

# **RBC Life Sciences, Inc. and Subsidiaries**

**Consolidated Financial Statements**

Years Ended December 31, 2016 and 2015

# RBC Life Sciences, Inc. and Subsidiaries

## Consolidated Financial Statements

Years Ended December 31, 2016 and 2015

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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
RBC Life Sciences, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of RBC Life Sciences, Inc. and Subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of comprehensive income (loss), shareholders’ equity, and cash flows for each of the years in the two-year period ended December 31, 2016. The Company’s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RBC Life Sciences, Inc. and Subsidiaries as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

**LANE GORMAN TRUBITT, LLC**

Dallas, Texas  
April 14, 2017

**RBC Life Sciences, Inc. and Subsidiaries**  
**CONSOLIDATED BALANCE SHEETS**

December 31,

	2016	2015
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 1,470,655	\$ 1,449,825
Accounts receivable, net of allowance for doubtful accounts of \$25,737 and \$36,180, respectively	1,165,275	1,216,770
Inventories	4,146,242	4,280,570
Prepaid expenses and other current assets	608,320	464,173
Deferred income taxes	301,678	377,834
Total current assets	7,692,170	7,789,172
Property and equipment, net	977,579	1,237,363
Goodwill, net	2,155,133	2,145,319
Other intangible assets, net	20,107	26,064
Other assets	115,874	97,788
	\$ 10,960,863	\$ 11,295,706
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable, trade	\$ 1,602,307	\$ 1,305,730
Accrued liabilities	1,760,392	1,563,581
Deferred revenue	6,688	95,170
Total current liabilities	3,369,387	2,964,481
Deferred income taxes	461,135	451,553
Commitments and contingencies		
Shareholders' equity		
Common stock, \$0.001 par value, authorized 50,000,000 shares; 2,213,010 shares issued and outstanding in 2016 and 2015	2,213	2,213
Additional paid-in capital	13,714,523	13,714,523
Accumulated deficit	(6,915,215)	(6,158,931)
Accumulated other comprehensive income	328,820	321,867
	7,130,341	7,879,672
	\$ 10,960,863	\$ 11,295,706

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

**RBC Life Sciences, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

Years Ended December 31,

	2016	2015
Net sales	\$ 25,772,572	\$ 24,365,048
Cost of sales	12,158,920	10,903,618
Gross profit	13,613,652	13,461,430
Operating Expenses		
General and administrative	9,742,591	11,283,468
Distributor commissions	4,122,568	4,187,233
Depreciation and amortization	414,776	502,148
Total operating expenses	14,279,935	15,972,849
Operating loss	(666,283)	(2,511,419)
Gain on sale of property and equipment	-	(1,706,818)
Interest expense	-	41,503
Loss before income taxes	(666,283)	(846,104)
Income tax provision (benefit)	90,001	(104,265)
Net loss	(756,284)	(741,839)
Other comprehensive income (loss):		
Foreign currency translation adjustment	6,953	194,992
Comprehensive loss	\$ (749,331)	\$ (546,847)
Basic loss per share	\$ (0.34)	\$ (0.34)
Basic weighted average shares outstanding	2,213,010	2,212,433
Diluted loss per share	\$ (0.34)	\$ (0.34)
Diluted weighted average shared outstanding	2,213,010	2,212,433

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

**RBC Life Sciences, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

	Common stock		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income	Total shareholders' equity
	Shares	Amount				
Balance at January 1, 2015	2,212,350	\$ 2,212	\$ 13,713,630	\$ (5,417,092)	\$ 126,875	\$ 8,425,625
Comprehensive income (loss)						
Net loss	-	-	-	(741,839)	-	(741,839)
Foreign currency translation adjustment	-	-	-	-	194,992	194,992
Total comprehensive loss						(546,847)
Exercise of stock option	660	1	893	-	-	894
Balance at December 31, 2015	2,213,010	2,213	13,714,523	(6,158,931)	321,867	7,879,672
Comprehensive income (loss)						
Net loss	-	-	-	(756,284)	-	(756,284)
Foreign currency translation adjustment	-	-	-	-	6,953	6,953
Total comprehensive loss						(749,331)
Balance at December 31, 2016	2,213,010	\$ 2,213	\$ 13,714,523	\$ (6,915,215)	\$ 328,820	\$ 7,130,341

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

**RBC Life Sciences, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended December 31,

	2016	2015
Cash flows from operating activities		
Net loss	\$ (756,284)	\$ (741,839)
Adjustments to reconcile net loss to net cash provided (used) by operating activities		
Depreciation and amortization	414,776	502,148
Gain on sale of property and equipment	-	(1,706,878)
Deferred income taxes	82,509	(107,178)
Changes in operating assets and liabilities		
Accounts receivable	51,577	68,732
Inventories	125,631	473,199
Prepaid expenses and other current assets	(143,891)	(27,765)
Other assets	(20,228)	100,878
Accounts payable	296,613	(989,443)
Accrued liabilities	194,295	224,836
Deferred revenue	(89,464)	(2,048,939)
Net cash provided (used) by operating activities	155,534	(4,252,249)
Cash flows from investing activities		
Purchase of property and equipment	(148,836)	(179,950)
Proceeds from sale of property and equipment	-	4,818,756
Net cash provided (used) by investing activities	(148,836)	4,638,806
Cash flows from financing activities		
Proceeds from exercise of common stock option	-	894
Payments of long-term obligations	-	(1,136,347)
Net cash used by financing activities	-	(1,135,453)
Effect of exchange rate changes on cash flows	14,132	277,372
Net increase (decrease) in cash and cash equivalents	20,830	(471,524)
Cash and cash equivalents at beginning of year	1,449,825	1,921,349
Cash and cash equivalents at end of year	\$ 1,470,655	\$ 1,449,825
Supplemental cash flow disclosures		
Interest paid	\$ -	\$ 42,108
Income taxes paid, net	47,184	54,589

