

REO Plastics, Inc.

Financial Report
April 30, 2022

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Independent Auditor's Report

Board of Directors and Stockholders
REO Plastics, Inc.

Opinion

We have audited the accompanying consolidated financial statements of REO Plastics, Inc. (the Company), which comprise the balance sheets as of April 30, 2022 and 2021, the related statements of income, stockholders' equity and cash flows for the years then ended; and the related notes to the financial statements (collectively, the financial statements).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of REO Plastics, Inc. as of April 30, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued or available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

RSM US LLP

Minneapolis, Minnesota
July 8, 2022

REO Plastics, Inc.

Balance Sheets
April 30, 2022 and 2021

	2022	2021
Assets		
Current assets:		
Cash	\$ 2,192,797	\$ 5,158,800
Trade receivables, net	12,340,205	8,106,720
Inventories, net:		
Raw materials	6,934,097	6,012,416
Work in process	1,684,754	1,038,646
Finished goods	2,947,957	1,848,276
Customer molds in process	444,179	651,445
Prepaid and other current assets	62,021	71,568
Total current assets	26,606,010	22,887,871
Property and equipment, at cost:		
Land	217,593	217,593
Building	6,509,378	5,100,764
Machinery and equipment	21,785,122	18,708,460
Construction in progress	3,766,478	1,262,936
	32,278,571	25,289,753
Less accumulated depreciation	19,299,550	17,973,059
	12,979,021	7,316,694
	\$ 39,585,031	\$ 30,204,565

See notes to financial statements.

	2022	2021
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 5,205,285	\$ 3,892,680
Income taxes payable	78,673	114,673
Accrued expenses, principally compensation	1,593,716	1,339,118
Customer deposits	317,182	382,648
Total current liabilities	7,194,856	5,729,119
Long-term liabilities:		
Construction loan payable	3,641,219	-
Deferred compensation, less current portion	425,557	457,113
Deferred income taxes	1,307,000	740,000
	5,373,776	1,197,113
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value \$0.10 per share; authorized 1,000,000 shares; issued and outstanding 445,909 shares as of April 30, 2022 and 446,009 shares as of April 30, 2021	44,591	44,601
Additional paid-in capital	224,438	224,488
Retained earnings	26,747,370	23,009,244
	27,016,399	23,278,333
	\$ 39,585,031	\$ 30,204,565

REO Plastics, Inc.

Statements of Income
Years Ended April 30, 2022 and 2021

	2022	2021
Net sales	\$ 52,612,865	\$ 36,663,340
Cost of goods sold	<u>45,181,650</u>	<u>31,402,668</u>
Gross profit	<u>7,431,215</u>	<u>5,260,672</u>
Operating expenses:		
General and administrative	2,066,969	1,896,320
Selling	522,109	874,594
Deferred compensation	<u>28,445</u>	<u>29,230</u>
	<u>2,617,523</u>	<u>2,800,144</u>
Operating income	4,813,692	2,460,528
Nonoperating income (expense):		
Interest income	1,015	16,850
Gain on forgiveness of PPP loan	-	2,012,144
Other, net	<u>(3,341)</u>	<u>(26,770)</u>
Net income before income tax expense	<u>4,811,366</u>	<u>4,462,752</u>
Income tax expense	<u>(1,070,000)</u>	<u>(630,000)</u>
Net income	<u>\$ 3,741,366</u>	<u>\$ 3,832,752</u>
Income per common share	<u>\$ 8.39</u>	<u>\$ 8.58</u>
Weighted-average common shares outstanding	<u><u>445,951</u></u>	<u><u>446,759</u></u>

See notes to financial statements.

REO Plastics, Inc.

**Statements of Stockholders' Equity
Years Ended April 30, 2022 and 2021**

	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance, April 30, 2020	\$ 44,771	\$ 225,338	\$ 19,217,972	\$ 19,488,081
Purchase of 1,700 shares of common stock for retirement	(170)	(850)	(41,480)	(42,500)
Net income	-	-	3,832,752	3,832,752
Balance, April 30, 2021	44,601	224,488	23,009,244	23,278,333
Purchase of 100 shares of common stock for retirement	(10)	(50)	(3,240)	(3,300)
Net income	-	-	3,741,366	3,741,366
Balance, April 30, 2022	\$ 44,591	\$ 224,438	\$ 26,747,370	\$ 27,016,399

See notes to financial statements.

REO Plastics, Inc.

