

ELECTROSTEEL USA, LLC  
AND SUBSIDIARY  
CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2019 AND 2018



Holland, Bromley,  
Barnhill & Brett LLP  
Certified Public Accountants and Business Advisors

ELECTROSTEEL USA, LLC AND SUBSIDIARY

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MARCH 31, 2019 AND 2018

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CHRISTOPHER H. HOLLAND, CPA  
S. STEWART BROMLEY, CPA  
RONNIE A. BARNHILL, JR., CPA  
SHANNON L. BRETT, CPA, CFE

## Independent Auditor's Report

April 25, 2019

To the Member of  
Electrosteel USA, LLC and Subsidiary

We have audited the accompanying consolidated financial statements of Electrosteel USA, LLC and subsidiary (the Company), which comprise the consolidated balance sheets as of March 31, 2019 and 2018, and the related consolidated statements of income, member's equity, and cash flows for the years then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electrosteel USA, LLC and subsidiary as of March 31, 2019 and 2018, 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.

A handwritten signature in black ink that reads "Holland, Bromley, Barnhill & Brett, LLP". The signature is written in a cursive, flowing style.

Holland, Bromley, Barnhill & Brett, LLP  
Savannah, Georgia

ELECTROSTEEL USA, LLC AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

MARCH 31, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
<b>ASSETS</b>		
Current assets		
Cash and equivalents	\$ 475,283	\$ 454,451
Accounts receivable	1,871,011	1,262,757
Inventory, net	2,791,667	2,587,841
Prepaid expenses	<u>44,121</u>	<u>22,665</u>
Total current assets	5,182,082	4,327,714
Property and equipment, net	<u>295,258</u>	<u>243,726</u>
Total assets	<u>\$ 5,477,340</u>	<u>\$ 4,571,440</u>
 <b>LIABILITIES AND MEMBER'S EQUITY</b>		
Current liabilities		
Accounts payable	\$ 225,612	\$ 93,099
Current portion of long-term capital lease obligations	19,231	19,037
Accrued expenses	135,632	166,370
Note payable to related party	500,000	-
Note payable	<u>2,250,000</u>	<u>2,250,000</u>
Total current liabilities	3,130,475	2,528,506
Note payable to related party	-	1,000,000
Long-term capital lease obligations	<u>56,653</u>	<u>26,079</u>
Total liabilities	<u>3,187,128</u>	<u>3,554,585</u>
Member's equity		
Contributed capital	3,000,000	3,000,000
Accumulated deficit	<u>(709,788)</u>	<u>(1,983,145)</u>
Total member's equity	<u>2,290,212</u>	<u>1,016,855</u>
Total liabilities and member's equity	<u>\$ 5,477,340</u>	<u>\$ 4,571,440</u>

(The accompanying notes are an integral part of the financial statements.)



ELECTROSTEEL USA, LLC AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED MARCH 31, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
Net sales	\$ 6,928,851	\$ 5,162,332
Cost of goods sold	(4,951,548)	(3,353,682)
Inventory provision	<u>(94,841)</u>	<u>(82,963)</u>
Gross profit	<u>1,882,462</u>	<u>1,725,687</u>
Operating expenses		
Payroll, related taxes and benefits	768,714	728,916
Interest	140,387	145,159
Supplies	103,686	72,493
Rent	88,969	125,376
Depreciation	64,418	59,747
Financing fees	64,265	57,055
Professional fees and contract labor	62,260	33,766
Travel	59,419	51,379
Insurance	49,445	50,830
Taxes	44,846	41,282
Repairs and maintenance	40,988	25,592
Utilities	31,956	32,637
Automobile	18,190	18,665
Dues and subscriptions	17,216	9,452
Technology	15,996	7,020
Meals and entertainment	11,314	11,450
Advertising and promotion	10,574	16,486
Bank fees	7,537	5,916
Licenses and permits	6,621	7,141
Shipping	6,073	10,732
Development support	371	3,069
Bad debt	-	4,593
Total operating expenses	<u>1,613,245</u>	<u>1,518,756</u>
Other income (expense)		
Consulting services	1,000,000	-
Gain (loss) on disposal of fixed assets	<u>4,140</u>	<u>(27,738)</u>
Total other expenses	<u>1,004,140</u>	<u>(27,738)</u>
Net income before income taxes	<u>1,273,357</u>	<u>179,193</u>
Income tax provision	<u>-</u>	<u>-</u>
Net income	<u>\$ 1,273,357</u>	<u>\$ 179,193</u>

(The accompanying notes are an integral part of the financial statements.)