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

**RBC Life Sciences, Inc. and Subsidiaries**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – NATURE OF OPERATIONS AND ORGANIZATION

RBC Life Sciences, Inc. (along with its subsidiaries, sometimes hereinafter referred to collectively as “RBC” or the “Company”) is principally engaged in the marketing of nutritional supplements and personal care products (collectively “Nutritional Products”) through subsidiaries in North America and Southeast Asia and through licensees in Russia/Eastern Europe. This product line is marketed under the “RBC Life®” brand name. In most of these markets, the Company markets its products through a network of distributors that are referred to as “Members”. The Members are independent contractors who purchase products for personal use, purchase products for resale to retail customers and sponsor other individuals as Members. Accordingly, Members may be product consumers only or they may also seek to derive compensation both from the direct sales of products and from sales generated by sponsored Members. In certain other markets in Southeast Asia and Australia, the Company sells its products through a not-for-resale (“NFR”) program. Individuals who participate in the NFR program function similarly to Members in that they can sponsor others and derive compensation from sales generated by individuals they sponsor. However, they may only order products for personal use and may not resell products to retail customers.

RBC also markets its Nutritional Products in certain international markets through license arrangements. The licensees are third parties who are granted exclusive rights to distribute RBC products in their respective territories and, for the most part, distribute these products through an independent Member network in the licensed territory. Under these arrangements, the independent Member network in a licensed territory is compensated by the licensee.

In addition to its Nutritional Products, RBC also markets a line of wound care products (“Medical Products”) under the MPM Medical brand name through a U.S. subsidiary. Medical Products are primarily distributed in the U.S. to hospitals, nursing homes, clinics and pharmacies through traditional medical/surgical supply dealers and pharmaceutical distributors. Medical Products are used to prevent and treat wounds, and manage pain associated with wounds, in the acute care, long-term care and oncology markets.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Principles of Consolidation and Reporting** - The consolidated financial statements include the accounts of RBC and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Subsequent events were evaluated through the issuance date of the financial statements.

On December 15, 2015, the Board of Directors of RBC approved a plan to terminate and suspend the registration of its common stock with the Securities and Exchange Commission (the “SEC”). In accordance with this plan, on February 12, 2016, the Company filed Form 15 with the SEC to voluntarily deregister its common stock and suspend its reporting obligations under the Securities Exchange Act of 1934, as amended. The Company is eligible to file Form 15 because there are fewer than 300 holders of record of its common stock. As a result of filing the Form 15, the Company’s obligation to file certain reports and forms with the SEC, including Forms 10-K, 10-Q, and 8-K, has ceased. Other filing requirements terminated upon the effectiveness of the deregistration, which occurred 90 days after the filing of the Form 15.

**Cash and Cash Equivalents** - The Company regularly holds cash deposits in foreign bank accounts in connection with its foreign operations. At December 31, 2016 and 2015, \$885,000 and \$829,000, respectively, were held in foreign banks. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The Company includes in its cash and cash equivalents credit card payments due from its credit card processors.

The Company maintains certain cash balances at a bank located in the U.S. which at times may exceed insured limits. The Company maintains an agreement with this bank that provides certain collateral as security against the possibility of losses in excess of insured limits. The Company has not experienced any losses with respect to these accounts and believes it is not exposed to any significant credit risk.

**Accounts Receivable** - The Company’s accounts receivable arise in the normal course of business and primarily relate to sales of Medical Products to various businesses and individuals. Accounts receivable are generally due within 30, 45 or 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts.

**RBC Life Sciences, Inc. and Subsidiaries**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accounts outstanding longer than the contractual payment term are considered to be past due. The Company determines its allowance by considering a number of factors including the length of time accounts are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company and the industry as a whole. The Company charges accounts receivable against the allowance when they become uncollectible, and any payments subsequently received on such accounts are credited to the allowance for doubtful accounts.

**Inventories** - Inventories consisting of raw materials and bulk products, packaging materials and finished goods are stated at the lower of cost or market. The cost of inventories is determined using the first in, first out method.

**Property and Equipment** - Property and equipment are recorded at cost. Depreciation and amortization are provided over the estimated useful lives of the related assets, principally on the straight-line method, ranging from three to 25 years.

**Intangible Assets and Amortization** - Goodwill and other intangible assets with indefinite useful lives are not amortized, but are reviewed annually for impairment or when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Intangible assets with finite lives are amortized over their useful lives. At December 31, 2016 and 2015, the Company's intangible assets with finite lives consisted of copyrights, trademarks and other registrations, and other intangibles, all of which are amortized over an average life of 19 years.

The Company has designated year end as the date of its annual goodwill impairment test. The Company tests goodwill for impairment by comparing the carrying value of a reporting unit, including goodwill, to the fair value of the unit. Fair value is determined by estimating the present value of future cash flows and the value of comparable companies based on sales multiples. An impairment loss would be recognized if the carrying value of a reporting unit exceeds the implied fair value. To date, the Company has not recognized any impairment losses related to the carrying value of its goodwill. See Note K for a discussion of the fair value assumptions used for assessing goodwill for impairment.

**Impairment of Long-Lived Assets** - Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**Revenue Recognition and Deferred Revenue** - Sales are recorded when products are shipped, which is the point the risks and rewards of ownership pass to the customer. Sales include amounts billed to customers for shipping and handling and are recorded net of sales taxes. The Company generally requires a cash or credit card payment at the point of sale for Nutritional Products sold to its Members. With regard to orders received from its third-party licensees, the Company generally requires the licensee to make a cash deposit equal to 25% to 50% of the order at the time an order is placed, and to pay the remaining balance when the products are segregated in the Company's warehouse for the account of the licensee or shipped, whichever is sooner; however, sales are not recognized until the products are shipped. Deposits and payments received for unshipped products are recorded as "deferred revenue."

