MINNESOTA DIVERSIFIED INDUSTRIES INC.
AND AFFILIATES

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2017 AND 2016

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CliftonLarsonAllen LLP
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Minnesota Diversified Industries Inc. and Affiliates
Minneapolis, Minnesota

We have audited the accompanying consolidated financial statements of Minnesota Diversified Industries Inc. and Affiliates (MDI), which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated 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.

Auditors' 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 auditors' 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.

Board of Directors
Minnesota Diversified Industries Inc. and Affiliates

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MDI as of December 31, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

CliftonLarsonAllen LLP

Minneapolis, Minnesota
March 21, 2018

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2017 AND 2016

	2017	2016
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 8,056,848	$ 15,925,451
Accounts Receivable, Net	4,066,769	5,087,177
Inventories	1,584,062	1,551,941
Prepaid Expenses and Other Assets	148,317	182,899
Total Current Assets	13,855,996	22,747,468
OTHER ASSETS		
Swap Asset	14,213	-
Investments	119,134	107,393
Total Other Assets	133,347	107,393
PROPERTY AND EQUIPMENT, NET	15,339,900	10,842,535
Total Assets	$ 29,329,243	$ 33,697,396
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	$ 288,892	$ 270,539
Accounts Payable	379,202	1,025,484
Accrued Personnel Expenses	680,687	1,436,402
Deferred Revenue	1,248,941	3,240,695
Other Current Liabilities	897,226	420,661
Total Current Liabilities	3,494,948	6,393,781
OTHER LIABILITIES		
Long-Term Debt	2,921,506	3,161,334
Deferred Rent	109,684	96,636
Retirement Benefit Liability	119,134	107,393
Swap Liability	-	7,428
Total Other Liabilities	3,150,324	3,372,791
UNRESTRICTED NET ASSETS	22,683,971	23,930,824
Total Liabilities and Net Assets	$ 29,329,243	$ 33,697,396

See accompanying Notes to Consolidated Financial Statements.

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF ACTIVITIES
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
SALES	$ 19,353,294	$ 37,491,405
COST OF GOODS SOLD		
Variable Manufacturing Costs	10,668,665	20,185,932
Fixed Manufacturing Costs	6,282,798	8,058,435
Total Cost of Goods Sold	16,951,463	28,244,367
GROSS MARGIN	2,401,831	9,247,038
OPERATING EXPENSES		
Selling and Administrative	(3,353,848)	(3,457,920)
Commissions	(163,895)	(514,291)
Total Operating Expenses	(3,517,743)	(3,972,211)
NET MANUFACTURING INCOME (LOSS)	(1,115,912)	5,274,827
OTHER OPERATING REVENUE (EXPENSE), SUPPORT AND DEVELOPMENT		
Training and Service Grants	471,441	592,464
Other Contributions and Grants	721,092	1,482,720
Training and Service Expenses	(613,057)	(518,927)
Advertising Expenses	(142,512)	(256,458)
Fundraising Expenses	(199,673)	(455,773)
Total Other Operating Expense, Support and Development	237,291	844,026
NET OPERATING INCOME (LOSS)	(878,621)	6,118,853
OTHER INCOME (EXPENSES)		
Interest Income	26,171	28,875
Change in Value of Swap	21,641	27,373
Other Income	6,748	27,546
Contributions	(1,000)	(101,000)
Real Estate Expenses	(310,495)	(101,147)
Interest and Other Finance Related Expenses	(111,297)	(120,433)
Total Other Expenses	(368,232)	(238,786)
CHANGE IN NET ASSETS	(1,246,853)	5,880,067
Net Assets - Beginning of Year	23,930,824	18,050,757
NET ASSETS - AT END OF YEAR	$ 22,683,971	$ 23,930,824

See accompanying Notes to Consolidated Financial Statements.

