MINNESOTA DIVERSIFIED INDUSTRIES INC.
AND AFFILIATES

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2016 AND 2015

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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, 2016 and 2015, 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, 2016 and 2015, 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

CliftonLarsonAllen LLP

Minneapolis, Minnesota
March 22, 2017

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 15,925,451	$ 12,143,736
Accounts Receivable, Net	5,019,181	3,468,829
Inventories	1,551,941	1,436,254
Prepaid Expenses and Other Assets	182,899	143,022
Total Current Assets	22,679,472	17,191,841
OTHER ASSETS		
Investments	107,393	86,665
PROPERTY AND EQUIPMENT, NET	10,842,535	7,827,641
Total Assets	$ 33,629,400	$ 25,106,147
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	$ 270,539	$ 261,279
Accounts Payable	1,025,484	909,668
Accrued Personnel Expenses	1,533,038	1,239,866
Other Current Liabilities	3,593,360	1,086,677
Total Current Liabilities	6,422,421	3,497,490
OTHER LIABILITIES		
Long-Term Debt	3,161,334	3,436,434
Retirement Benefit Liability	107,393	86,665
Swap Liability	7,428	34,801
Total Other Liabilities	3,276,155	3,557,900
UNRESTRICTED NET ASSETS	23,930,824	18,050,757
Total Liabilities and Net Assets	$ 33,629,400	$ 25,106,147

See accompanying Notes to Consolidated Financial Statements.

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF ACTIVITIES
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
SALES	$ 36,055,769	$ 43,608,283
COST OF GOODS SOLD		
Variable Manufacturing Costs	19,582,413	24,303,736
Fixed Manufacturing Costs	7,395,335	7,079,911
Total Cost of Goods Sold	26,977,748	31,383,647
GROSS MARGIN	9,078,021	12,224,636
OPERATING EXPENSES		
Selling and Administrative	(3,767,718)	(3,031,273)
Commissions	(461,291)	(573,872)
Total Operating Expenses	(4,229,009)	(3,605,145)
NET MANUFACTURING INCOME (LOSS)	4,849,012	8,619,491
OTHER OPERATING REVENUE (EXPENSE), SUPPORT AND DEVELOPMENT		
Training and Service Grants	592,464	439,350
Other Contributions and Grants	1,482,720	73,914
Program Service Recycling Revenue	1,435,636	1,299,165
Training and Service Expenses	(525,258)	(462,850)
Advertising Expenses	(275,439)	(84,108)
Fundraising Expenses	(180,334)	(175,137)
Program Service Recycling Expenses	(1,265,193)	(1,436,202)
Total Other Operating Expense, Support and Development	1,264,596	(345,868)
NET OPERATING INCOME	6,113,608	8,273,623
OTHER INCOME (EXPENSES)		
Interest Income	28,875	15,863
Change in Value of Swap	27,373	(19,254)
Other Income	32,791	16,491
Contributions	(101,000)	(100,000)
Real Estate Expenses	(101,147)	-
Interest and Other Finance Related Expenses	(120,433)	(128,022)
Total Other Expenses	(233,541)	(214,922)
CHANGE IN NET ASSETS	5,880,067	8,058,701
Net Assets - Beginning of Year	18,050,757	9,992,056
NET ASSETS - AT END OF YEAR	$ 23,930,824	$ 18,050,757

See accompanying Notes to Consolidated Financial Statements.

MINNESOTA DIVERSIFIED INDUSTRIES INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	$ 5,880,067	$ 8,058,701
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation	996,585	791,824
Allowance for Doubtful Accounts	10,250	46,858
Change in Value of Swap	(27,373)	19,254
Changes in Assets and Liabilities:		
Accounts Receivable	(1,560,602)	344,694
Inventories	(115,687)	358,449
Prepaid Expenses and Other Assets	(39,877)	12,022
Accounts Payable	115,816	(341,806)
Accrued Expenses	293,172	337,854
Other Liabilities	2,506,683	229,924
Net Cash Provided by Operating Activities	8,059,034	9,857,774
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(4,011,479)	(1,287,073)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal Payments on Long-Term Debt	(265,840)	(253,426)
Proceeds from Long-Term Debt	-	34,984
Net Cash Used by Financing Activities	(265,840)	(218,442)
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,781,715	8,352,259
Cash and Cash Equivalents - Beginning of Year	12,143,736	3,791,477
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 15,925,451	$ 12,143,736
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Payments for Interest	$ 120,433	$ 128,022

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 five locations in Minnesota – Minneapolis, Hibbing, Grand Rapids, Deer River, 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, 2016 and 2015.

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 $57,108 and $46,858 at December 31, 2016 and 2015, 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:

	2016	2015
Raw Materials	$ 1,340,841	$ 1,235,588
Finished Goods	391,212	373,245
Reserve	(180,112)	(172,579)
Total	$ 1,551,941	$ 1,436,254

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2016 and 2015:

	2016	2015
Cash	$ 33,751	$ 31,107
Bond Mutual Funds	17,770	10,824
Equity Mutual Funds	55,872	44,734
Total	$ 107,393	$ 86,665

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	15-50 Years
Machinery and Equipment	5-10 Years
Office and Computer Equipment	3-5 Years

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 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.

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.

Program service recycling revenues are recognized when earned.

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.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 22, 2017, the date the consolidated financial statements were available to be issued.

