable immediately, with the remaining 3,334 granted to non-employee directors valued at \$40 and issuable as of July 1, 2016. As of June 30, 2016, 43,334 of the shares had not yet been issued by the Company's transfer agent and accordingly were classified as subscribed stock at June 30, 2016. Total stock-based compensation of \$736 for the year ended June 30, 2016 includes the \$520 value of restricted stock issued to employees and directors, as well as \$216 for the vesting of stock options issued to employees. During the year ended June 30, 2016, 4,500 common stock options were exercised for cash (Note 7).

On May 23, 2016, the Company's Board of Directors declared a special cash dividend of \$0.10 per share, payable to holders of record as of June 2, 2016. On June 13, 2016, the total dividend paid was \$222 on the then outstanding 2,221,056 shares of common stock.

**DYNTEK, INC. AND SUBSIDIARY**  
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**NOTE 6. STOCKHOLDERS' EQUITY (CONTINUED)**

***Equity Transactions Completed During the Year Ended June 30, 2017***

On June 30, 2017, the Company granted 3,334 shares of restricted stock to non-employee directors under the 2015 Plan (Note 7), all of which have been earned as of June 30, 2017. The 3,334 shares granted to non-employee directors valued at \$40 and are issuable as of July 1, 2017. As of June 30, 2017, 3,334 of the shares had not yet been issued by the Company's transfer agent and accordingly were classified as subscribed stock at June 30, 2017. Total stock-based compensation of \$191 for the year ended June 30, 2017 includes the \$40 value of restricted stock issued to directors, as well as \$151 for the vesting of stock options issued to employees.

On September 21, 2016, the Company's Board of Directors declared a special cash dividend of \$0.15 per share, payable to holders of record as of October 3, 2016. On October 13, 2016, the total dividend paid was \$340 on the then outstanding 2,264,390 shares of common stock.

***Equity Transactions Completed During the Year Ended June 30, 2018***

On June 30, 2018, the Company granted 15,768 shares of restricted stock to certain employees and non-employee directors under the 2015 Plan (Note 7), all of which have been earned as of June 30, 2018. The 2,668 shares granted to non-employee directors valued at \$40 and are issuable as of July 1, 2018. As of June 30, 2018, 15,768 of the shares had not yet been issued by the Company's transfer agent and accordingly were classified as subscribed stock at June 30, 2018. In addition, during fiscal year 2018, the Company granted and issued 33,200 shares of restricted stock to certain employees. Total stock-based compensation of \$716 for the year ended June 30, 2018 includes the \$574 value of restricted stock issued to employees, the \$40 value of restricted stock issued to directors, as well as \$102 for the vesting of stock options issued to employees.

On July 11, 2017, the Company's Board of Directors approved the buyback of certain outstanding and vested common stock options and common stock shares for cash of \$13 per share. This transaction closed on July 31, 2017 with the repurchase of 173,555 vested common stock options and 18,250 shares of common stock. The Company paid cash of \$1,626 and decreased stockholders' equity by \$1,626.

**NOTE 7. STOCK BASED COMPENSATION**

The Company, since its inception, has granted both non-qualified ("NSO") and qualified ("ISO") stock options to various employees and non-employees at the discretion of the Board of Directors. Substantially all options granted to date have exercise prices equal to the fair value of the underlying stock at the date of grant and contractual terms of up to ten years.

The Company has one active stock option plan to grant options to purchase common stock to employees, directors of the Company, and certain other individuals. As of June 30, 2018, there were approximately 200,000 options available for grant.

On September 15, 2015, the Company's Board of Directors approved the 2015 Stock Incentive Plan (the "2015 Plan"), which provides for the grant of up to an aggregate 150,000 options to purchase common stock. The 2015 Plan provides for either ISOs to employees or NSOs to officers, directors, key employees or other individuals at the discretion of the compensation committee of the Board of Directors.