In August 2014, the Company entered into a new two-year license agreement with its principle licensee, Coral Club International, Inc. ("CCI") that restructured the royalty calculations provided under the previous agreement. To affect this transition, the Company recognized royalties of \$941,000 on a one-time basis in the third quarter of 2014. Of this \$941,000 in royalties approximately \$476,000 was recorded as royalty revenue in the third quarter of 2014 while the remainder was recorded as deferred revenue pending shipment of the related products.

**Distributor Commissions** - Distributor commissions consist primarily of commissions paid to Members in accordance with the Member compensation plan. These commissions are calculated based on the total monthly sales by the Member and his or her downline organization. Most commissions are paid to Members monthly. Sales incentives paid to Members that represent rebates are recorded as a reduction of sales rather than distributor commission expense. Members can earn rebates if the amount of their personal

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

monthly sales exceeds a threshold amount set forth under the Member compensation plan. Member rebates recorded as a reduction of sales were \$293,000 and \$260,000 in 2016 and 2015, respectively.

**Income Taxes** - The Company utilizes the liability method of accounting for income taxes. Under the liability method, deferred income tax assets and liabilities are provided based on the difference between the financial statement and tax bases of assets and liabilities as measured by the currently enacted tax rates in effect for the years in which these differences are expected to reverse. Deferred tax expense or benefit is the result of changes in deferred tax assets and liabilities. An allowance against deferred tax assets is recorded in whole or in part when it is more likely than not that such tax benefits will not be realized.

At December 31, 2016 and 2015, the Company had no unrecognized tax benefits. The Company's policy is to record any interest and penalties related to gross unrecognized tax benefits within its provision for income taxes.

**Earnings (Loss) Per Share** - Basic earnings (loss) per common share is based upon the weighted average number of common shares outstanding during each period presented. Diluted earnings (loss) per share is based upon the weighted average number of common shares outstanding and, when dilutive, common shares issuable for stock options.

**Accounting Estimates** - In preparing financial statements in conformity with accounting principles generally accepted in the U.S. ("US GAAP"), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues during the reporting period. Actual results could differ from those estimates.

**Financial Instruments** - The carrying value of cash, interest-bearing deposits, accounts receivable and payable and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. Fair value of long-term debt, if outstanding, is estimated based on interest rates for the same or similar instruments offered having the same or similar maturities and collateral requirements. On July 15, 2015, the Company completed the sale of its headquarters building and related parcel of land in Irving, Texas, and paid the outstanding mortgage debt of approximately \$1.13 million. Accordingly there was no fixed-rate long-term debt outstanding at December 31, 2016 and 2015.

**Segment Information** - The Company's operations involve two operating segments: the Nutritional Products segment and the Medical Products segment. Nutritional Products are developed and distributed to a network of independent Members operating primarily in North America, Southeast Asia and Australia and to licensees operating in certain other countries. Medical Products are developed and sold primarily throughout the U.S. through medical/surgical supply dealers and pharmaceutical distributors to medical institutions such as hospitals, nursing homes and pharmacies.

**Product Return Policy** - Up to one year from the date of purchase, Nutritional Products that are unused and resalable may be returned by a Member for a refund equal to 100% of the sales price to the Member less a 10% restocking fee and commissions paid. The return of product by a Member, other than product damaged at the time of receipt, may result in cancellation of the distributorship. Generally, unused Medical Products may be returned up to six months from date of purchase for a refund equal to 100% of the sales price less a 25% restocking fee. Returned products damaged during shipment are replaced by the Company. Nutritional Products purchased by licensees may not be returned to the Company for a refund except in the case of a product defect.

**Advertising** - Advertising expense is charged to operations when incurred. Advertising expenses were \$48,000 and \$74,000 in 2016 and 2015, respectively.

**Translation of Foreign Currencies** - All assets and liabilities of foreign subsidiaries are translated into U.S. dollars at the exchange rate in effect at the consolidated balance sheet date. Revenue and expense accounts are translated at weighted average exchange rates. Translation gains and losses are reflected as a component of other comprehensive income in shareholders' equity. Gains and losses on foreign currency transactions are included in the consolidated statements of comprehensive income (loss). In 2016 and 2015, the Company recorded losses on foreign currency transactions of \$184,000 and \$283,000, respectively, which were charged to general and administrative expenses.

**RBC Life Sciences, Inc. and Subsidiaries**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Other Comprehensive Income (Loss)** - Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under US GAAP are included in comprehensive income (loss) but are excluded from net earnings (loss) as the amounts are recorded directly as an adjustment to shareholders' equity. The Company's other comprehensive income (loss) is attributed to translation gains or losses of foreign currencies.

**Share-Based Compensation** - The Company recognizes share-based compensation expense based on the fair value of share-based awards. Share-based compensation is estimated at the grant date based on the fair value of the awards expected to vest and recognized as expense ratably over the requisite service period of the award. The Company uses the Black-Scholes valuation model to estimate fair value of share-based awards, which requires various assumptions including estimating stock price volatility, risk-free interest rate and expected life.

**Recent Accounting Pronouncements** - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, that outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 is based on the principle that an entity should recognize revenue to depict the transfer of 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. It also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. Entities have the option of using either a full retrospective or a modified retrospective approach for the adoption of the new standard. In July 2015, the FASB approved the deferral of the effective date for annual reporting periods that begin after December 15, 2017, including interim reporting periods. Early adoption is permitted to the original effective date of December 15, 2016, including interim reporting periods. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements. The Company continues to review this guidance, potential disclosures and the Company's method of adoption to complete its evaluation of the impact on its consolidated financial statements. In addition, the Company continues to monitor additional changes, modifications, clarifications or interpretations being undertaken by the FASB, which may impact the Company's current conclusions.