Statements of Cash Flows
Years Ended April 30, 2022 and 2021

	2022	2021
Cash flows from operating activities:		
Net income	\$ 3,741,366	\$ 3,832,752
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,426,434	1,259,638
Loss on disposal of equipment	5,217	22,734
Deferred income taxes	567,000	48,000
Deferred compensation expense	28,444	29,230
Deferred compensation payments	(40,000)	(40,000)
PPP loan forgiveness	-	(2,012,144)
Noncash interest expense on PPP loan	-	15,144
Changes in operating assets and liabilities:		
Trade receivables	(4,233,485)	(2,242,023)
Inventories	(2,667,470)	(482,068)
Customer molds in process	207,266	(20,316)
Prepaid and other current assets	9,547	(25,055)
Accounts payable and accrued expenses	1,547,203	2,379,519
Customer deposits	(65,466)	(114,231)
Income taxes payable	(36,000)	4,201
Net cash provided by operating activities	490,056	2,655,381
Cash flows from investing activities:		
Proceeds from redemptions of investments	-	2,500,000
Purchases of investments	-	(750,000)
Purchases of property and equipment	(7,159,213)	(2,296,265)
Proceeds from disposal of property and equipment	65,235	21,000
Net cash used in investing activities	(7,093,978)	(525,265)
Cash flows from financing activities:		
Advances on construction loan	3,641,219	-
Purchase of shares of common stock for retirement	(3,300)	(42,500)
Proceeds from forgivable PPP loan	-	1,997,000
Net cash provided by financing activities	3,637,919	1,954,500
(Decrease) increase in cash	(2,966,003)	4,084,616
Cash:		
Beginning	5,158,800	1,074,184
Ending	\$ 2,192,797	\$ 5,158,800
Supplemental disclosures of cash flow information:		
Cash payments for income taxes	\$ 539,000	\$ 575,000

See notes to financial statements.

REO Plastics, Inc.

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Nature of business: REO Plastics, Inc.'s (the Company) operations principally involve the custom injection molding, decorating and assembling of thermoplastics for customers in various industries, primarily in the United States of America. The Company establishes credit terms on an individual customer basis.

A summary of the Company's significant accounting policies follows:

Use of estimates in the preparation of financial statements: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition: The Company recognizes revenue in accordance with Accounting Standards Codification (ASC) Topic 606, which provides a five-step model for recognizing revenue from contracts with customers as follows:

- Identify the contract with a customer.
- Identify the performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to the performance obligations in the contract.
- Recognize revenue when or as performance obligations are satisfied.

The Company's revenue is derived from sales of custom injection tooling, moldings, decorating and assembling of thermoplastics for original equipment manufacturers in various industries. Sales of products are subject to economic conditions and may fluctuate based on changes in the industry, trade policies and financial markets.

Nature of products and services: Revenue from the sale of the Company's products is recognized at a point in time, upon transfer of control to the customer, which is typically upon shipment, Free on Board (FOB) shipping point. The Company has elected to treat shipping and handling activities related to contracts with customers as costs to fulfill the promise to transfer the associated equipment and not as a separate performance obligation.

Transaction price: The transaction price is the amount of consideration to which the Company expects to be entitled in exchange for transferring goods to the customer. Revenue is recorded based on the transaction price, which includes fixed consideration and estimates of variable consideration such as early payment discounts, rebates, rights of return, and other allowances.

The amount of variable consideration included in the transaction price is constrained and is included only to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Variable consideration is estimated using the expected-value method (i.e., probability-weighted approach) based on review of specific transactions, historical experience, and market and economic conditions. Variable consideration is not significant to the overall transaction price.

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Contract balances: The timing of revenue recognition aligns with the right to invoice the customer. The Company records accounts receivable when it has the unconditional right to issue an invoice and receive payment, which is upon shipment of the product to the customer or completion of the delivery. Payment terms on invoiced amounts range from 30 to 90 days. The primary purpose of the Company's invoicing terms is to provide customers with simplified and predictable ways of purchasing the products and not to provide financing to the customer.

The Company excludes from revenue sales taxes and other government-assessed and imposed taxes on revenue-generating activities that are invoiced to customers.

Warranties: The Company generally provides limited-assurance-type warranties for standard equipment and work performed under its contracts. The warranty periods typically extend for a limited duration following transfer of control of the equipment. Historically, warranty claims have not resulted in material costs incurred. The Company does not consider these warranties to be performance obligations.

Costs to obtain a contract: The Company has elected to apply the practical expedient to expense sales commissions and associated costs as incurred when the expected amortization period is one year or less, which applies to all customer contracts.

Cash: For purposes of reporting cash flows, the Company considers all money market funds to be cash. The Company maintains its cash in bank deposit accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Trade receivables: Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a periodic basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition and credit history, and current economic conditions. The allowance for doubtful accounts approximates \$21,000 as of April 30, 2022 and 2021. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. A trade receivable is generally considered to be past due if any portion of the receivable balance is outstanding for more than 90 days beyond a customer's credit terms.