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	$ (1,246,853)	$ 5,880,067
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Depreciation	1,210,609	996,585
Noncash Fix Asset Additions	(515,595)	-
Amortization of Deferred Rent	13,048	-
Allowance for Doubtful Accounts	10,250	10,250
Change in Value of Swap	(21,641)	(27,373)
Changes in Assets and Liabilities:		
Accounts Receivable	1,010,158	(1,560,602)
Inventories	(32,121)	(115,687)
Prepaid Expenses and Other Assets	34,582	(39,877)
Accounts Payable	(646,282)	115,816
Accrued Expenses	(755,715)	293,172
Deferred Revenue	(1,991,754)	2,350,393
Other Liabilities	476,565	156,290
Net Cash Provided (Used) by Operating Activities	(2,454,749)	8,059,034
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(5,192,379)	(4,011,479)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal Payments on Long-Term Debt	(274,827)	(265,840)
Proceeds from Long-Term Debt	53,352	-
Net Cash Used by Financing Activities	(221,475)	(265,840)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(7,868,603)	3,781,715
Cash and Cash Equivalents - Beginning of Year	15,925,451	12,143,736
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 8,056,848	$ 15,925,451
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Payments for Interest	$ 111,297	$ 120,433
Noncash Property and Equipment Purchases	$ 515,595	$ -

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Minnesota Diversified Industries Inc. and Affiliates (MDI or Organization) is a nonprofit social enterprise that exists to serve people with disabilities by offering inclusive employment opportunities and services. 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 many commercial companies. MDI employs people at four locations in Minnesota – Minneapolis, Hibbing, Grand Rapids and Cohasset – and pays their employees at least minimum wage and benefits. Deer River Hired Hands changed their legal name to MDI Hired Hands during the year ended December 31, 2016.

MDI created a new nonprofit limited liability company named MDI Real Estate, LLC during the year ended December 31, 2016. The purpose of MDI Real Estate, LLC is to purchase real estate including land and buildings and lease the facilities back to MDI at market-based rates.

Basis of Presentation

The accompanying consolidated financial statements have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. 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 consolidated 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 MDI. The donors of these resources permit MDI 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, 2017 and 2016.

Consolidation

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

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

MDI maintains its cash at financial institutions in Minnesota. MDI considers all unrestricted highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents. At times such deposits at financial institutions may be in excess of FDIC insurance limits. MDI has not experienced any losses in such accounts, and does not believe it is exposed to any significant credit risk on cash investments.

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 $84,283 and $57,108 at December 31, 2017 and 2016, 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:

	2017	2016
Raw Materials	$ 1,336,349	$ 1,340,841
Finished Goods	447,825	391,212
Reserve	(200,112)	(180,112)
Total	$ 1,584,062	$ 1,551,941

Investments

MDI carries its investments at fair market value. Realized and unrealized gains and losses from marketable securities are not material to the consolidated financial statements and are included in the consolidated statement of activities.

Investments consist of the following as of December 31, 2017 and 2016:

	2017	2016
Cash	$ 37,547	$ 33,751
Bond Mutual Funds	23,487	17,770
Equity Mutual Funds	58,100	55,872
Total	$ 119,134	$ 107,393

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements

MDI follows an accounting standard that defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and requires expanded disclosures about fair value measurements. MDI accounts for its investments and swap asset at fair value and has categorized its investments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Property and Equipment

Property and equipment are recorded at original cost. Additions, improvements, or major renewals over $2,500 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	5-50 Years
Machinery and Equipment	5-15 Years
Office and Computer Equipment	3-5 Years

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 consolidated financial statements.

Revenue Recognition

MDI has contracts with the 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.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition (Continued)

Government grants and contract revenues are recognized when earned. Revenue is earned when eligible expenditures, as defined in each grant or contract, are made. Expenditures under government contracts are subject to review by the granting authority. To the extent, if any, that such a review reduces expenditures allowable under these contracts, MDI will record such disallowance at the time the final assessment is made.

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.

Accounting Estimates

The presentation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

MDI is exempt from federal and state 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.

