



CCOM GROUP, INC.

**ANNUAL FINANCIAL STATEMENTS
AND RELATED FOOTNOTES**

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

CCOM GROUP, INC. AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
CCOM Group, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of CCOM Group, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 consolidated financial position of CCOM Group, Inc. and Subsidiaries as of December 31, 2018 and 2017, and the consolidated results of their operations and their cash flows for each of the years then ended in accordance with accounting principles generally accepted in the United States of America.



EISNERAMPER LLP
Iselin, New Jersey
April 26, 2019



CCOM GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash	\$ 307,472	\$ 506,635
Accounts receivable, net of allowance for doubtful accounts of \$497,526 and \$1,052,963, respectively	11,384,957	11,522,688
Inventory	18,740,410	16,231,516
Prepaid expenses and other current assets	1,046,161	1,121,745
Total current assets	31,479,000	29,382,584
Property and equipment, net	612,600	568,079
Goodwill	1,416,929	1,416,929
Other assets - noncurrent	471,178	424,375
Deferred income tax asset - noncurrent	2,700,000	1,682,000
	\$36,679,707	\$33,473,967
Liabilities and Stockholders' Equity		
Current liabilities:		
Borrowings under credit facility - revolving credit	\$13,476,541	\$14,464,649
Notes payable, current portion; includes related party notes of \$211,226 and \$196,587, respectively	264,266	279,606
Trade payables	5,655,011	4,558,305
Accrued liabilities	2,479,556	2,165,224
Income taxes payable	715	18,488
Total current liabilities	21,876,089	21,486,272
Notes payable, non-current portion; includes related party notes of \$389,109 and \$599,291, respectively	602,887	645,231
Deferred income tax liability - noncurrent	354,000	567,000
Total liabilities	22,832,976	22,698,503
Commitments and contingencies		
Stockholders' equity:		
Redeemable convertible preferred stock, \$.05 par value, 2,500,000 shares authorized, 284,612 shares issued and outstanding, liquidation preference of \$1,423,060	14,231	14,231
Common stock, \$.05 par value, 20,000,000 shares authorized, 9,154,928 shares issued and outstanding	457,746	457,746
Additional paid-in capital	12,596,853	12,596,853
Retained earnings (accumulated deficit)	777,901	(2,293,366)
Total stockholders' equity	13,846,731	10,775,464
	\$36,679,707	\$33,473,967

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

CCOM GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Income

	For the Years Ended December 31,	
	2018	2017
Sales	\$104,657,935	\$92,330,429
Cost of sales	77,380,788	67,751,419
Gross profit	27,277,147	24,579,010
Selling, general and administrative expenses, net	24,837,160	23,000,348
Operating income	2,439,987	1,578,662
Other income	269,325	205,456
Interest expense, net; includes related party interest expense of \$59,728 and \$79,093, respectively	(745,019)	(646,523)
Income before income tax (benefit) expense	1,964,293	1,137,595
Income tax (benefit) expense	(1,106,974)	623,188
Net income	\$3,071,267	\$514,407
Income per common share:		
Basic	\$ 0.33	\$ 0.05
Diluted	\$ 0.32	\$ 0.05
Weighted average common shares outstanding:		
Basic	9,154,928	9,154,928
Diluted	9,439,540	9,439,540

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

CCOM GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2018 and 2017

	Number of shares		Redeemable Convertible Preferred Stock	Common Stock	Redeemable Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Redeemable Convertible Preferred Stock	Common Stock							
Balance at December 31, 2016	284,612	9,154,928	\$ 14,231	\$ 457,746	\$12,596,853	\$(2,807,773)	\$10,261,057		
Net Income	-	-	-	-	-	514,407	514,407		
Balance at December 31, 2017	284,612	9,154,928	\$ 14,231	\$ 457,746	\$12,596,853	\$(2,293,366)	\$10,775,464		
Net Income	-	-	-	-	-	3,071,267	3,071,267		
Balance at December 31, 2018	284,612	9,154,928	\$ 14,231	\$ 457,746	\$12,596,853	\$ 777,901	\$13,846,731		