In August 2014, FASB issued ASU No. 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40)*. ASU No. 2014-15 provides guidance regarding management's responsibility to evaluate whether there exists substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. ASU No. 2014-15 is effective for annual reporting periods ending after December 15, 2016, and interim periods thereafter. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*, that requires inventory not measured using either the last in, first out (LIFO) or the retail inventory method to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. The new standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, and will be applied prospectively. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, that requires deferred tax liabilities and assets to be classified as noncurrent in a classified statement of financial position. ASU 2015-17 will align the presentation of deferred income tax assets and liabilities with International Financial Reporting Standards. The new standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those annual years, and early application is permitted as of the beginning of an interim or annual reporting period either prospectively or retrospectively. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The updated guidance enhances the reporting model for financial instruments by modifying how entities measure and recognize equity investments and present changes in the fair value of financial liabilities, and by simplifying the disclosure guidance for financial instruments. The amendments in this update are effective for fiscal years beginning after

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December 15, 2017. The amendments in this update should be applied prospectively. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The updated guidance requires lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. Recognition, measurement and presentation of expenses will depend on classification as finance or operating leases. The amendments also require certain quantitative and qualitative disclosures. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. A modified retrospective approach must be applied for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-04, *Liabilities — Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products*. This ASU requires entities that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize breakage (i.e. the value that is ultimately not redeemed by the consumer) in a way that is consistent with how it will be recognized under the new revenue recognition standard. Under current U.S. GAAP, there is diversity in practice in how entities account for breakage that results when a consumer does not redeem the entire product balance. This ASU clarifies that an entity's liability for prepaid stored-value products within its scope meets the definition of a financial liability. The amendments in this update are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The amendment may be applied using either a modified retrospective approach or a full retrospective approach. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*. This ASU provides guidance clarifying that the novation of a derivative contract (i.e. a change in counterparty) in a hedge accounting relationship does not, in and of itself, require dedesignation of that hedge accounting relationship. If all of the other hedge accounting criteria are met, including the expectation that the hedge will be highly effective when the creditworthiness of the new counterpart to the derivative contract is considered, the hedging relationship will continue uninterrupted. The amendments in this update are effective for reporting periods beginning after December 15, 2016, with early adoption permitted. Entities may adopt the guidance prospectively or use a modified retrospective approach. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-06, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments*. This ASU clarifies the requirements for assessing whether contingent put or call options that can accelerate the payment of principal on debt instruments are clearly and closely related (i.e. an entity is required to assess whether the economic characteristics and risks of embedded put or call options are clearly and closely related to those of their debt hosts only in accordance with the four-step decision sequence of FASB Accounting Standards Codification, or ASC 815, *Derivatives and Hedging* ). An entity should no longer assess whether the event that triggers the ability to exercise a put or call option is related to interest rates or credit risk of the entity. The amendments in this update are effective for reporting periods beginning after December 15, 2016, with early adoption permitted. Entities are required to apply the guidance to existing debt instruments using a modified retrospective transition method as of the period of adoption. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. This ASU is intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements, including the income tax effects of share-based payments and accounting for forfeitures. The amendments in this update are effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU changes the impairment model for most financial assets, requiring the use of an expected loss model which requires entities to estimate the lifetime expected credit loss on financial assets measured at amortized cost. Such credit losses will be recorded as an allowance to offset the amortized cost of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. In addition, credit losses relating to available-for-sale debt securities will now be

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recorded through an allowance for credit losses rather than as a direct write-down to the security. The amendments in this update are effective for reporting periods beginning after December 15, 2019, with early adoption permitted for reporting periods beginning after December 15, 2018. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU provides clarification on eight specific cash flow issues regarding presentation and classification in the statement of cash flows with the objective of reducing the existing diversity in practice. The amendments in this update are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. This ASU requires that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this update do not change GAAP for the pre-tax effects of an intra-entity asset transfer under Topic 810, *Consolidation*, or for an intra-entity transfer of inventory. The amendments in this update are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. This ASU removes the Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment is necessary. The amendments in this update are effective for reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

**NOTE C – ACCOUNTS RECEIVABLE**

At December 31, 2016 and 2015, accounts receivable consist of the following:

	2016	2015
Accounts Receivable		
Trade	\$ 1,191,012	\$ 1,252,950
Less allowance for doubtful accounts	25,737	36,180
Net accounts receivable	\$ 1,165,275	\$ 1,216,770

Changes in the Company's allowance for doubtful accounts for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Beginning balance	\$ 36,180	\$ 35,219
Bad debt provision	3,000	961
Accounts written off	(13,443)	-
Ending balance	\$ 25,737	\$ 36,180

One medical/surgical dealer accounts for a significant portion of Medical Products sales. This dealer filed a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Central District of California in Santa Ana, California on February 24, 2012. In accordance with an arrangement approved by the Bankruptcy Court, the pre-petition accounts receivable balance of approximately \$240,000 that was outstanding at December 31, 2013 was paid in full during 2014. In May 2015, this dealer emerged from bankruptcy following the Bankruptcy Court's confirmation of its plan of reorganization. As of both December 31, 2016 and 2015, this dealer accounted for 38% of total accounts receivable.

In August 2014, the Company entered into a new two-year exclusive distributorship agreement with CCI pursuant to which the royalty calculations were restructured. To affect the transition of royalty calculations from the previous agreement to the new agreement,

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the Company recorded a royalty receivable of \$941,000, which was paid over an 18-month period beginning October 2014 in the amount of approximately \$52,000 per month.

