

**MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND
AFFILIATES**

**CONSOLIDATED FINANCIAL STATEMENTS
TOGETHER WITH
INDEPENDENT AUDITORS' REPORT**

DECEMBER 31, 2009

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Minnesota Diversified Industries, Inc. and Affiliates
St. Paul, Minnesota

We have audited the accompanying consolidated statement of financial position of Minnesota Diversified Industries, Inc. and Affiliates (MDI) as of December 31, 2009 and 2008, and the related consolidated statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Minnesota Diversified Industries, Inc. and Affiliates as of December 31, 2009 and 2008, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Olsen Thielen + Co., Ltd

St. Paul, Minnesota
April 19, 2010

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2009 AND 2008**

ASSETS		
	<u>2009</u>	<u>2008</u>
CURRENT ASSETS:		
Cash	\$ 1,880,421	\$ 1,196,593
Accounts Receivable	1,207,404	2,385,723
Inventories	852,110	1,491,603
Prepaid Expenses and Other Assets	586,087	620,551
Total Current Assets	<u>4,526,022</u>	<u>5,694,470</u>
OTHER ASSETS:		
Investments	11,122	26,522
Loan Origination Fees, Net of Accumulated Amortization of \$44,569 and \$3,428	<u>327,731</u>	<u>368,872</u>
Total Other Assets	<u>338,853</u>	<u>395,394</u>
PROPERTY AND EQUIPMENT	<u>8,295,376</u>	<u>9,446,667</u>
TOTAL ASSETS	<u>\$ 13,160,251</u>	<u>\$ 15,536,531</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current Portion of Long-Term Debt	\$ 838,000	\$ 877,000
Accounts Payable	613,289	1,027,231
Other Current Liabilities	516,044	1,665,475
Total Current Liabilities	<u>1,967,333</u>	<u>3,569,706</u>
OTHER LIABILITIES:		
Long-Term Debt	8,018,077	9,633,038
Retirement Benefit Liability	11,122	26,522
Other Long-Term Liabilities	478,622	599,031
Total Other Liabilities	<u>8,507,821</u>	<u>10,258,591</u>
UNRESTRICTED NET ASSETS	<u>2,685,097</u>	<u>1,708,234</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 13,160,251</u>	<u>\$ 15,536,531</u>

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

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

**CONSOLIDATED STATEMENT OF ACTIVITIES
YEARS ENDED DECEMBER 31, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
SALES	<u>\$ 11,428,996</u>	<u>\$ 25,824,081</u>
COST OF GOODS SOLD:		
Variable Manufacturing Costs	5,820,454	14,968,027
Fixed Manufacturing Costs	<u>3,437,893</u>	<u>5,129,182</u>
Total Cost of Goods Sold	<u>9,258,347</u>	<u>20,097,209</u>
GROSS MARGIN	<u>2,170,649</u>	<u>5,726,872</u>
OPERATING EXPENSES:		
Selling and Administrative	(1,596,549)	(2,538,620)
Commissions	<u>(182,088)</u>	<u>(438,725)</u>
Total Operating Expenses	<u>(1,778,637)</u>	<u>(2,977,345)</u>
NET MANUFACTURING INCOME	<u>392,012</u>	<u>2,749,527</u>
OTHER OPERATING SUPPORT AND DEVELOPMENT:		
Training and Service Grants	23,439	43,410
Other Contributions and Grants	83,846	134,566
Other Income	542,000	-
Training and Service Expenses	<u>(205,877)</u>	<u>(303,001)</u>
Total Employee Support and Development	<u>443,408</u>	<u>(125,025)</u>
NET OPERATING INCOME	<u>835,420</u>	<u>2,624,502</u>
OTHER INCOME (EXPENSES):		
Interest Income	20,812	3,205
Other Income and Expenses	33,707	130,899
Loss on Sale and Disposal of Property and Equipment	-	(2,139,095)
Interest and Other Finance Related Expenses	<u>(688,076)</u>	<u>(1,410,875)</u>
Total Other Income (Expenses)	<u>(633,557)</u>	<u>(3,415,866)</u>
INCREASE (DECREASE) IN NET ASSETS - BEFORE EXTRAORDINARY ITEM	201,863	(791,364)
EXTRAORDINARY ITEM - FORGIVENESS OF DEBT	<u>775,000</u>	<u>-</u>
INCREASE (DECREASE) IN NET ASSETS	976,863	(791,364)
NET ASSETS at Beginning of Year	<u>1,708,234</u>	<u>2,499,598</u>
NET ASSETS at End of Year	<u>\$ 2,685,097</u>	<u>\$ 1,708,234</u>