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

CCOM GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the Years Ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 3,071,267	\$ 514,407
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred income tax (benefit) expense	(1,231,000)	517,899
Provision for doubtful accounts	334,558	585,168
Depreciation and amortization	298,654	359,184
Net gain on sale of property and equipment	(24,756)	(200)
Changes in operating assets and liabilities:		
Accounts receivable	(196,827)	(1,319,599)
Inventory	(2,508,894)	(1,343,491)
Prepaid expenses and other current assets	75,584	(441,706)
Other assets – noncurrent	(46,803)	(136,630)
Trade payables	1,096,706	706,298
Accrued liabilities	314,332	170,141
Income taxes payable	(17,773)	(23,700)
Net cash provided by (used in) operating activities	1,165,048	(412,229)
Cash flows from investing activities:		
Additions to property and equipment	(108,356)	(119,301)
Proceeds from disposal of property and equipment	43,027	200
Net cash used in investing activities	(65,329)	(119,101)
Cash flows from financing activities:		
Repayments of notes payable; includes related party repayments of \$195,763 and \$276,283, respectively	(310,774)	(457,587)
Repayments of short-term financing, related party	(1,500,000)	(2,000,000)
Issuance of short-term financing, related party	1,500,000	2,000,000
(Repayments) borrowings under credit facility - revolving credit, net	(988,108)	1,046,794
Net cash (used in) provided by financing activities	(1,298,882)	589,207
(Decrease) increase in cash	(199,163)	57,877
Cash - beginning of year	506,635	448,758
Cash - end of year	\$ 307,472	\$ 506,635

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

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

December 31, 2018 and 2017

1. Summary of Significant Accounting Policies and Practices

(a) Description of Business and Liquidity

CCOM Group, Inc., through its operating subsidiaries Universal Supply Group, Inc. (“Universal”), The RAL Supply Group, Inc. (“RAL”), and S&A Supply, Inc. (“S&A”) (together, the “Company”), is a distributor of heating, ventilating and air conditioning equipment (HVAC), parts and accessories, whole-house generators, climate control systems, and plumbing and electrical fixtures and supplies to building contractors and other users, which the Company considers its only operating segment. The Company’s products are marketed primarily to HVAC, plumbing and electrical contractors, who, in turn, sell such products to residential and commercial/industrial customers. The Company’s customers are primarily located in New Jersey, New York, Massachusetts and portions of eastern Pennsylvania, Connecticut and Vermont. The Company has no long-term agreement with any customer. The Company deals with its customers one sale at a time. The Company has no material long-term agreements with any supplier. The Company enters into agreements with vendors which include volume rebates, pricing and advertising, all within the standard practices of the industry. Additionally, certain supplier agreements limit the sale of competitive products in designated markets that the Company serves. All purchases are made with domestic vendors, some of which, however, may manufacture products in foreign locations.

On November 12, 2013, the Company filed a Form 15 with the Securities and Exchange Commission to voluntarily deregister its common stock and convertible preferred stock under the Securities Exchange Act of 1934. The filing suspended the Company’s obligation to file all periodic reports with the SEC.

As discussed further in Note 3, the Company’s primary financing arrangement currently terminates on September 18, 2019. The Company is in preliminary discussions with its lender and expects to extend and/or refinance these arrangements under similar terms, though there can be no assurances that this will occur. Should the Company be unable to extend or refinance its current financing arrangements or should it be unable to get similar terms, this could have a materially adverse effect on the Company’s consolidated financial position and liquidity. No adjustments have been made to these consolidated financial statements as a result of this uncertainty.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of CCOM Group, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(c) Revenue Recognition

Revenue is recognized when the earnings process is complete, which is generally upon shipment or delivery of products, and the price is determined and collectability is reasonably assured, in accordance with agreed-upon shipping terms and when title and risk of loss transfers to the customer. The Company has no further obligations subsequent to shipment or delivery. Customers have the right to return defective products, which are substantially covered under the manufacturer's warranty. The customer receives a credit from the Company for defective products returned and the Company receives a corresponding credit provided by the manufacturer. The only warranty provided on products sold is the one provided by the manufacturer.