**NOTE D – INVENTORIES**

At December 31, 2016 and 2015, inventories, which are stated at the lower of cost or market, consist of the following:

	<u>2016</u>	<u>2015</u>
Raw materials and bulk products	\$ 241,959	\$ 674,770
Packaging materials	278,751	246,968
Finished goods	3,625,532	3,358,832
	<u>\$ 4,146,242</u>	<u>\$ 4,280,570</u>

**NOTE E – PREPAID EXPENSES AND OTHER CURRENT ASSETS**

At December 31, 2016 and 2015, prepaid expenses and other current assets consist of the following:

	<u>2016</u>	<u>2015</u>
Advance payments to suppliers	\$ 119,359	\$ 186,853
Certificates of deposit - restricted	62,832	61,285
Prepaid insurance and other	426,129	216,035
Total	<u>\$ 608,320</u>	<u>\$ 464,173</u>

At December 31, 2016 and 2015, the Company held certificates of deposit in the amount of approximately \$63,000 and \$61,000, respectively, which were pledged to secure surety bonds.

**NOTE F – PROPERTY AND EQUIPMENT**

At December 31, 2016 and 2015, property and equipment consist of the following:

	<u>2016</u>	<u>2015</u>
Building and improvements	\$ 201,380	\$ 193,464
Computer software and office equipment	2,619,485	2,595,187
Warehouse equipment	367,949	254,034
Automotive equipment	14,717	14,717
	<u>3,203,531</u>	<u>3,057,402</u>
Less accumulated depreciation and amortization	2,225,952	1,820,039
	<u>\$ 977,579</u>	<u>\$ 1,237,363</u>

Depreciation expense totaled approximately \$408,800 and \$489,100 for the years ended December 31, 2016, and 2015, respectively.

On July 15, 2015, the Company completed the sale of its headquarters facility and related parcel of land in Irving, Texas for approximately \$5.18 million. After repayment of outstanding mortgage debt of approximately \$1.13 million secured by this facility and payment of other closing costs and adjustments, the Company received net cash proceeds of approximately \$3.75 million. Effective upon closing of this sale, the Company entered into an agreement to lease back this facility from the purchaser under a lease that provided for, among other things, a lease term ending April 30, 2016 and rent of approximately \$35,000 per month. On March 26, 2016, the Company entered into a three-year lease with the purchaser to lease approximately 57,000 square feet of this facility. This lease agreement provides for, among other things, a lease term of three years effective May 1, 2016 and monthly rent of approximately \$21,660. The Company is responsible for a pro rata share of operating expenses including ad valorem real estate taxes, property

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insurance and property maintenance costs. In addition, the landlord may cancel the lease any time after twenty-two months upon eight months' notice.

**NOTE G – GOODWILL AND OTHER INTANGIBLE ASSETS**

The Company measures its goodwill for impairment at the end of each year or in the event of an impairment indicator. No impairment losses have been recognized as a result of this testing. See Note K for a discussion of the fair value assumptions used for assessing goodwill for impairment.

Goodwill balances are summarized as follows:

	<u>Gross Carrying Value</u>	<u>Accumulated Amortization</u>
Balance, January 1, 2015	3,285,690	(1,064,343)
Currency translation adjustment	(152,516)	76,488
Balance, December 31, 2015	<u>\$ 3,133,174</u>	<u>\$ (987,855)</u>
Currency translation adjustment	23,310	(13,496)
Balance, December 31, 2016	<u>\$ 3,156,484</u>	<u>\$ (1,001,351)</u>

At December 31, 2016 and 2015, other intangible assets consist of the following:

	<u>2016</u>			<u>2015</u>		
	<u>Average Life (years)</u>	<u>Gross Carrying Value</u>	<u>Accumulated Amortization</u>	<u>Average Life (years)</u>	<u>Gross Carrying Value</u>	<u>Accumulated Amortization</u>
Copyrights, trademarks and other registrations	19	\$ 99,100	\$ (81,262)	19	\$ 99,100	\$ (75,976)
Other	19	12,600	(10,331)	19	12,600	(9,660)
		<u>\$ 148,893</u>	<u>\$ (128,786)</u>		<u>\$ 148,893</u>	<u>\$ (122,829)</u>

Amortization expense related to other intangible assets totaled approximately \$6,000 and \$13,000 for the years ended December 31, 2016 and 2015, respectively. The aggregate estimated amortization expense for other intangible assets is as follows:

Year ended December 31,	
2017	\$ 5,957
2018	5,957
2019	5,957
2020	2,236
	<u>\$ 20,107</u>

**NOTE H – ACCRUED LIABILITIES**

At December 31, 2016 and 2015, accrued liabilities consist of the following:

	<u>2016</u>	<u>2015</u>
Distributor commissions and awards	\$ 1,120,244	\$ 1,047,593
Salaries and wages	521,828	501,048
Sales and property taxes	31,821	7,462
Other	86,499	7,478
Total	<u>\$ 1,760,392</u>	<u>\$ 1,563,581</u>

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NOTE I – SHARE-BASED COMPENSATION

**Stock incentive plans** - On July 1, 1998, the Company's shareholders adopted the 1998 Stock Option Plan and reserved 50,000 shares of common stock for issuance under this plan. Effective September 4, 2003, the Company's shareholders adopted an amendment and restatement of this plan, which, among other things, increased the number of shares reserved under this plan to 350,000. This plan expired July 1, 2008 although options granted under this plan remain outstanding at December 31, 2016.

On June 1, 2006, the Company's shareholders adopted the 2006 Stock Incentive Plan (the "2006 Plan") under which 250,000 shares of common stock were reserved for issuance. The 2006 Plan provides for the issuance of non-qualified stock options, incentive stock options, restricted stock awards and stock appreciation rights, and permits grants to employees, non-employee directors and consultants of the Company.

Generally, stock options granted under these plans vest over a period from four to five years and have a term of nine years. Certain stock options granted under these plans were fully vested upon grant and certain options have terms of five years.

