

ELECTROSTEEL USA, LLC
AND SUBSIDIARY
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2017 AND 2016

HOLLAND, HENRY & BROMLEY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

ELECTROSTEEL USA, LLC AND SUBSIDIARY

TABLE OF CONTENTS

MARCH 31, 2017 AND 2016

Independent Auditor's Report.....	1-2
Consolidated Balance Sheets	3
Consolidated Statements of Income.....	4
Consolidated Statements of Member's Equity.....	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements.....	7-12

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Independent Auditor's Report

MEMBER:

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Private Companies Practice
Section Firms Division of
American Institute of
Certified Public Accountants

April 20, 2017

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, 2017 and 2016, and the related consolidated statements of income, of member's equity, and of 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 audit. We conducted our audit 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, 2017 and 2016, 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, Henry & Bromley, LLP". The signature is written in a cursive, flowing style.

Holland, Henry & Bromley, LLP
Savannah, Georgia

ELECTROSTEEL USA, LLC AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

MARCH 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Current assets		
Cash and equivalents	\$ 550,547	\$ 341,180
Accounts receivable	1,425,727	1,132,111
Inventory	2,735,207	3,411,206
Prepaid insurance	<u>9,798</u>	<u>14,963</u>
Total current assets	4,721,279	4,899,460
 Property and equipment, net	 <u>351,994</u>	 <u>377,362</u>
Total assets	<u>\$ 5,073,273</u>	<u>\$ 5,276,822</u>
 LIABILITIES AND MEMBER'S EQUITY		
Current liabilities		
Accounts payable	\$ 750,135	\$ 3,920,258
Current portion of long-term capital lease obligations	17,624	10,267
Accrued expenses	172,736	295,313
Note payable to related party	1,000,000	-
Note payable	<u>2,250,000</u>	<u>-</u>
Total current liabilities	4,190,495	4,225,838
 Long-term capital lease obligations	 <u>45,116</u>	 <u>23,950</u>
Total liabilities	<u>4,235,611</u>	<u>4,249,788</u>
 Member's equity		
Contributed capital	3,000,000	3,000,000
Accumulated deficit	<u>(2,162,338)</u>	<u>(1,972,966)</u>
Total member's equity	<u>837,662</u>	<u>1,027,034</u>
Total liabilities and member's equity	<u>\$ 5,073,273</u>	<u>\$ 5,276,822</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, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Net sales	\$ 6,510,708	\$ 5,153,927
Cost of goods sold	(4,523,873)	(3,744,034)
Inventory provision	<u>(237,060)</u>	<u>(144,523)</u>
Gross profit	<u>1,749,775</u>	<u>1,265,370</u>
Operating expenses		
Payroll, related taxes and benefits	993,778	871,517
Rent	147,855	158,458
Financing fees	100,017	-
Travel	89,830	73,349
Interest	86,449	1,840
Supplies	84,434	61,666
Depreciation	72,939	68,968
Insurance	68,610	67,973
Utilities	42,270	37,091
Taxes	37,536	59,883
Automobile	30,357	27,859
Professional fees	27,697	37,293
Development support	25,950	15,303
Repairs and maintenance	24,985	23,253
Meals and entertainment	23,221	16,164
Shipping	21,420	28,645
Advertising and promotion	17,250	49,790
Technology	14,405	12,874
Dues and subscriptions	13,327	9,088
Licenses and permits	7,856	2,236
Bank fees	5,356	3,732
Contract labor	3,605	20,542
Fabrication shop	<u>-</u>	<u>7,625</u>
Total operating expenses	<u>1,939,147</u>	<u>1,655,149</u>
Net loss before income taxes	<u>(189,372)</u>	<u>(389,779)</u>
Income tax provision	<u>-</u>	<u>-</u>
Net loss	<u>\$ (189,372)</u>	<u>\$ (389,779)</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, 2017 AND 2016