(d) Accounts Receivable

Accounts receivable consist of trade receivables recorded at original invoice amount, less an estimated allowance for doubtful accounts. Trade credit is generally extended on a short-term basis; thus, trade receivables generally do not bear interest. However, a service charge may be applied to receivables that are past due. These charges, when collected, are included as other income. Trade receivables are periodically evaluated for collectability based on past credit history with customers and their current financial condition. Changes in the estimated collectability of trade receivables are recorded in the results of operations for the period in which the estimate is revised. Trade receivables that are deemed doubtful are offset against the allowance for doubtful accounts. The Company generally does not require collateral for trade receivables.

(e) Inventory

Inventory is stated at the lower of cost or net realizable value and consists solely of finished goods. Cost is determined using the first-in, first-out method. Inventory is analyzed for potential obsolescence and slow-moving items based upon the aging of the inventory and the inventory turns by product. Inventory items designated as obsolete or slow moving are reduced to their estimated net realizable value.

(f) Distribution Costs

Distribution costs of incoming freight, purchasing, receiving, inspection, warehousing and handling costs are included in selling, general and administrative expenses. Such costs were \$603,294 and \$551,655 for the years ended December 31, 2018 and 2017, respectively.

(g) Vendor Rebates

The Company has arrangements with several vendors that provide rebates to be payable to the Company when the Company achieves various specified measures, generally related to the volume level of purchases. The Company accounts for such rebates as a reduction of inventory until the sale of the product and had \$243,847 and \$339,319 for the years ended December 31, 2018 and 2017, respectively. Rebates under arrangements with vendors that require a specified cumulative level of purchases are recognized by the Company based on progress toward achieving such levels, provided the rebates are probable and estimable.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(h) Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets as follows:

Computer hardware and software	3-5 years
Furniture and fixtures	5 years
Automobiles	3-5 years
Showroom fixtures and displays	3 years

Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset.

(i) Goodwill

The Company completed its annual impairment tests on goodwill in December 2018 and 2017, and no impairments were recognized in either year. Goodwill is assessed for impairment using either a qualitative or quantitative approach. Where a qualitative assessment is used, the Company first determines if, based on qualitative factors, it is more likely than not that an impairment exists. Factors considered include historical financial performance, macroeconomic and industry conditions and legal and regulatory environment. If the qualitative assessment indicates that it is more likely than not that an impairment exists, then a quantitative assessment is performed. The quantitative assessment requires an analysis of several estimates including future cash flows or income consistent with management's strategic business plans, annual sales growth rates and the selection of assumptions underlying a discount rate (weighted average cost of capital) based on market data available at the time.

(j) Net Income Per Common Share

Basic income per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Dilutive earnings per share reflect the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock.

(k) Income Taxes

The Company accounts for income taxes in accordance with the asset and liability approach for financial accounting and reporting of income taxes. The realization of future tax benefits of deductible temporary differences and operating loss or tax credit carryforwards will depend on whether the Company will have sufficient taxable income of an appropriate character within the carryback and carryforward period permitted by the tax law to allow for utilization of the deductible amounts and carryforwards. Without sufficient taxable income to offset the deductible amounts and carryforwards, the related tax benefits will expire unused. The Company evaluates both positive and negative evidence in making a determination as to whether it is more likely than not that all or some portion of the deferred tax asset will not be realized.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

Management has determined that based on the cumulative recent history of income and income projections, including the expense related to the amortization of goodwill for tax purposes, that it will be more likely than not that only a portion of the deferred tax asset will be realized. Due to the “Tax Cuts and Jobs Act” signed in December 2017, the Company re-evaluated its deferred tax asset both with updated projections and revised tax rates. Management determined a deferred tax asset of approximately \$1,682,000 will be realized and, accordingly, adjusted the valuation allowance from December 31, 2016 by \$634,500 in total, of which, \$514,500 related to the new law changes in rates. In 2018, based on actual results and updated projections, and the estimated utilization of net operating loss carryforwards, management determined that a deferred tax asset of approximately \$2,700,000 will be realized and, accordingly, released an additional valuation allowance of \$1,018,000.