**Stock Option Accounting** - The Company recognizes share-based compensation expense based on the fair value of share-based awards as estimated at the grant date. There was no share-based compensation expense for 2016 or 2015. Tax benefits related to this expense were immaterial because virtually all share-based compensation resulted from grants of Incentive Stock Options ("ISO"). No tax benefit is recorded for an ISO unless upon exercise a disqualifying disposition occurs. The Company will prospectively record any excess tax benefits from the exercise of stock options as cash flows from financing activities. There were no material excess tax benefits in 2016 or 2015.

**Fair Value** - The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. There were no option grants during the year ended December 31, 2016 or 2015.

**Stock Option Activity** - A summary of stock option activity for the two years ended December 31, 2016 and 2015 is as follows:

	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, January 1, 2015	50,896	\$ 4.35		
Granted	-	-		
Exercised	(660)	1.35		
Forfeited/canceled	(20,676)	3.00		
Outstanding, December 31, 2015	29,560	5.55		
Granted	-			
Exercised	-			
Forfeited/canceled	(10,830)	8.15		
Outstanding, December 31, 2016	18,730	\$ 4.05	2.17	\$ -
Exercisable, December 31, 2016	18,730	\$ 4.05	2.17	\$ -

There were no non-vested stock options outstanding at any time during 2016 or 2015. Also, during the years ended December 31, 2016 and 2015, no stock options were granted or vested, and stock options exercised had no intrinsic value. As of December 31, 2016 and 2015, there was no unrecognized compensation cost related to stock option grants.

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**NOTE J – INCOME TAXES**

The income tax provision (benefit) reconciled to the tax computed at the statutory federal rate of 34% is as follows:

	Year Ended December 31,	
	2016	2015
Federal income tax provision (benefit) at statutory rate	\$ (228,043)	\$ (287,729)
State income taxes, net of federal benefit	9,265	(5,518)
Effect of foreign operations, net of foreign tax credits	117,205	26,740
Other, net	191,574	162,242
Income tax provision (benefit)	<u>\$ 90,001</u>	<u>\$ (104,265)</u>

Deferred tax assets and liabilities at December 31, 2016 and 2015 are comprised of the following:

	December 31,	
	2016	2015
Deferred tax assets related to:		
Inventories	\$ 214,946	\$ 271,669
Accounts receivable and other assets	9,008	12,663
Accrued liabilities	77,724	93,502
Tax loss and tax credit carryforwards	590,928	397,014
Other	16,349	16,349
	<u>908,955</u>	<u>791,197</u>
Valuation allowance	(168,645)	(164,493)
Net deferred tax assets	<u>740,310</u>	<u>626,704</u>
Deferred tax liabilities related to:		
Property and equipment	(277,935)	(80,145)
Intangible assets	(621,832)	(620,278)
Deferred tax liabilities	<u>(899,767)</u>	<u>(700,423)</u>
Net deferred tax liabilities	<u>\$ (159,457)</u>	<u>\$ (73,719)</u>
Net current deferred tax assets	\$ 301,678	\$ 377,834
Net long-term deferred tax liabilities	(461,135)	(451,553)
	<u>\$ (159,457)</u>	<u>\$ (73,719)</u>

At December 31, 2016, the Company has U.S. federal net operating loss carryforwards of approximately \$219,000 and tax credit carryforwards of approximately \$175,000 that begin to expire in 2020, if not utilized. The Company also has net operating loss carryforwards totaling approximately \$2,666,000 related to various foreign jurisdictions.

The Company files federal income tax returns in the U.S. and certain foreign jurisdictions where the Company conducts operations and in certain U.S. state jurisdictions. The most significant taxing jurisdiction is the U.S. federal jurisdiction. The Company's 2012 through 2016 tax years remain subject to examination by the IRS for U.S. federal tax purposes. As of December 31, 2016, no tax years were under examination in any taxing jurisdiction.

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Income tax expense (benefit) consists of the following:

	Year Ended December 31,	
	2016	2015
Current		
Federal	\$ 7,492	\$ 2,902
Foreign	-	11
Deferred		
Federal	207,027	(148,216)
Foreign	(124,518)	41,038
Income tax benefit	\$ 90,001	\$ (104,265)

**NOTE K - FAIR VALUE MEASUREMENTS**

As defined in ASC 820, *Fair Value Measurements*, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level valuation hierarchy for fair value measurements. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect less transparent active market data, as well as internal assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1-Quoted prices for *identical* instruments in active markets
- Level 2-Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable
- Level 3-Instruments with significant unobservable inputs

The Company has performed the required impairment review related to goodwill, as described in Note B. A fair value-based methodology is used in testing the carrying value of goodwill, utilizing assumptions including: (1) a long-term projection of revenues and expenses; (2) estimated discounted future cash flows; (3) weighted-average cost of capital; (4) expected tax rate and (5) the enterprise value of comparable companies as a percentage of sales. Factors used in the valuation of goodwill include, but are not limited to, management's plans for future operations, recent operating results and discounted projected future cash flows. These factors are considered Level 3 inputs within the fair value hierarchy.

**NOTE L – COMMITMENTS AND CONTINGENCIES**

**Leases** - The Company leases office and warehouse space and certain equipment using operating leases for various periods through 2021. Rental expense under non-cancelable operating leases totaled \$751,000 and \$637,000 in 2016 and 2015, respectively. Future minimum payments under non-cancelable operating leases are as follows:

Year ended December 31,	
2017	\$ 739,866
2018	467,112
2019	214,491
2020	74,265
2021	69,084
	\$ 1,564,818

**Employee Arrangements** - The Company has entered into employment agreements with certain of its key executives. In October, 2013, the Company entered into an employment agreement with the Company's then Chief Executive Officer. This agreement provided for employment through December 31, 2014, automatic renewal of employment for an additional one-year term unless either party provided notice of non-renewal and, upon termination of employment, a three-year consulting arrangement to be compensated at a specified portion of salary. The employment agreement was not renewed as of December 31, 2014.