ELECTROSTEEL USA, LLC AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF MEMBER'S EQUITY  
FOR THE YEARS ENDED MARCH 31, 2019 AND 2018

	Contributed Capital	Accumulated Deficit	Member's Equity
Balance at March 31, 2017	\$ 3,000,000	\$ (2,162,338)	\$ 837,662
Net income	<u>-</u>	<u>179,193</u>	<u>179,193</u>
Balance at March 31, 2018	3,000,000	(1,983,145)	1,016,855
Net income	<u>-</u>	<u>1,273,357</u>	<u>1,273,357</u>
Balance at March 31, 2019	<u>\$ 3,000,000</u>	<u>\$ (709,788)</u>	<u>\$ 2,290,212</u>

(The accompanying notes are an integral part of the financial statements.)

ELECTROSTEEL USA, LLC AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED MARCH 31, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities		
Net income	\$ 1,273,357	\$ 179,193
Adjustments to reconcile net income to net cash provided by (used for) operating activities		
Depreciation	64,418	59,747
(Gain) loss on disposal of assets	(4,140)	27,738
Changes in assets and liabilities		
(Increase) decrease in accounts receivable	(608,254)	162,970
(Increase) decrease in inventory	(203,826)	147,366
Increase in prepaid expenses	(21,456)	(12,867)
Increase (decrease) in accounts payable	132,513	(657,036)
Decrease in accrued expenses	(30,738)	(6,366)
Net cash provided by (used for) operating activities	<u>601,874</u>	<u>(99,255)</u>
Cash flows from investing activities		
Proceeds from sale of property and equipment	-	29,000
Purchases of property and equipment	(111,809)	(8,217)
Net cash (used for) provided by investing activities	<u>(111,809)</u>	<u>20,783</u>
Cash flows from financing activities		
Borrowings under capital lease agreements	50,537	-
Repayments under capital lease agreements	(19,770)	(17,624)
Repayments under note payable agreements	(500,000)	-
Net cash used for financing activities	<u>(469,233)</u>	<u>(17,624)</u>
Net increase (decrease) in cash	20,832	(96,096)
Cash - beginning of year	<u>454,451</u>	<u>550,547</u>
Cash - end of year	<u>\$ 475,283</u>	<u>\$ 454,451</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for		
Interest	\$ 139,769	\$ 114,081
Income taxes	\$ -	\$ -

(The accompanying notes are an integral part of the financial statements.)



ELECTROSTEEL USA, LLC AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2019 AND 2018

NOTE 1 - DESCRIPTION OF ORGANIZATION

Electrosteel USA, LLC (the Company) is a wholly-owned subsidiary of Electrosteel Castings, LTD (the Parent) and is responsible for the exclusive distribution of their castings throughout North America. These castings include ductile iron pipe, fabricated ductile iron pipe and ductile iron fittings used extensively in the waterworks industry. The Company unloads inventory and fabricates the castings in the United States of America (U.S.) while maintaining a sales team responsible for marketing to utilities and contractors. The Company was organized on September 30, 2008, as a limited liability company in the state of Delaware to engage principally in the business of providing ductile iron pipes and fittings. The Company does not have a termination date. The liability of the member of the Company is limited to the member's total capital contributions.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The Company's financial statements are prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Expenses are recognized when incurred, rather than when paid. Revenues are recognized when earned, rather than when received.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of Electrosteel USA, LLC and its wholly-owned subsidiary, Waterfab LLC, collectively referred to as "the Company". Upon consolidation, all material intercompany balances and transactions are eliminated. Effective March 31, 2014, operations of Waterfab, LLC were discontinued.

Cash and cash equivalents

For financial statement purposes, the Company considers cash and cash equivalents to include all investments with an original maturity of ninety days or less.

Accounts receivable

The Company maintains an insurance policy which insures the collectability of all customer balances up to a preapproved credit limit. Based on management's analysis of receivables, past experience, and the insurance policy, no allowance for uncollectible accounts has been recorded.

Inventory

Inventory is stated at the lower of cost or net realizable value, with cost determined on the basis of the average cost of all similar items available during the period. Prior to fiscal year 2018, the Company stated inventory at the lower of cost or market. The change was made prospectively in fiscal year 2018 in accordance with a new accounting standard. The change had no effect on 2018 earnings. As of March 31, 2019 and 2018, inventory consists of finished goods, including pipes, fittings, glands, and related products. Based on management's review of the net realizable value of certain slow moving or obsolete inventory, an impairment reserve for inventory of \$64,000 and \$0, is included in inventory on the accompanying consolidated balance sheets as of March 31, 2019 and 2018, respectively.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Shipping income and related cost

Revenue related to shipping charged to customers is included in sales, and overall shipping expenses are separately reported in operating expenses in the accompanying consolidated statements of income.