	Contributed Capital	Accumulated Deficit	Member's Equity
Balance at March 31, 2015	\$ 3,000,000	\$ (1,583,187)	\$ 1,416,813
Net loss	<u>-</u>	<u>(389,779)</u>	<u>(389,779)</u>
Balance at March 31, 2016	3,000,000	(1,972,966)	1,027,034
Net loss	<u>-</u>	<u>(189,372)</u>	<u>(189,372)</u>
Balance at March 31, 2017	<u>\$ 3,000,000</u>	<u>\$ (2,162,338)</u>	<u>\$ 837,662</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, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Net loss	\$ (189,372)	\$ (389,779)
Adjustments to reconcile net loss to net cash used for operating activities		
Depreciation	72,939	68,968
Changes in assets and liabilities		
(Increase) decrease in accounts receivable	(293,616)	156,565
Decrease in inventory	675,999	206,283
Decrease in prepaid insurance	5,165	2,356
Decrease in accounts payable	(3,170,123)	(561,518)
Decrease in accrued credit insurance	-	(8,136)
(Decrease) increase in accrued expenses	(122,577)	47,275
Net cash used for operating activities	<u>(3,021,585)</u>	<u>(477,986)</u>
Cash flows from investing activities		
Purchases of property and equipment	<u>(47,571)</u>	<u>(1,568)</u>
Net cash used for investing activities	<u>(47,571)</u>	<u>(1,568)</u>
Cash flows from financing activities		
Borrowings under capital lease agreements	43,080	-
Repayments under capital lease agreements	(14,557)	(9,801)
Borrowings under note payable agreements	3,950,000	-
Repayments under note payable agreements	<u>(700,000)</u>	<u>-</u>
Net cash provided by (used for) financing activities	<u>3,278,523</u>	<u>(9,801)</u>
Net increase (decrease) in cash	209,367	(489,355)
Cash - beginning of year	<u>341,180</u>	<u>830,535</u>
Cash - end of year	<u>\$ 550,547</u>	<u>\$ 341,180</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for		
Interest	\$ 78,238	\$ 1,840
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, 2017 AND 2016

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 inventories and fabricates these 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. Under this policy, the Company pays a premium and an additional established amount per customer each year to cover all accounts receivable. 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 market, with cost determined on the basis of the average cost of all similar items available during the period. As of March 31, 2017 and 2016, inventory consists of finished goods, including pipes, fittings, glands, and related products. Based on management's review of potentially slow moving or obsolete inventory, a reserve for inventory was not deemed necessary at either fiscal year end.

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 \$72,939 and \$68,968 for the years ended March 31, 2017 and 2016, 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 2013.

If incurred, the Company would recognize interest and penalties related to unrecognized tax benefits in interest expense. The Company has no amounts accrued for interest or penalties as of March 31, 2017 and 2016. Additionally, no interest or penalties were recorded for the years then ended.

Advertising

The Company expenses advertising as incurred. Advertising expense totaled \$17,250 and \$49,790 for the years ended March 31, 2017 and 2016, 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. An accrual related to estimated warranties of \$0 and \$26,190, respectively, is recorded in accrued expenses on the accompanying consolidated balance sheets as of March 31, 2017 and 2016.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Concentration of credit risk

During the years ended March 31, 2017 and 2016, approximately 63% and 73%, respectively, of total sales were to two customers. At March 31, 2017 and 2016, approximately 64% and 82%, respectively, of total accounts receivable were from two customers.

During the years ended March 31, 2017 and 2016, the Company purchased substantially all inventory from the Parent.

The Company maintains cash at a commercial bank in deposit accounts. As of March 31, 2017, the Federal Deposit Insurance Corporation (FDIC) insured deposits up to \$250,000 per financial institution. At March 31, 2017 and 2016, the Company had uninsured cash of approximately \$372,000 and \$90,000, 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.

Subsequent events

The Company has evaluated subsequent events through April 20, 2017, 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. In the first quarter of fiscal year 2018, key terms of this agreement are being renegotiated by the Company and the distributor.

The Company's pricing of pipe sold to this distributor is based on market prices of ductile iron pipe. Sales are first recorded at an established initial price. Market prices are then agreed upon periodically by the Company and the distributor. The Company issues credit memos to the distributor when market prices are below prices initially invoiced. The Company invoices the distributor for the price difference when market prices are above prices initially invoiced. As of March 31, 2017 and 2016, a liability of \$0 and \$119,513, respectively, is included in accrued expenses on the consolidated balance sheets to reserve for estimated decreases in market prices of ductile iron pipe below the prices initially invoiced.