The Company follows the provisions that tax positions must meet a “more-likely-than-not” recognition threshold at the effective date to be recognized. The Company had no unrecognized tax benefits recorded for the years ended December 31, 2018 and 2017. When an accrual for interest and penalties is required, interest and penalties will be recognized in tax expense.

The Company files income tax returns in the U.S. federal jurisdiction and various states. There are currently no federal or state income tax examinations in process.

(l) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets, such as furniture, equipment and leasehold improvements, are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets will be written down to fair value. No such impairments were recorded in 2018 or 2017.

(m) Use of Estimates

The preparation of financial statements in accordance 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. Significant estimates include valuation reserves for accounts receivable, inventory, income taxes, assessment of goodwill impairment and the impairment of long-lived assets. Actual results could differ from those estimates.

(n) Recent Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“ASU 2014-09”). This standard establishes a principle for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. ASU 2014-09 will be effective for fiscal years beginning after December 15, 2018. The Company expects that the adoption of this standard will not have a material effect on its consolidated financial statements.

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In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. The FASB subsequently issued ASU No. 2018-10 and 2018-11 in July 2018, which provide clarifications and improvements to ASU 2016-02 (collectively, the “new lease standard”).

ASU No. 2018-11 also provides the optional transition method which allows companies to apply the new lease standard at the adoption date instead of at the earliest comparative period presented and continue to apply the provisions of the previous lease standard in its annual disclosures for the comparative periods. The new lease standard requires lessees to present a right-of-use asset and a corresponding lease liability on the balance sheet. Lessor accounting is substantially unchanged compared to the current accounting guidance. Additional footnote disclosures related to leases will also be required. This ASU will be effective beginning on or after January 1, 2020. The Company is currently evaluating the impact of adopting the new leases standard on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). ASU 2016-01, among other things, eliminates the requirement for entities that are not public business entities to disclose fair value information for financial instruments measured at amortized cost, and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements. ASU 2016-01 is effective for periods beginning after December 15, 2018 including interim periods within those fiscal years. The new guidance must be applied using a modified-retrospective approach with a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year in which the guidance is adopted, except the guidance on equity securities without readily determinable fair values will be applied prospectively to all equity investments that exist as of the date of adoption. ASU 2016-01 does not permit early adoption of most of its amendments except it does permit early adoption of the amendment that exempts the Company from disclosing the fair value of financial instruments that are not recognized and measured at fair value. The Company expects that the adoption of this standard will not have a material effect on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments (Topic 326) - Credit Losses: Measurement of Credit Losses on Financial Instruments*, which provides guidance regarding the measurement of credit losses on financial instruments. The new guidance replaces the incurred loss impairment methodology in the current guidance with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. This ASU will be effective for fiscal years beginning after December 15, 2020, with early adoption permitted for fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

CCOM GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*. ASU 2017-04 removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This standard will be effective for the Company beginning in the fiscal year after December 15, 2021 and is required to be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company's adoption of this standard did not have a material effect on its consolidated financial statements.

(o) Subsequent Events

The Company has evaluated subsequent events through the date that the consolidated financial statements were available to be issued on April 26, 2019.

(p) Other Comprehensive Income

The Company does not currently have any items of other comprehensive income and therefore has not included a statement of comprehensive income in its consolidated financial statements.

(q) Reclassification

Certain amounts previously reported have been reclassified to conform to current year presentation.