### Property and equipment

Property and equipment acquisitions are recorded at cost. Depreciation is calculated over the estimated useful lives of the related assets using the straight-line method. Estimated useful lives by asset class are as follows: machinery and equipment, three to ten years; office equipment, three to seven years; and land improvements, five to ten years. Depreciation expense totaled \$64,418 and \$59,747 for the years ended March 31, 2019 and 2018, respectively.

### Revenue recognition

The Company recognizes revenue for product sales when persuasive evidence of an arrangement exists, title and risk of ownership passes to the customer, the sales price is fixed or determinable, and collectability is probable. These criteria are typically met at the time the product is shipped. A provision is made at the time the related revenue is recognized for estimated product returns, discounts, and other sales promotion expenses. Sales, use, value-added, and other excise taxes are not recognized in revenue.

### Income taxes

The Company is organized as a limited liability company. For federal and state income tax purposes, the Company elected to be treated as a C-corporation and is subject to income taxes under Internal Revenue Service guidelines.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. Once this threshold is met, the amount recognized in the financial statements is the largest amount of tax benefit likely realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company does not expect the total amount of unrecognized tax benefit to significantly change in the next twelve months. The Company is no longer subject to examination by taxing authorities for the years before 2015.

If incurred, the Company recognizes interest and penalties related to income tax withholdings and unrecognized tax benefits in interest expense. The Company has \$0 and \$5,147, respectively accrued for interest and penalties as of March 31, 2019 and 2018 which represents all related interest and penalties recorded for the years then ended.

### Advertising

The Company expenses advertising as incurred. Advertising expense totaled \$10,574 and \$16,486 for the years ended March 31, 2019 and 2018, respectively.

### Product warranties

The Company provides a one-year warranty on all products sold, which covers defects in materials. The Company's warranty liability is based upon historical warranty cost experience. For each of the years ending March 31, 2019 and 2018, management determined an accrual related to estimated warranties was not deemed necessary.



## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Concentration of credit risk

During the years ended March 31, 2019 and 2018, approximately 34% and 45%, respectively, of total sales were to two customers. Three of the Company's customers individually met the 10% threshold of sales during the year ended March 31, 2019, and four of the Company's customers met this threshold in fiscal year 2018. At March 31, 2019 and 2018, approximately 42% and 48%, respectively, of total accounts receivable were from two customers. Three of the Company's customers individually met the 10% threshold of accounts receivable for the year ended March 31, 2019 and four of the Company's customers met this threshold for the year ended March 31, 2018.

During the years ended March 31, 2019 and 2018, the Company purchased substantially all inventory from the Parent.

The Company maintains cash at a commercial bank in deposit accounts. As of March 31, 2019, the Federal Deposit Insurance Corporation (FDIC) insured deposits up to \$250,000 per financial institution. At March 31, 2019 and 2018, the Company had uninsured cash of approximately \$153,000 and \$106,000, respectively.

### Use of estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

### Subsequent events

The Company has evaluated subsequent events through April 25, 2019, the date the consolidated financial statements were available to be issued.

## NOTE 3 - SIGNIFICANT AGREEMENT

In October 2014, the Company entered into a five-year agreement with a pipe distributor to provide ductile iron pipe to seven branches located throughout the western U.S. As part of this agreement, the Company opened a new depot in Stockton, California to facilitate the receiving, storing and delivering of ductile iron pipe to this pipe distributor. This agreement was dissolved effective March 31, 2017, and the Company's operations at the California depot ceased in April 2017.

## NOTE 4 - RETIREMENT PLAN

In 2014, the Company began sponsoring a SIMPLE IRA retirement plan. Employees are eligible to participate immediately with no minimum service requirement. The SIMPLE IRA plan provides for an employer match of 100% of the first 3% of salary deferred by an employee. For the years ended March 31, 2019 and 2018, the Company's contributions into the retirement plan totaled \$8,960 and \$7,494, respectively.

#### NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment at March 31, 2019 and 2018 consists of the following:

	<u>2019</u>	<u>2018</u>
Computer equipment	\$ 2,184	\$ 11,439
Land improvements	76,063	76,063
Machinery and equipment	<u>590,524</u>	<u>525,770</u>
	668,771	613,272
Accumulated depreciation	<u>(373,513)</u>	<u>(369,546)</u>
Total property and equipment	<u>\$ 295,258</u>	<u>\$ 243,726</u>

For the years ended March 31, 2019 and 2018, equipment acquired under capital lease agreements totaling \$173,430 and \$106,843, respectively, is included in the property, plant and equipment balances.