NOTE 2 PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	2016	2015
Land, Buildings, and Improvements	$ 10,330,038	$ 7,587,450
Machinery and Equipment	13,959,990	13,184,191
Office and Computer Equipment	788,861	588,405
Total	25,078,889	21,360,046
Less Accumulated Depreciation	(14,236,354)	(13,532,405)
Net	$ 10,842,535	$ 7,827,641

MDI has entered into signed agreements for various capital asset purchases that are not yet complete as of December 31, 2016. As of December 31, 2016, there is approximately $718,000 yet to be paid for these capital purchases based on signed agreements.

NOTE 3 LONG-TERM DEBT

Long-term debt is as follows:

Description	2016	2015
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.	$ 3,400,497	$ 3,662,729
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.	31,376	34,984
Subtotal	3,431,873	3,697,713
Less Amount Due Within One Year	(270,539)	(261,279)
Net Long-Term Debt	$ 3,161,334	$ 3,436,434

The scheduled maturities of long-term debt were as follows at December 31, 2016:

Year Ending December 31,	Amount
2017	$ 270,539
2018	284,254
2019	294,009
2020	304,102
2021	314,545
Thereafter	1,964,424
Total	$ 3,431,873

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, 0.52% as of December 31, 2016. As of December 31, 2016, the notional amount of the swap agreement was consistent with the outstanding amount of the loan noted in the table above. At December 31, 2016 and 2015, the fair value of the swap agreement liability was $7,428 and $34,801, respectively.

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

NOTE 3 LONG-TERM DEBT (CONTINUED)

MDI has one line of credit for $1,500,000 with a maturity date of September 24, 2018. There were no outstanding draws on this line of credit as of December 31, 2016. The line bears interest at prime of 3.50%.

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 $31,228 in 2016 and $38,829 in 2015.

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 $149,195 in 2016 and $95,900 in 2015.

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 $16,351 in 2016 and $14,876 in 2015. The total value of investments, at fair market value, held for the participants' benefit and the related vested deferred liability is $107,393 and $86,665 at December 31, 2016 and 2015, respectively.

NOTE 5 FUNCTIONAL ALLOCATION OF EXPENSES

Functional expenses were as follows:

	2016	2015
Program Services	$ 28,853,560	$ 33,346,254
Administrative and General Expenses	4,922,001	4,028,857
Total	$ 33,775,561	$ 37,375,111

NOTE 5 FUNCTIONAL ALLOCATION OF EXPENSES (CONTINUED)

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

	2016	2015
Cost of Goods Sold	$ 26,977,748	$ 31,383,647
Selling and Administrative Expense	3,767,718	3,031,273
Commissions	461,291	573,872
Interest and Other Finance Related Expense	120,433	128,022
Other Income and Expenses	101,147	-
Program Service Recycling Expenses	1,265,193	1,436,202
Training and Service Fees	525,258	462,850
Advertising Expenses	275,439	84,108
Fundraising Expenses	180,334	175,137
Contributions	101,000	100,000
Total	$ 33,775,561	$ 37,375,111

The contributions expense reflects a donation to Success at Work Non-Endowed and Endowed Fund at the Grand Rapids Area Community Foundation for support of people with disabilities.

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:

	2016	2015
Plastic Production Overhead	$ 7,723,939	$ 9,554,316
Twin Cities Overhead (Excluding Plastic Production)	1,397,947	1,673,228
Cohasset Overhead (Excluding Plastic Production)	2,070,705	819,722
Total Overhead	$ 11,192,591	$ 12,047,266
Allowable General and Administrative	$ 3,006,783	$ 2,247,311
Marketing and Advertising	1,216,708	1,043,207
Total Selling, Administrative, Advertising and Fundraising	$ 4,223,491	$ 3,290,518

NOTE 7 MAJOR CUSTOMERS AND CREDIT RISK CONCENTRATIONS

The USPS is a major customer of MDI. Sales to the USPS accounted for $28,290,389 (71%) and $36,648,935 (81%) of total revenue for the years ended December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015, 77% and 75%, 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, 2016 and 2015:

	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

	2015			
	Level 1	Level 2	Level 3	Total
Investments:				
Bond Mutual Funds	$ 10,824	$ -	$ -	$ 10,824
Equity Mutual Funds	44,734	-	-	44,734
Total	55,558	-	-	55,558
Swap Asset (Liability)	-	(34,801)	-	(34,801)
Total Fair Value Assets	$ 55,558	$ (34,801)	$ -	$ 20,757

NOTE 9 LEASES

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 $331,180 and $202,113 for the years ended December 31, 2016 and 2015, respectively. In addition, MDI leases various office equipment. Monthly equipment rental payments range from $2,000 to $10,000.

Future minimum lease payments were as follows as of December 31, 2016:

Year Ending December 31,	Amount
2017	$ 222,452
2018	218,481
2019	222,682
2020	227,017
2021	230,615
Thereafter	1,088,726
Total	$ 2,209,973

NOTE 10 SUBSEQUENT EVENTS

Subsequent to year-end, Minnesota Diversified Industries, Inc. entered into a contract to purchase land for a new facility in Hibbing, Minnesota. The transaction is expected to close by April 15, 2017. The land purchase agreement was signed effective January 20, 2017 for $79,000. The new facility will contain 35,000 square feet and cost approximately $4.6 million to build. The project will be funded through grants, a forgivable loan, and cash reserves. A $1,000,000 forgivable loan and $350,000 infrastructure grant has been approved by Iron Range Resources and Rehabilitation Board for this project. The $1,000,000 forgivable loan contains contingencies regarding job creation. The loan would be an interest only loan for 12 years and after three years the loan becomes forgivable based on job creation over the remaining nine years. If any loan balance remains after 12 years, the balance will be amortized over a five-year term for repayment