MDI reviews income tax positions taken or expected to be taken in income tax returns to determine if there are any income tax uncertainties. MDI 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, based on the technical merits of the positions. MDI has identified no income tax uncertainties.

Reclassifications

Certain reclassifications have been made to the prior year consolidated financial statements to agree with the current year presentation. The reclassification had no effect on the change in unrestricted net assets or total net assets as previously reported.

Subsequent Events

In preparing these consolidated financial statements, MDI has evaluated for recognition or disclosure the events or transactions that occurred through March 21, 2018, the date the consolidated financial statements were available to be issued.

NOTE 2 PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	2017	2016
Land, Buildings, and Improvements	$ 14,715,392	$ 10,330,038
Machinery and Equipment	15,200,188	13,959,990
Office and Computer Equipment	871,285	788,861
Total	30,786,865	25,078,889
Less: Accumulated Depreciation	(15,446,965)	(14,236,354)
Net	$ 15,339,900	$ 10,842,535

NOTE 3 LONG-TERM DEBT

Long-term debt is as follows:

Description	2017	2016
City of Hibbing manufacturing facilities revenue note due in monthly installments of $31,951 including fixed interest at 3.42% through July 20, 2027. This note is secured by substantially all assets of MDI.	$ 3,129,156	$ 3,400,497
City of St. Louis County Economic Development Fund deferred loan with a maturity date of May 31, 2027. The loan proceeds will be used to help finance the construction of a new facility located in Hibbing, MN and will be forgiven after five years of operating the facility. 0% interest.	53,352	-
Cities of Deer River/Kootasca Community Action Small Cities Development Program deferred loan with a ten year term, with 10% forgiven each year. This note is secured by real estate located in Deer River.	27,890	31,376
Subtotal	3,210,398	3,431,873
Less: Amount Due Within One Year	(288,892)	(270,539)
Net Long-Term Debt	$ 2,921,506	$ 3,161,334

The scheduled maturities of long-term debt were as follows at December 31, 2017:

Year Ending December 31,	Amount
2018	$ 288,892
2019	299,344
2020	309,437
2021	319,880
2022	330,688
Thereafter	1,662,157
Total	$ 3,210,398

NOTE 3 LONG-TERM DEBT (CONTINUED)

In conjunction with the loan agreement due on July 20, 2027, MDI entered into an interest rate swap agreement with a financial institution to minimize the risks associated with market rate fluctuations due to the variable rate of the loan (1-month LIBOR + 2.04%). Pursuant to the terms of the interest rate swap agreement, MDI pays interest to the financial institution at a fixed rate of 3.42%. The financial institution pays MDI interest at a variable rate equal to 68% of the then current 1-month LIBOR index, 1.56% as of December 31, 2017. As of December 31, 2017, the notional amount of the swap agreement was consistent with the outstanding amount of the loan noted in the table above. At December 31, 2017 and 2016, the fair value of the swap agreement (asset) liability was $(14,213) and $7,428, respectively.

MDI must comply with Minnesota Bank & Trust loan covenants including several financial ratios.

MDI has one line of credit for $5,000,000 with a maturity date of April 28, 2019. There were no outstanding draws on this line of credit as of December 31, 2017. The line bears interest at prime of 4.50%.

On September 2, 2015, MDI entered into a deferred loan agreement with the Cities of Deer River/Kootasca Community Action Small Cities Development Program. The loan has a ten-year term with 10% of the loan being forgiven each year with the loan being totally forgiven on the first day of the eleventh year.

NOTE 4 RETIREMENT BENEFITS

MDI maintains a defined-contribution health and welfare money purchase pension 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 $44,835 in 2017 and $31,228 in 2016.

MDI has a 403b 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 $94,853 in 2017 and $149,195 in 2016.

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 $9,924 in 2017 and $16,351 in 2016. The total value of investments, at fair market value, held for the participants' benefit and the related vested deferred liability is $119,134 and $107,393 at December 31, 2017 and 2016, respectively.