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

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

**CONSOLIDATED STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008**

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in Net Assets	\$ 976,863	\$ (791,364)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided By Operating Activities:		
Depreciation	1,196,511	1,697,971
Amortization of Loan Origination Fees	41,141	59,218
Loss on Sale and Disposal of Property and Equipment	-	2,139,095
Change in Accounting Estimate	(924,142)	-
Extraordinary Item	(775,000)	-
Changes in Assets and Liabilities:		
Receivables	1,178,319	2,356,509
Inventories	639,493	(203,292)
Prepaid Expenses and Other Assets	34,464	(1,305)
Accounts Payable	(413,942)	(2,897,385)
Other Current Liabilities	(225,289)	(577,714)
Net Cash Provided By Operating Activities	1,728,418	1,781,733
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Property and Equipment	(45,220)	(38,595)
Proceeds from Sale of Property and Equipment, Net of Sales Costs	-	9,422,377
Net Cash Provided By (Used In) Investing Activities	(45,220)	9,383,782
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in Loan Origination Fees	-	(372,300)
Proceeds from Line of Credit	-	4,483,234
Payments on Line of Credit	-	(9,859,086)
Increase (Decrease) in Other Long-Term Liabilities	(120,409)	599,031
Proceeds from Long-Term Debt	-	10,562,010
Principal Payments on Long-Term Debt	(878,961)	(15,825,101)
Net Cash Used In Financing Activities	(999,370)	(10,412,212)
NET INCREASE IN CASH	683,828	753,303
CASH at Beginning of Year	1,196,593	443,290
CASH at End of Year	\$ 1,880,421	\$ 1,196,593
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Payments for Interest	\$ 624,806	\$ 1,205,596

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

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Minnesota Diversified Industries, Inc. and Affiliates (MDI) has been in existence over 45 years. MDI is a nonprofit social enterprise that exists to serve people with disabilities by offering progressive development and employment opportunities in competitive business enterprises. MDI provides competitively priced plastic products (totes, trays, etc) and a variety of assembly, production and packaging services for the United States Postal Service (USPS) and several commercial companies. MDI employs people at three locations in Minnesota: St. Paul, Hibbing and Grand Rapids.

Basis of Presentation

The accompanying financial statements have been prepared using the accrual basis of accounting in accordance with generally accepted accounting principles. Revenues, expenses, gains and losses, and net assets are classified based on the existence or absence of donor imposed restrictions. Accordingly, net assets of MDI and related changes are classified and reported as follows:

Unrestricted net assets - Resources over which the Board of Directors has discretionary control.

Temporarily restricted - Resources received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. When a restriction is accomplished within the same year of the donation, the funds are shown as unrestricted.

Permanently restricted - Resources subject to donor imposed restriction that they be maintained permanently by the Organization. The donors of these resources permit the Organization to use all or part of the income earned, including capital appreciation, on related investments for unrestricted or temporarily restricted purposes.

MDI had no temporarily restricted or permanently restricted net assets at December 31, 2009 and 2008.

Accounting Estimates

The presentation 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 disclosure 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.

In 2009, the Organization changed the estimates used to record liabilities related to unemployment compensation and a product settlement. The change in estimates resulted in an increase in net assets of \$924,142. These changes are reflected on the statement of activities by decreasing operating expenses by \$382,142 for the unemployment compensation change and increasing other income by \$542,000, included in other operating support and development, for the product settlement.

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent Events

In preparing these financial statements, the Organization has evaluated for recognition or disclosure the events or transactions that occurred through April 19, 2010, the date the financial statements were available to be issued.

Consolidation

The accompanying consolidated financial statements include the activities of Minnesota Diversified Industries, Inc., MDI Government Services and MDI Commercial Services. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Accounts Receivable

MDI provides credit to its customers determined on a customer-by-customer basis. Receivables are stated at the amounts MDI expects to collect from outstanding balances.

MDI provides for probable uncollectible amounts through charges to earnings and credits to the valuation allowance based on management's assessment of the current status of individual accounts. Balances that are still outstanding after MDI has used reasonable collection efforts are written off through charges to the valuation allowance and credits to receivable accounts. The balance in the valuation allowance was \$41,932 at December 31, 2009 and \$68,212 at December 31, 2008, respectively.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Work in process and finished goods include materials, labor and allocated overhead.

Inventories consist of the following:

	<u>2009</u>	<u>2008</u>
Raw Materials	\$ 644,323	\$ 779,123
Finished Goods	265,787	895,472
Reserve	<u>(58,000)</u>	<u>(182,992)</u>
Total	<u>\$ 852,110</u>	<u>\$ 1,491,603</u>

Property and Equipment

Property, plant and equipment are recorded at original cost. Additions, improvements or major renewals are capitalized. Any gains or losses on property and equipment retirements are reflected currently in operations.