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In December 2014, the Company entered into an employment agreement with the Company's current Chief Executive Officer with an initial term ending December 31, 2015. This agreement automatically renews for an additional one-year term at end of the initial term or any subsequent renewal term unless either party provides notice to the other 60 days prior to the last day of the then current term. Among other things, the agreement provides that if employment is terminated for certain reasons set forth in the agreement, which reasons do not include a change of control, the Company will be required to make a severance payment in an amount equal to the greater of (i) the remaining compensation due through the end of the current term or (ii) one-half of the annual base salary. In the event that the Company chooses not to renew the agreement, the Chief Executive Officer will be entitled to one-half of the annual base salary as severance.

In December 2014 and January 2015, the Company entered into employment agreements with six other officers or members of the executive team, expiring December 31, 2015. These agreements generally replaced agreements which expired December 31, 2014. Among other things, the agreements provide that if employment is terminated for certain reasons set forth in the agreements, which reasons do not include a change of control, the Company will be required to make a severance payment in an amount equal to the greater of (i) the remaining compensation due through the end of the current term or (ii) one-half of the annual base salary. These agreements were not renewed as of December 31, 2015.

The Company's employees can participate in an employee benefit plan under Section 401(k) of the Internal Revenue Code offered through its Professional Employer Organization. This plan covers employees in the U.S. who are at least 18 years of age and have been employed by the Company longer than three months. The Company makes discretionary matching contributions equal to 10% of the employees' contributions. Total matching contributions made by the Company during both 2016 and 2015 were approximately \$10,000.

**Litigation** - The Company is from time to time engaged in routine litigation. The Company regularly reviews all pending litigation matters in which it is involved and establishes reserves deemed appropriate by management.

One medical/surgical dealer accounted for 63% and 42% of Medical Products net sales in 2016 and 2015, respectively. On February 24, 2012, this dealer filed a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code. Pursuant to an arrangement approved by the Bankruptcy Court, the pre-petition accounts receivable balance owed by this dealer to the Company was paid in full in July 2014 and, in May 2015, this dealer emerged from bankruptcy.

On April 4, 2014, the Company received a notice from Environmental Research Center ("ERC"), a California non-profit corporation, alleging that the Company failed to include a warning notice related to lead content on labels of certain nutritional products sold in California as required under California's Safe Drinking Water and Toxic Enforcement Act of 1986 (commonly known as Proposition 65). Sales of products identified in this notice totaled approximately \$60,000 for the period covered by the notice. During the first quarter of 2015, the Company and ERC entered into a settlement agreement, which was approved by the Court having jurisdiction over this matter, pursuant to which the Company agreed to modify its labeling of the affected products and pay certain settlement costs. These settlement costs have been recognized in the accompanying consolidated financial statements.

On April 28, 2015, Mannatech, Incorporated, a distributor of nutritional supplement products, filed suit against the Company alleging patent infringement with respect to sales of two of the Company's products. In July 2015, the parties entered into a settlement agreement and the suit was dismissed. All related settlement costs have been recognized in the accompanying consolidated financial statements.

We are not aware of any legal or administrative proceedings which, if determined adversely to us, individually or in the aggregate, would have a material effect on our financial position, results of operations or cash flows.

**Letter of Credit** - The Company has an irrevocable letter of credit in the aggregate amount of approximately \$63,000. The letter of credit expires on October 1, 2017 and automatically extends for one year periods, unless thirty days prior to such date, the financial institution notifies the Company in writing they elect not to consider this letter of credit renewed for any additional period.

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NOTE M – SEGMENTS AND GEOGRAPHIC AREA

The Company's segments are based on the organization structure that is used by management for making operating and investment decisions and for assessing performance. Based on this structure, the Company has two operating segments: Nutritional Products and Medical Products.

The Nutritional Products segment manufactures and distributes a line of approximately 100 nutritional supplements and personal care products, including herbs, vitamins and minerals, as well as natural skin, hair and body care products. Nutritional Products are marketed under the "RBC Life" brand name through subsidiaries in North America and Southeast Asia. These products are distributed by a network comprised of independent Members and NFR program participants in certain markets, primarily North America and Southeast Asia, and by licensees in other international markets. For the most part, licensees also market the Nutritional Products in their respective territories through a network of independent Members.

The Medical Products segment markets a line of over 35 wound care products under the "MPM Medical" brand name through a subsidiary operating primarily in the U.S. These wound care products are distributed to hospitals, nursing homes, home health care agencies, clinics and pharmacies through a network of medical/surgical supply dealers, pharmaceutical distributors and our own sales representatives. Medical Products are used to treat and manage pain associated with wounds, in the acute care, long-term care and oncology markets.

The accounting policies of the segments are the same as those described in Note B. The Company evaluates the performance of its segments primarily based on operating income. All intercompany transactions have been eliminated, and intersegment revenues are not significant. In calculating operating income (loss) for these two segments, administrative expenses incurred that are common to the two segments are allocated on a usage basis.