Inventories: Raw materials are stated at the lower of cost (first-in, first-out) or market. Inventories of work in process and finished goods are stated at standard costs, which approximate the lower of cost (first-in, first-out) or market. Inventories are reduced by valuation reserves of approximately \$15,000 and \$19,000 as of April 30, 2022 and 2021, respectively.

Property and equipment: Property and equipment is stated at acquisition cost. Repair and maintenance are expensed as incurred. Major improvements and betterments are capitalized. Depreciation is provided using the straight-line method based on the following estimated useful lives:

	<u>Years</u>
Building	10-40
Machinery and equipment	3-10

The Company had repairs and maintenance expense of approximately \$956,000 and \$712,000 for the years ended April 30, 2022 and 2021, respectively.

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

The Company is expanding its manufacturing plant to increase capacity and the expansion costs incurred are being capitalized into construction in progress on the balance sheets, until the project is completed and the assets placed in service. The total project cost is estimated to be \$6,000,000, with completion anticipated in the fall of 2022. The Company has obtained a construction loan (see Note 2) to finance most of the project costs and will fund the remain costs with cash flows from operations. During the year ended April 30, 2022, the Company incurred an insignificant amount of interest expense on the construction loan which was capitalized into construction in progress.

Long-lived assets: Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable or if depreciable lives should be modified. To date, management has determined that no impairment of long-lived assets exists.

Customer mold in process and customer deposits: The Company requires a cash deposit and milestone payments for customer-specific mold production, which is generally outsourced to a third-party mold manufacturer. Customer specific molds are recorded as current assets as costs are incurred and the revenue, and the corresponding cost of goods sold, is recognized on the molds when product samples have been approved by the customer.

Income taxes: Deferred income taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance if, in the opinion of management, it is more likely than not that some portion of the deferred tax assets may not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The Company classifies all deferred income taxes as a single, noncurrent net asset in the accompanying balance sheets.

The Company recognizes income tax liabilities when the Company believes that certain positions may not be fully sustained upon review by tax authorities. Benefits from income tax positions are measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Management has evaluated the Company's income tax positions and determined there are no material uncertain income tax positions that require adjustment to the financial statements. To the extent that the final income tax outcome of these matters is different from the amounts recorded, such differences impact income tax expense in the period in which such determination is made. Interest and penalties, if any, related to accrued liabilities for potential income tax assessments are included in income tax expense.

Income per common share: Income per common share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the year.

Recent accounting pronouncements: In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard will be effective for the Company's fiscal year ending April 30, 2023, with early adoption permitted. The Company is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

REO Plastics, Inc.

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in ASC 740 and also clarifies and amends existing guidance to improve consistent application. This ASU is effective for the Company beginning on May 1, 2022. The Company is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

Subsequent events: The Company has evaluated subsequent events through July 8, 2022, the date on which the financial statements were available to be issued.

Note 2. Debt

Construction loan agreement: In December of 2021, the Company entered into a construction loan agreement with a bank, providing for advances of up to \$5,500,000 through December 31, 2022, at which time the outstanding balance will convert to a term note payable. Through September 2022, interest is due monthly at 3.000% and increases to 3.125% in October 2022 through the end of the term loan. The monthly principal payment will be based on a 20-year loan amortization and with a balloon payment for the unpaid principal due December 26, 2028. The Company is allowed to pre-pay the outstanding balance at any point in time without incurring a pre-payment penalty. All borrowings are secured by a mortgage agreement. Advances of approximately \$3,641,000 were outstanding on the construction loan as of April 30, 2022, and are classified as noncurrent in the balance sheet.

Note 3. Federal and State Income Taxes

Deferred income taxes consist of the following components:

	April 30	
	2022	2021
Deferred tax assets:		
Accounts receivable	\$ 5,000	\$ 5,000
Inventory	155,000	37,000
Accrued expenses	92,000	90,000
Deferred compensation	117,000	120,000
	<u>369,000</u>	<u>252,000</u>
Deferred tax liabilities:		
Property and equipment	(1,676,000)	(992,000)
Net deferred tax liabilities	<u>\$ (1,307,000)</u>	<u>\$ (740,000)</u>

The provision for income taxes charged to operations consisted of the following:

	Years Ended April 30	
	2022	2021
Current tax expense	\$ 503,000	\$ 582,000
Deferred tax expense	567,000	48,000
Income tax expense	<u>\$ 1,070,000</u>	<u>\$ 630,000</u>

REO Plastics, Inc.