#### NOTE 6 - INCOME TAXES

The Company accounts for income taxes in accordance with U.S. GAAP which requires, among other things, the determination of deferred tax assets and liabilities based on the differences between the financial accounting and tax bases of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the currently enacted tax rate to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be settled or realized. At March 31, 2019, the Company had a net long term deferred tax asset which was fully offset by a valuation allowance as detailed below:

Net operating loss carryforwards (NOLs)	\$ 210,000
Depreciation difference	<u>(48,000)</u>
	162,000
Less valuation allowance	<u>(162,000)</u>
	<u>\$ -</u>

During the year ended March 31, 2019, the Company experienced net operating income of approximately \$1,019,000 for income tax purposes. The Company has accumulated NOLs of approximately \$1,930,000 for the years ended March 31, 2018 and earlier, and they will be utilized to offset current year taxable income and carried forward to offset taxable income in future years. Because the NOLs fully offset the taxable income for the year ended March 31, 2019, no income tax provision is reflected on the consolidated statements of income. The NOLs will begin to expire in 2030. A related deferred tax asset of \$162,000 has been recorded, and a valuation allowance has been established for the entire amount.

#### NOTE 7 - NOTE PAYABLE

In August 2016, the Company entered into a short-term loan facility agreement with ICICI Bank UK for \$2,250,000. Interest on the loan is charged at a rate of LIBOR plus 2% and is payable by the Company to ICICI Bank UK quarterly. Interest expense of \$100,026 and \$76,196 related to this note is included in the accompanying consolidated statements of income for the years ended March 31, 2019 and 2018, respectively. The loan originally matured on August 23, 2017. The loan was renewed through August 19, 2018 and again through August 20, 2019. The loan is included in current liabilities in the accompanying consolidated balance sheets. The loan is collateralized by a \$2,500,000 line of credit maintained by the Parent. Fees paid and payable to the Parent for maintaining this line of credit as collateral, as well as other loan fees, totaled \$64,265 and \$57,055 for the years ended March 31, 2019 and 2018, respectively. These fees are included as financing fees in the accompanying consolidated statements of income.

#### NOTE 8 - RELATED PARTY TRANSACTIONS

For the years ended March 31, 2019 and 2018, the Company purchased inventory from the Parent totaling \$1,173,497 and \$1,035,686, respectively.

During the years ended March 31, 2019 and 2018, respectively, the Company expensed \$64,265 and \$45,805 for amounts paid and payable to the Parent in consideration of the line of credit maintained by the Parent and used as collateral for the Company's short-term loan facility with ICICI Bank UK, as described in Note 7.

The Company has an amount due to the Parent of \$17,580 and \$17,359 at March 31, 2019 and 2018, respectively, which is included in accounts payable on the consolidated balance sheets.

In April 2016, the Company entered into a short-term loan agreement with another wholly-owned subsidiary of the Parent. As part of this agreement, the Company received a total of \$1,700,000 during the fiscal year ended March 31, 2017. Interest expense of \$15,600 and \$35,000 related to this note is included in the accompanying consolidated statements of income for the years ended March 31, 2019 and 2018, respectively. At March 31, 2019 and 2018, \$500,000 and \$1,000,000, respectively, was outstanding under this agreement and is included on the consolidated balance sheets. The principal balance outstanding and related interest, accrued at a rate of 2.12%, are due to be repaid March 31, 2020.

During the year ended March 31, 2019, the Company began providing consulting services to Electrosteel Doha for Trading, LLC, another wholly-owned subsidiary of the Parent. The company received and recognized revenue of \$1,000,000 related to these services.



## NOTE 9 - LEASE AGREEMENTS

The Company leases real estate under operating lease agreements that expire at various times through fiscal year 2021. Total expenses under these operating lease agreements were \$86,500 and \$123,778 for the years ended March 31, 2019 and 2018, respectively. The depot location in Stockton, CA was closed, and the related lease terminated during fiscal year 2018. The Company also leases equipment under capital lease agreements that mature at various times through fiscal year 2024.

The minimum future installments under capital and operating lease agreements are as follows:

Year ending <u>March 31,</u>	Capital <u>Leases</u>	Operating <u>Leases</u>
2020	\$ 24,535	\$ 84,000
2021	20,401	7,000
2022	20,401	-
2023	12,485	-
2024	11,020	-
Thereafter	-	-
	<u>88,842</u>	<u>\$ 91,000</u>
Less amount representing interest	<u>12,958</u>	
Principal portion of lease payments	<u>\$ 75,884</u>	
Current maturities	\$ 19,231	
Noncurrent maturities	<u>56,653</u>	
	<u>\$ 75,884</u>	

Total interest expense incurred during the years ended March 31, 2019 and 2018 for the capital lease obligations was \$4,217 and \$5,406, respectively.