Segment information is as follows (U.S. dollars in thousands):

	<u>Nutritional Products</u>	<u>Medical Products</u>	<u>Consolidated</u>
Year ended December 31, 2016			
Net sales	\$ 15,331	\$ 10,442	\$ 25,773
Depreciation and amortization	404	11	415
Operating profit (loss)	(2,433)	1767	(666)
Capital expenditures	140	8	148
Total assets	6,962	3,999	10,961
Year ended December 31, 2015			
Net sales	\$ 17,041	\$ 7,324	\$ 24,365
Depreciation and amortization	458	44	502
Operating profit (loss)	(3,358)	847	(2,511)
Capital expenditures	1,125	-	1,125
Total assets	7,695	3,601	11,296

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Financial information summarized geographically based on the customer's ordering location for the years ended December 31, 2016 and 2015 is listed below (U.S. dollars in thousands):

	Net Sales	Long-lived Assets
Year ended December 31, 2016		
Domestic	\$ 12,476	\$ 2,679
Russia/Eastern Europe	5,585	-
Canada	569	399
Southeast Asia	7,014	191
All others	129	-
Totals	<u>\$ 25,773</u>	<u>\$ 3,269</u>
Year ended December 31, 2015		
Domestic	\$ 9,759	\$ 2,881
Russia/Eastern Europe	6,722	-
Canada	772	389
Southeast Asia	6,856	237
All others	256	-
Totals	<u>\$ 24,365</u>	<u>\$ 3,507</u>

**Significant Customers** - The Company recorded sales to CCI, a licensee of the Company, in the amount of \$5,585,000 and \$6,722,000 for the years ended December 31, 2016 and 2015, respectively. The Company also recorded sales to a medical/surgical dealer in the amount of \$6,617,000 and \$3,065,000 for the years ended December 31, 2016 and 2015, respectively. In no other case did a customer of the Company account for more than 10% of net sales for the years ended December 31, 2016 or 2015. At December 31, 2016, two customers accounted for 46% of year-end accounts receivable.

NOTE N – LOSS PER SHARE

Summarized basic and diluted loss per common share were calculated as follows:

	Net Loss	Shares	Per Share
Year ended December 31, 2016			
Basic loss per common share	\$ (756,284)	2,213,010	\$ (0.34)
Effect of dilutive stock options	-	-	-
Diluted loss per common share	<u>\$ (756,284)</u>	<u>2,213,010</u>	\$ (0.34)
Year ended December 31, 2015			
Basic loss per common share	\$ (741,839)	2,212,433	\$ (0.34)
Effect of dilutive stock options	-	-	0
Diluted loss per common share	<u>\$ (741,839)</u>	<u>2,212,433</u>	\$ (0.34)

For 2016 and 2015, the number of stock options that were outstanding but not included in the computation of diluted loss per common share because their exercise price was greater than the average market price of our common stock or were otherwise anti-dilutive, was approximately 19,000 and 30,000, respectively.

NOTE O – RELATED PARTY TRANSACTIONS

**Customer Arrangement** - The Company's principle licensee is CCI. The president of CCI beneficially owned approximately 18% of the Company's outstanding common stock at December 31, 2016. The Company recorded sales to CCI in the amount of \$5,585,000 and \$6,722,000 for the years ended December 31, 2016 and 2015, respectively.

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In August 2014, the Company entered into a two-year exclusive distributorship agreement with CCI, which agreement automatically renews upon expiration for an additional one-year term unless either party notifies the other of cancellation six months prior to the end of the then current term. This agreement replaced the 10-year exclusive distributorship agreement between the parties that expired in July 2014. Pursuant to the agreement, CCI's exclusive territory includes Russia and other countries located primarily in Europe and Central Asia.

In accordance with the terms of the agreement, CCI is required to pay a 25% deposit at the time it places an order and then pay the balance when products are delivered. Delivery occurs at the time products are segregated in the Company's warehouse for CCI's account or when they are shipped to CCI, whichever is sooner. In December 2015, the Company and CCI completed an arrangement whereby the Company no longer holds products for CCI. Accordingly, all products held for CCI, totaling approximately \$1,775,000, were shipped to CCI prior to December 31, 2015 and recognized as sales in the fourth quarter of 2015. Deferred revenue associated with CCI's account at December 31, 2015, which included deposits for orders placed and payments for products held was \$67,000. There was no deferred revenue associated with CCI's account at December 31, 2016.

**Member Sales and Marketing System** - In December 2013, the Company engaged GSAT, Inc. ("GSATi") to develop a new Member sales and marketing system, which was deployed April 1, 2015, and included in the capital expenditures for the year ended December 31, 2015. The founder and CEO of GSATi was a member of the Company's Board of Directors from June 2014 through February 2016.

NOTE P - SUBSEQUENT EVENT

As of January 1, 2017, the Company entered into a "Contract for Sale – Purchase of Assets and Property of Business as a Going Concern" with Narsha Korea, Inc. (the "Seller"). Pursuant to this agreement, the Company agreed to purchase Seller in two steps. The first step provides that the Company will make a capital contribution to Seller of \$700,000 in exchange for 51% of the total number of outstanding shares of Seller, payable in cash and shipments of the Company's product to Seller. The second step provides the Company an option to purchase the remaining 49% of the shares of Seller for \$1.3 million payable in 13 equal installments if the option is exercised within 24 months of the date of the agreement. Narsha Korea, Inc. is a multi-level marketing business located in Seoul, South Korea, and the purchase of Narsha Korea, Inc. allows the Company to engage in the multi-level marketing business in South Korea.

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NOTE Q – QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial data for the years ended December 31, 2016 and 2015 is summarized as follows:

	Quarter Ended			
	March 31	June 30	September 30	December 31
2016	<i>(Unaudited - In thousands, except per share data)</i>			
Net sales	\$ 5,197	\$ 5,991	\$ 7,328	\$ 7,257
Gross profit	2,709	3,321	3,904	3,680
Net income (loss)	(409)	(183)	107	(271)
Income (loss) per share:				
Basic	(0.18)	(0.08)	0.05	(0.13)
Diluted	(0.18)	(0.08)	0.05	(0.13)
2015				
Net sales	\$ 5,360	\$ 6,192	\$ 5,406	\$ 7,407
Gross profit	3,049	3,500	3,123	3,789
Net income (loss)	(550)	(245)	331	(278)
Income (loss) per share:				
Basic	(0.25)	(0.11)	0.15	(0.13)
Diluted	(0.25)	(0.11)	0.15	(0.13)