Notes to Financial Statements

Note 3. Federal and State Income Taxes (Continued)

For the years ended April 30, 2022 and 2021, the difference between the tax expense and that which would be computed by applying the U.S. federal income tax rate (21%) to pretax net income is as follows:

	Years Ended April 30	
	2022	2021
Computed "expected" federal tax expense at statutory rates	\$ 1,010,000	\$ 937,000
State income tax expense, net of federal effect	113,000	110,000
Permanent differences	1,000	5,000
PPP loan forgiveness income	(50,000)	(423,000)
Other	(4,000)	1,000
Income tax expense	<u>\$ 1,070,000</u>	<u>\$ 630,000</u>

Note 4. Commitments and Contingencies

Employee benefit plans: The Company has a 401(k) tax-deferred savings plan in effect for its employees. Employees over the age of 21 are eligible to participate on the 1st day of the month following 30 days of employment. The Company matches 50 cents of each dollar contributed by the employee, up to 6% of the employee's salary. Matching contributions are made on a weekly basis. The Company recorded employer match expense of approximately \$127,000 and \$113,000 for the years ended April 30, 2022 and 2021, respectively.

Lease commitments: The Company leases certain warehouse facilities under a noncancelable lease agreement that expires in August 2024. In addition to base rent, the Company is required to pay its share of maintenance and real estate taxes. Additionally, the Company leases various equipment under noncancelable lease agreements with varying terms.

Future minimum rental payments due under noncancelable operating leases are approximately as follows:

Years ending April 30:	
2023	\$ 383,000
2024	395,000
2025	141,000
2026	21,000
2027	21,000
Thereafter	27,000
	<u>\$ 988,000</u>

Rent expense under operating leases was approximately \$479,000 and \$386,000 for the years ended April 30, 2022 and 2021, respectively.

Litigation: The Company is involved in certain legal proceedings and claims incidental to the normal course of business. Although the ultimate outcome of these outstanding claims cannot be determined, management believes their final resolution will not have a material adverse effect on the financial position of the Company.

REO Plastics, Inc.

Notes to Financial Statements

Note 5. Major Customers

Net sales and trade receivables for the years ended April 30, 2022 and 2021, from major customers (in excess of 10% of total net sales) were as follows:

	Net Sales, Years Ended April 30		Trade Receivables as of April 30	
	2022	2021	2022	2021
Customer A	47%	40%	\$ 6,577,000	\$ 4,156,000
Customer B	*	12%	*	645,000
Customer C	10%	*	987,000	*

*Represents less than 10% of total sales in the year indicated

Note 6. Paycheck Protection Program Loan

In May 2020, the Company entered into a note payable with a bank in the amount of \$1,997,000, under the Paycheck Protection Program (PPP), authorized under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This was a two-year loan with 1.00% interest, which was forgivable under conditions as defined in the CARES Act. The Company applied for and was granted full loan forgiveness, including accrued interest of approximately \$15,000, on February 10, 2021. A gain on debt forgiveness of approximately \$2,012,000 was recognized in the statement of income for the year ended April 30, 2021. All expenses related to the required expenditures under the PPP loan are included in operations for the year ended April 30, 2021. The PPP loan forgiveness is subject to audit by the Small Business Administration for a period up to six years after the loan has been forgiven. No provision has been recorded as the Company believes they met the eligibility criteria to qualify for the loan used the proceeds for qualified operating expenses.

Note 7. Deferred Compensation

The Company has deferred compensation arrangements with four current and retired key executives of the Company. Upon retirement, as defined, each executive receives annual payments of \$20,000 for a period of 11 years. The payments cease upon the death of the executive. All deferred compensation benefits were fully vested as of the signing of the contracts. Deferred compensation expense was approximately \$28,000 and \$29,000 for the years ended April 30, 2022 and 2021, respectively, and consists of the change in the present value of the remaining payments, including estimated retirement dates, and the difference between actual deferred compensation payment and the mortality adjusted expected payments.

REO Plastics, Inc.

Notes to Financial Statements

Note 7. Deferred Compensation (Continued)

Based on estimated retirement dates, the Company expects deferred compensation payments to continue through 2033. Future deferred compensation payments approximate as follows:

Years ending April 30:

2023	\$	80,000
2024		80,000
2025		80,000
2026		80,000
2027		80,000
Thereafter		<u>360,000</u>
		760,000
Less amounts representing interest and life expectancy adjustments		<u>(254,000)</u>
		506,000
Less current portion, included with accrued expenses		<u>(80,000)</u>
Deferred compensation, less current portion, at April 30, 2022	\$	<u><u>426,000</u></u>