Depreciation is computed using the straight-line method over the estimated economic lives of the assets as follows:

Buildings and Improvements	15-50 Years
Machinery and Equipment	5-10 Years
Office Equipment	3-5 Years

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long Lived Assets

MDI reviews its long-lived assets whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. MDI determines potential impairment by comparing the carrying value of its assets with the sum of the undiscounted cash flows expected to be provided by operating and eventually disposing of the asset. Should the sum of the expected future net cash flows be less than carrying values, MDI would determine whether an impairment loss should be recognized. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value (estimated discounted future cash flows or appraisal of assets). No impairment losses have been identified in the financial statements.

Investments

MDI carries its investments at fair market value. Realized and unrealized gains and losses from marketable securities are included in the statement of activities.

For all investments, fair value is determined by reference to quoted prices in active markets.

Revenue Recognition

MDI has contracts with the United States Postal Service (USPS) for the production of various products including plastic totes and stamps. The USPS commits to an annual order of products subject to contract modifications and amendments. Plastics revenue is recognized when product is shipped. Stamp production revenue is recognized as production is completed. Fulfillment revenue is recognized as customer product is shipped or as other fulfillment services are performed.

Contribution revenue is recognized when it has been determined that there is a legal right to the contribution, and a reasonable estimate of the amount to be received has been determined. Unconditional pledges are recorded as revenue at the time the pledge is made. Conditional pledges are recorded when the condition has been satisfied.

Functional Expenses

Expenses are specifically identified with, or allocated to, program-related, administrative and fund-raising functions. Expense allocations are generally computed based on the amount of time spent by employees performing those functions. Occupancy-related expenses are computed based on occupied space.

Income Taxes

MDI is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. However, MDI is subject to income tax on certain activities not directly related to MDI's tax-exempt purpose as net unrelated business income.

Effective January 1, 2009, the Organization adopted new accounting guidance related to uncertainty in income taxes. This guidance clarifies the recognition threshold and measurement requirements for income tax positions taken or expected to be taken in income tax returns. This includes positions that the entity is exempt from income taxes or not subject to income taxes on unrelated business income. Under the new standards, the Organization recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities. Prior to January 1, 2009, the Organization accrued liabilities for uncertain positions if losses were probable and could be reasonably estimated. The Organization has identified no significant income tax uncertainties. The Organization is open to examination for tax years 2006 through 2008.

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - PROPERTY AND EQUIPMENT

Property and Equipment at December 31, 2009 and 2008, are summarized as follows:

	2009	2008
Land, Buildings and Improvements	\$ 6,665,753	\$ 6,620,533
Machinery and Equipment	11,101,431	11,101,431
Office and Computer Equipment	549,288	549,288
Total	18,316,472	18,271,252
Accumulated Depreciation	10,021,096	8,824,585
Net	\$ 8,295,376	\$ 9,446,667

NOTE 3 - LONG- TERM DEBT

Long-term debt consists of the following at December 31, 2009 and 2008:

	2009	2008
Note payable to Northland Foundation in monthly installments of \$9,402 including interest at 4.75% through January 2010. This note is secured by equipment, furniture and fixtures, subject to liens of other participating lenders.	26,771	135,486
Note payable to Bank of Alma in monthly installments of \$61,158 including variable interest at 1.5% above the prime rate or 6.5%, whichever is greater through December 5, 2015. The interest rate effective at December 31, 2009 was 6.5%. This note is secured by substantially all assets of MDI.	3,771,982	4,245,000
Note payable to Bank of Alma in monthly installments of \$50,894 including variable interest at 1.5% above the prime rate or 6.5%, whichever is greater through December 5, 2020. The interest rate effective at December 31, 2009 was 6.5%. This note is secured by substantially all assets of MDI.	4,763,024	5,055,000
Note payable to Grand Rapids State Bank in monthly installments of \$2,822 including interest at 9.50% through October 2013 and a balloon payment of approximately \$271,100 of remaining principal and interest due November 2013. The note is secured by real estate of the Grand Rapids Plant.	294,300	299,552
Note payable to The Blandin Foundation in monthly installments of \$14,542 bearing 0% interest through January 2011. This note was forgiven in 2009.	-	349,000
Note payable to The Blandin Foundation in monthly principal installments of \$17,750 plus interest at 6.5% through January 2011. This note was forgiven in 2009.	-	426,000
Subtotal	8,856,077	10,510,038
Less Amount Due Within One Year	838,000	877,000
Net Long-Term Debt	\$ 8,018,077	\$ 9,633,038

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - LONG-TERM DEBT (Continued)

Debt Refinancing and Sale of St. Paul Building

On December 1, 2008, MDI sold their St. Paul building facility for \$9.6 million. A loss of \$2,139,095 was recognized. Proceeds from the sale were used to repay the contract for deed and the note payable to the City of St. Paul.