2. Property and Equipment

Property and equipment consists of the following at December 31:

	<u>2018</u>	<u>2017</u>
Computer hardware and software	\$1,687,556	\$1,662,816
Furniture and fixtures	248,716	248,716
Leasehold improvements	2,098,705	2,081,952
Showroom fixtures and displays	425,559	425,559
Automobiles	<u>1,074,454</u>	<u>954,196</u>
	5,534,991	5,373,239
Less accumulated depreciation and amortization	<u>(4,922,390)</u>	<u>(4,805,160)</u>
	<u>\$ 612,600</u>	<u>\$ 568,079</u>

Depreciation and amortization expense amounted to \$298,654 and \$359,184 for the years ended December 31, 2018 and 2017, respectively, and is included in general and administrative expenses.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

3. Financing Arrangements

The Company and KeyBank National Association (“KeyBank”) are parties to a Credit and Security Agreement dated as of October 18, 2011, as amended (the “KeyBank Agreement”). The KeyBank Agreement, based on the September 5, 2017 amendment, provides for a revolving credit facility under which the Company may borrow up to the lesser of (i) \$20,000,000 or (ii) 85% of eligible accounts receivable, plus 55% (but not more than \$8,500,000) of the lower of cost or market of eligible inventory, or \$9,000,000 during any Inventory Advance Limit Increase Period, defined as the period from March 1 (or January 1 with respect to the 2019 calendar year) to May 31 of each calendar year, less designated reserves and extended the maturity date to September 18, 2019. Any Temporary Increase Amount during any Temporary Increase Period is subject to the Company having then met the Temporary Increase Conditions (as each of these terms are defined).

Borrowings bear interest at 2.0% above the Eurodollar Rate (as defined) or 1.75% above the Eurodollar Rate if the Fixed Charge Coverage Ratio (as defined) is above 2.0, or the Base Rate (as defined), and are secured by a first lien on substantially all of the Company’s assets, as well as a pledge of the stock of CCOM Group, Inc.’s operating subsidiaries. The facility contains covenants relating to the financial condition of the Company and its business operations. Among other things, the covenants require that as of December 31, 2018, the Company maintain a consolidated net worth of at least \$9,009,480, and a Fixed Charge Coverage Ratio of 1.1. As of December 31, 2018, the Company’s Eurodollar Rate was 4.125% and Base Rate was 5.5%, additionally the Company was in compliance with the loan covenants.

On February 23, 2017, the KeyBank Agreement was amended to, among other things, temporarily raise the inventory cap and provide for a special overadvance from February 23, 2017 to May 31, 2017.

On April 7, 2017, the KeyBank Agreement was amended to, among other things, permit deposits from a third-party payment collection company no later than two business days after receipt of customer payments.

On December 26, 2018, the KeyBank Agreement was amended to, among other things, increase the Temporary Increase Amount to \$1,000,000 for the 2019 calendar year for no more than three Temporary Increase Periods with respect to the 2019 calendar year.

During the year ended December 31, 2018, the Company borrowed an aggregate of \$117,221,671 and repaid an aggregate of \$118,209,779 under the revolving credit facility with KeyBank. As of December 31, 2018, the balance outstanding under the facility was \$13,476,541 and availability was \$3,801,168.

The Company believes that the KeyBank credit facility is sufficient to finance its current operating needs. The business of the Company will be materially and adversely affected if KeyBank substantially reduces the amount of the credit availability under the terms of the facility or KeyBank demands payment and the Company is unable to refinance the facility, or if liquidity is otherwise substantially reduced.

On February 10, 2017, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 4% per annum and the loan was repaid on May 10, 2017.

On April 20, 2017, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 4% per annum and the loan was repaid on June 27, 2017.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

On May 10, 2017, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 4% per annum and the loan was repaid on August 2, 2017.

On July 10, 2017, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 5% per annum and the loan was repaid on September 8, 2017.

On March 7, 2018, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 5% per annum and the loan was repaid on April 9, 2018.