NOTE 5 FUNCTIONAL ALLOCATION OF EXPENSES

Functional expenses were as follows:

	2017	2016
Program Services	$ 17,102,523	$ 28,848,315
Administrative and General Expenses	4,744,717	4,922,001
Total	$ 21,847,240	$ 33,770,316

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

	2017	2016
Cost of Goods Sold	$ 16,951,463	$ 28,244,367
Selling and Administrative Expense	3,353,848	3,457,920
Commissions	163,895	514,291
Interest and Other Finance Related Expense	111,297	120,433
Real Estate Expenses	310,495	101,147
Training and Service Expenses	613,057	518,927
Advertising Expenses	142,512	256,458
Fundraising Expenses	199,673	455,773
Contributions	1,000	101,000
Total	$ 21,847,240	$ 33,770,316

NOTE 6 OVERHEAD EXPENSES

MDI's operations consist of Grand Rapids, Hibbing, and a portion of Minneapolis facilities (plastic production), and Cohasset. Costs for these operations consist of the following:

	2017	2016
Plastic Production Overhead	$ 5,472,297	$ 7,723,939
Twin Cities Overhead (Excluding Plastic Production)	1,305,149	1,397,947
Cohasset Overhead (Excluding Plastic Production)	1,414,652	2,070,705
Total Overhead	$ 8,192,098	$ 11,192,591
Allowable General and Administrative	$ 2,676,850	$ 3,468,074
Marketing and Advertising	1,183,078	1,216,368
Total Selling, Administrative, Advertising and Fundraising	$ 3,859,928	$ 4,684,442

NOTE 7 MAJOR CUSTOMERS AND CREDIT RISK CONCENTRATIONS

The USPS is a major customer of MDI. Sales to the USPS accounted for $9,755,589 (47%) and $28,290,389 (71%) of total revenue for the years ended December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, 70% and 78%, respectively, of total accounts receivable were from one customer.

NOTE 8 FAIR VALUE MEASUREMENTS

MDI uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how MDI measures fair value refer to Note 1 – Summary of Significant Accounting Policies. The following table presents the fair value hierarchy for the balances of the assets of MDI measured at fair value on a recurring basis as of December 31, 2017 and 2016:

	2017			
	Level 1	Level 2	Level 3	Total
Investments:				
Bond Mutual Funds	$ 23,487	$ -	$ -	$ 23,487
Equity Mutual Funds	58,100	-	-	58,100
Total	81,587	-	-	81,587
Swap Asset (Liability)	-	14,213	-	14,213
Total Fair Value Assets	$ 81,587	$ 14,213	$ -	$ 95,800

	2016			
	Level 1	Level 2	Level 3	Total
Investments:				
Bond Mutual Funds	$ 17,770	$ -	$ -	$ 17,770
Equity Mutual Funds	55,872	-	-	55,872
Total	73,642	-	-	73,642
Swap Asset (Liability)	-	(7,428)	-	(7,428)
Total Fair Value Assets	$ 73,642	$ (7,428)	$ -	$ 66,214

NOTE 9 FUTURE COMMITMENTS

MDI leases office space under operating leases. On November 12, 2013, MDI entered into a new lease agreement for office space, which expires on May 31, 2026. Rental expense under the leases was $225,515 and $331,180 for the years ended December 31, 2017 and 2016, respectively. In addition, MDI leases various office equipment. Monthly equipment rental payments range from $2,000 to $10,000.

NOTE 9 FUTURE COMMITMENTS (CONTINUED)

Future minimum lease payments were as follows as of December 31, 2017:

Year Ending December 31,	Amount
2018	$ 218,481
2019	220,655
2020	224,990
2021	230,615
2022	236,380
Thereafter	852,346
Total	$ 1,983,467

In April 2017 MDI closed on the purchase of land in Hibbing, MN and entered into a contract with Hawk Construction to build a new approximately 35,000 square feet facility on the site. The total construction cost is estimated at $4.6 million. As of December 31, 2017, there is approximately $269,000 yet to be paid for future capital purchases based on the signed agreement.