On December 11, 2008, MDI refinanced the majority of their lines of credit and notes payable it had outstanding with proceeds from \$9,300,000 of loans made by the Bank of Alma. Seventy percent (70%) of the Bank of Alma notes payable are guaranteed by the United States Department of Agriculture (USDA). Loan origination fees of \$372,300 were paid related to this refinancing and are being amortized over the life of the Bank of Alma loans (between seven and twelve years).

Participants in the Bank of Alma loan and balances as of December 31, 2009 are as follows:

Associated Bank	\$1,536,301
Blandin Foundation	206,214
IRRB	390,432
Bank of Alma	427,554
Bank of Alma	<u>5,974,505</u>
Total	<u>\$ 8,535,006</u>

MDI must comply with Bank of Alma and USDA loan covenants including several financial ratios. Principal payments required during the next five years are: 2010 - \$838,000; 2011 - \$867,000; 2012 - \$926,000; 2013 - \$1,257,000; and 2014 - \$1,049,000.

In 2009, the Blandin Foundation forgave the outstanding debt related to two notes payable totaling \$775,000. This amount was recorded as an extraordinary item on the consolidated statement of activities.

NOTE 4 - RETIREMENT BENEFITS

MDI maintains a defined-contribution retirement plan covering certain employees. MDI makes contributions to the plan based on the contracts of a specific division. The expense for this plan was approximately \$33,300 in 2009 and \$145,800 in 2008.

MDI has a retirement plan, which covers substantially all employees. Employees can contribute pretax dollars towards retirement, with the employer providing certain matching contributions. The expense for the plan was approximately \$21,400 in 2009 and \$58,600 in 2008. In July 2009, MDI suspended the employer match for this plan indefinitely.

MDI has a nonqualified retirement plan for its management and key employees. Employees can defer income toward retirement. MDI contributes amounts for certain highly compensated employees who do not qualify for contributions under other plans. The expense for the plan was approximately \$1,300 in 2009 and \$3,400 in 2008. The total value of investments, at fair market value, held for the participants' benefit and the related vested deferred liability is \$11,122 and \$26,522 at December 31, 2009 and 2008. In July 2009, MDI suspended the employer match for this plan indefinitely.

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - FUNCTIONAL ALLOCATION OF EXPENSES

Functional expenses for the years ended December 31, 2009 and 2008 were as follows;

	2009	2008
Program Services	\$ 8,367,279	\$ 18,277,961
Administrative and General Expenses	3,564,643	6,510,831
	\$ 11,931,922	\$ 24,788,792

These expenses are reflected in the consolidated statements of activities in the following categories:

	2009	2008
Cost of Goods Sold	\$ 9,258,347	\$ 20,097,209
Selling and Administrative Expense	1,596,549	2,538,620
Commissions	182,088	438,725
Interest and Other Finance Related Expense	688,076	1,410,875
Other Income and Expenses	985	362
Training and Service Fees	205,877	303,001
	\$ 11,931,922	\$ 24,788,792

NOTE 6 - MAJOR CUSTOMERS AND CREDIT RISK CONCENTRATIONS

The United States Postal Service (USPS) is a major customer of MDI. Sales to the USPS accounted for \$9,232,526 (81%) and \$20,022,725 (78%) of total sales for the years ended December 31, 2009 and 2008. Receivables from the USPS accounted for \$843,740 (70%) and \$2,160,180 (91%) of total receivables at December 31, 2009 and 2008. In 2008, sales to another customer accounted for \$3,124,736 (12%) of total sales.

Financial instruments that potentially subject MDI to concentrations of credit risk consists principally of cash and cash equivalents and accounts receivable. MDI places its cash and cash equivalents with high credit quality financial institutions and generally limits the amount of credit exposure to any one financial institution. As of December 31, 2009, MDI had a credit risk of \$1,691,830 as a result of depositing more than the FDIC insurance coverage in one bank.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

At December 31, 2008, MDI had accrued an estimated settlement liability of \$692,072 (net of a present value discount of \$56,407), which is consistent with a settlement agreement signed in March 2008. The amount to be paid is contingent on the amount of plastic sales to a customer for each year of a three-year settlement period ending September 30, 2010. During 2009, discounts earned of \$124,291 were applied to the liability and \$542,000 was written off due to the contingency on the amount of plastic sales will not be met. The amount written off in 2009 is included in other operating support and development on the consolidated statement of activities. Unused earned discounts can be carried over to 2010. At December 31, 2009, the estimated liability is \$25,781 and is included in other current liabilities in the consolidated statement of financial position.

MINNESOTA DIVERSIFIED INDUSTRIES, INC. AND AFFILIATES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - LEASE COMMITMENTS

MDI has operating leases for certain office and production facilities and equipment. Rental expense amounts to \$255,806 in 2009 and \$146,848 in 2008.

Commitments for minimum rentals under noncancellable leases at the end of 2009 are as follows:

Commitment:

2010

\$ 164,230