The Company is responsible for certain shipping costs related to the delivery of pipe. As of March 31, 2017 and 2016, a liability of \$111,265 and \$65,718, respectively, is included in accrued expenses on the consolidated balance sheets for the estimated shipping costs of undelivered products owned by the distributor and located at the Company's California depot.

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, 2017 and 2016, the Company's contributions into the retirement plan total \$4,785 and \$3,661, respectively.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment at March 31, 2017 and 2016 consists of the following:

	<u>2017</u>	<u>2016</u>
Computer equipment	\$ 11,439	\$ 11,439
Land improvements	76,063	76,063
Machinery and equipment	<u>631,462</u>	<u>583,891</u>
	718,964	671,393
Accumulated depreciation	<u>(366,970)</u>	<u>(294,031)</u>
Total property and equipment	<u>\$ 351,994</u>	<u>\$ 377,362</u>

Equipment acquired under capital lease agreements totaling \$106,843 and \$63,763 is included in the property, plant and equipment balances for the years ending March 31, 2017 and 2016, respectively.

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, 2017, 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)	\$ 862,000
Depreciation difference	<u>(101,000)</u>
	761,000
Less valuation allowance	<u>(761,000)</u>
	<u>\$ -</u>

During the year ended March 31, 2017, the Company experienced a net operating loss of approximately \$144,000 for income tax purposes. The Company has accumulated NOLs of approximately \$2,132,000 for the years ended March 31, 2016 and earlier, and they will be carried forward to offset taxable income in future years. The total NOL of approximately \$2,276,000 will begin to expire in 2030. A related deferred tax asset of \$764,000 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 \$41,371 related to this note is included in the accompanying consolidated statements of income. The loan matures on August 23, 2017 and 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 to the Parent for maintaining this line of credit as collateral totaled \$88,767 for the year ended March 31, 2017. These fees along with loan costs of \$11,250 are included as financing fees in the accompanying consolidated statements of income.

NOTE 8 - RELATED PARTY TRANSACTIONS

For the years ended March 31, 2017 and 2016, the Company purchased inventory from the Parent totaling \$1,764,124 and \$3,004,875, respectively. Additionally, purchases of \$218,831 and \$5,675 were made from another subsidiary of the Parent during the years ended March 31, 2017 and 2016, respectively.

The Company sold \$4,700 and \$0 of inventory to the Parent during the years ended March 31, 2017 and 2016, respectively.

During the year ended March 31, 2017, the Company paid \$88,767 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.

Commissions totaling \$42,139 were paid to the Company by the Parent during the year ended March 31, 2017.

The Company has an amount due to the Parent of \$730,128 and \$3,889,569 at March 31, 2017 and 2016, 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 \$39,624 related to this note is included in the accompanying consolidated statements of income. At March 31, 2017, \$1,000,000 was outstanding under this agreement. The principal balance outstanding and related interest at a rate of 3.5% are due to be repaid March 31, 2018.

NOTE 9 - LEASE AGREEMENTS

The Company leases real estate under operating lease agreements that expire at various times through 2019. Total expenses under these operating lease agreements were \$146,209 and \$152,250 for the years ended March 31, 2017 and 2016, respectively. The Company also leased two vehicles under operating lease agreements that expired in 2016. The Company also leases equipment under capital lease agreements that mature at various times through fiscal year 2023.

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>
2018	\$ 22,939	\$ 123,778
2019	22,939	13,000
2020	12,779	-
2021	8,648	-
2022	8,648	-
Thereafter	<u>721</u>	<u>-</u>
	76,674	<u>\$ 136,778</u>
Less amount representing interest	<u>13,934</u>	
Principal portion of lease payments	<u>\$ 62,740</u>	
Current maturities	\$ 17,624	
Noncurrent maturities	<u>45,116</u>	
	<u>\$ 62,740</u>	

Total interest expense incurred during the years ended March 31, 2017 and 2016 for the capital lease obligations was \$5,454 and \$1,840, respectively.