The terms of the awards are subject to the provisions in an option agreement, consistent with the terms of the plans. The exercise price of a stock option shall not be less than the fair value of the Company's common stock on the date of grant. No stock option shall be exercisable later than ten (10) years after the date it is granted.

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**NOTE 7. STOCK BASED COMPENSATION (CONTINUED)**

A summary of the status of the Company's stock option activity for the years ended June 30, 2018, 2017 and 2016 is as shown below. All of the stock options issued and outstanding at June 30, 2018 are NSOs.

<b>Options</b>	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at June 30, 2015	305,774	\$ 5.43	6.69	-
Exercisable at June 30, 2015	203,204	4.89	5.59	-
Granted	95,000	9.10	-	-
Exercised	(4,500)	4.50	-	-
Forfeited or expired	(25,020)	(8.72)	-	-
Outstanding at June 30, 2016	371,254	6.16	6.41	-
Exercisable at June 30, 2016	246,383	5.17	5.17	-
Forfeited or expired	(27,210)	(3.90)	-	-
Outstanding at June 30, 2017	344,044	5.87	5.22	-
Exercisable at June 30, 2017	292,372	5.46	4.73	-
Repurchased/canceled	(173,555)	( 5.00)	-	-
Exercised	(6,250)	( 6.52)	-	-
Outstanding at June 30, 2018	164,239	\$ 6.77	5.22	\$ 1,351
Exercisable at June 30, 2018	147,570	\$ 6.51	4.98	\$ 1,253

The weighted-average fair value of options granted to employees during fiscal years 2018, 2017, and 2016 was \$0, \$0, and \$4.03, respectively. The weighted-average remaining contractual term of options outstanding gives effect to employee terminations which, under the provisions of the plans reduces the remaining life of such options to a period of 30 days following the respective dates of such terminations.

At June 30, 2018, total unrecognized estimated compensation cost related to non-vested stock options granted prior to that date was \$17, which is expected to be recognized over 0.3 years.

During the year ended June 30, 2018, 6,250 stock options were exercised for cash proceeds of \$41. The weighted average share price on the date of exercise was \$12.00 and the intrinsic value of the options exercised was \$34. No stock options were exercised in the year ended June 30, 2017. During the year ended June 30, 2016, 4,500 stock options were exercised for cash proceeds of \$20. The weighted average share price on the date of exercise was \$9.10 and the intrinsic value of the options exercised was \$21. The Company did not modify any stock option agreements granted to employees or non-employees under any of its share-based payment arrangements. In addition, the Company did not capitalize the cost associated with stock-based compensation awards.

During fiscal year 2018, the Company granted 48,968 shares of restricted stock to certain employees and non-employee directors under the 2015 Plan, all of which have been earned as of June 30, 2018. The total expense associated with these awards was \$614 and was recorded as a general and administrative expense for the year ended June 30, 2018.

During fiscal year 2017, the Company granted 3,334 shares of restricted stock to non-employee directors under the 2015 Plan, all of which have been earned as of June 30, 2017. The total expense associated with these awards was \$40 and was recorded as a general and administrative expense for the year ended June 30, 2017.

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**NOTE 7. STOCK BASED COMPENSATION (CONTINUED)**

During fiscal year 2016, the Company granted 43,334 shares of restricted stock to certain employees and non-employee directors under the 2015 Plan, all of which have been earned as of June 30, 2016. The total expense associated with these awards was \$520 and was recorded as a general and administrative expense for the year ended June 30, 2016.

**NOTE 8. DEFINED CONTRIBUTION PLAN**

The Company maintains a defined contribution 401(k) plan that covers substantially all employees. Contributions to the plan may be made by the Company (which are discretionary) or by plan participants through elective salary reductions. During the years ended June 30, 2018 and 2017, the Company accrued \$303 and \$248, respectively, in discretionary employer matching contributions to the plan, and paid \$299, \$283, and \$272 during the years ended June 30, 2018, 2017 and 2016, respectively.

**NOTE 9. INCOME TAXES**

The Company recognizes deferred tax assets and liabilities for the expected impact of differences between the financial statements and tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax loss and tax credit carry forwards. The Company establishes a valuation allowance to reflect the likelihood of realization of deferred tax assets. Deferred tax assets and liabilities and the related valuation allowances, as well as liabilities for unrecognized tax benefits, involve a high degree of judgment and such estimates are subject to change in the near term, which could be material to the financial statements.

The income tax provision is comprised of the following:

	Year ended June 30,		
	2018	2017	2016
Current:			
Federal	\$ 338	\$ 75	\$ 99
State	391	191	46
	<u>729</u>	<u>266</u>	<u>145</u>
Deferred:			
Federal	2,331	1,225	1,652
State	378	521	(253)
	<u>2,709</u>	<u>1,746</u>	<u>1,399</u>
	<u>\$ 3,438</u>	<u>\$ 2,012</u>	<u>\$ 1,544</u>

A reconciliation of the expected statutory rate to the Company's effective rate as reported for each of the periods presented is as follows:

	Year ended June 30,		
	2018	2017	2015
Statutory rate	28.1 %	34.0 %	34.0 %
State income tax rate, net of Federal benefit	6.5	6.0	5.4
Federal income tax rate change	17.2	-	-
State income tax rate changes	0.2	-	(9.2)
Expired and limited net operating losses	9.9	-	-
Stock compensation windfall	(3.7)	-	-
Other	0.8	3.2	3.0
Effect of permanent differences	2.0	1.4	1.4
Effective tax rate	<u>61.0 %</u>	<u>44.6 %</u>	<u>34.6 %</u>

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**NOTE 9. INCOME TAXES (CONTINUED)**

In connection with the adoption of ASU 2016-09 on July 1, 2017, the Company realized windfall income tax benefits of \$210, which was recognized as a discrete period income tax benefit as required by the ASU. This benefit resulted in lowering the Company's annual effective income tax rate by 3.7 percentage points.

Deferred tax assets, net of deferred tax liabilities, consist of the following:

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Net operating loss carryforwards	\$ 768	\$ 1,976
Allowance for doubtful accounts	141	175
Depreciation	(253)	(83)
Accrued compensation	895	1,023
Amortization	250	609
Stock based compensation	301	570
Other	300	841
	<u>\$ 2,402</u>	<u>\$ 5,111</u>

  

	<b>June 30,</b>	
	<b>2018</b>	<b>2017</b>
Current deferred tax assets	\$ 1,336	\$ 1,563
Non-current deferred tax assets	1,066	3,548
	<u>\$ 2,402</u>	<u>\$ 5,111</u>

As of June 30, 2018, the Company has net operating losses of approximately \$1.7 million and \$6.7 million for federal and state purposes, respectively, that may be available to offset future taxable income. If not utilized, these federal and state carry forwards will begin to expire in tax years 2026 and 2017, respectively.

Permanent differences principally relate to non-deductible expenses such as meals and entertainment expenses.

The Company is subject to U.S. federal, state and local taxes in the normal course of business, and its income tax returns are subject to examination by the relevant tax authorities. Tax years 2015-2017 are still open for examination by Federal tax authorities and tax years 2015-2017 are generally open for examination by state tax authorities. The Company has not fully utilized net operating loss carry forwards which were generated in the tax years 2000-2008, so the statute of limitations for these years remains open for purposes of adjusting the amounts of the losses carried forward from those years. As of June 30, 2018 and 2017, the Company has no unrecognized tax benefits.

While management believes that the Company has adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than the recorded positions. Accordingly, the Company's provisions on federal and state tax related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

**NOTE 10. SUBSEQUENT EVENTS**

The Company has performed an evaluation of subsequent events through September 5, 2018, which is the date the consolidated financial statements were available for issuance.