On April 9, 2018, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 5% per annum and the loan was repaid on July 2, 2018. On April 10, 2018, KeyBank increased the Borrowing Base by \$500,000.

On July 2, 2018, Goldman Associates loaned \$500,000 to the Company. Interest accrued on the loan at 5% per annum and the loan was repaid on August 16, 2018.

On April 1, 2019, Goldman Associates loaned \$500,000 to the Company. Interest accrues on the loan at 6% per annum and the loan is repayable on July 28, 2019. On April 8, 2019, KeyBank increased the Borrowing Base by \$500,000.

All increases to the Borrowing Base were made pursuant to the KeyBank Agreement that provides, in the event the Company then meets the Temporary Increase Conditions, for KeyBank to make up to \$500,000 (\$1,000,000 for the 2019 calendar year) in additional loans to the Company to match loans in the same aggregate amount that one or more Investor Subordinated Creditors (as defined) elect to make.

Michael Goldman is the majority shareholder, Chief Executive Officer and Chairman of the Board of Goldman Associates. Michael Goldman is the Chairman of the Board of the Company. Mr. Goldman served as Chief Executive Officer of the Company from February 15, 2013 until his resignation as Chief Executive Officer on July 1, 2013. On July 1, 2013, Peter Gasiewicz was appointed Chief Executive Officer of the Company. Prior to July 1, 2013, Peter Gasiewicz served as President and Chief Operating Officer of the Company. The Company will be considered in default of the KeyBank Agreement in the event Peter Gasiewicz shall cease to hold the position of Chief Executive Officer, or a similar or higher position of the Company and the Company shall fail to hire a replacement consultant or Chief Executive Officer with technical expertise, experience and management skills, in the opinion of KeyBank, necessary for the successful management of the Company. Additionally, the facility restricts, among other things, the payment of dividends, and further restricts, subject to specified exceptions, subordinated debt, purchase of securities, and the merger and sale of the Company. The KeyBank Agreement terminates on September 18, 2019.

CCOM GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

4. Notes Payable

Notes payable consist of the following at December 31:

	<u>2018</u>	<u>2017</u>
Various term notes payable: (collateralized by equipment, the purchase of which such notes financed) with aggregate monthly principal and interest installments of \$7,631 and \$8,619 for 2018 and 2017, respectively, bearing interest between 0.9% and 6.2%.	\$266,818	\$116,673
Term note of \$750,000 payable to a related party entity: subordinated secured note payable, bearing interest at the prime rate, which was 5.5% and 4.5% at December 31, 2018 and 2017, respectively, plus 2%, interest payable quarterly. On September 1, 2017, the note was amended to bear interest at the prime rate plus 2% with interest only monthly payments from October 1, 2017 through April 1, 2018 and forty-one monthly payments of principle and interest commencing May 1, 2018. Interest expense amounted to \$48,077 and \$45,703 for the years ended December 31, 2018 and 2017, respectively.	600,335	750,000
Promissory notes payable to related parties, a related party entity and a private investor: subordinated unsecured notes payable, bearing interest at 8% per annum, repaid in equal monthly installments aggregating \$19,810 commencing April 2013 and ending March 2018. Interest expense amounted to \$774 and \$14,446 for the years ended December 31, 2018 and 2017, respectively.	-	58,164
	867,153	924,837
Less current installments	(264,266)	(279,606)
	\$602,887	\$645,231

Maturities of notes payable are as follows:

2019	\$264,266
2020	282,677
2021	219,670
2022	51,997
2023	36,794
Thereafter	11,749
	\$867,153

5. Capital Stock

Each share of the Company's convertible preferred stock is convertible into one share of the Company's common stock. Convertible preferred stockholders will be entitled to a dividend, based upon a formula, when and if any dividends are declared on the Company's common stock. The convertible preferred stock is redeemable, at the option of the Company, at \$7.50 per share. The shares contain a liquidation preference provision entitling the holder to receive payments equaling \$5.00 per share.

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The voting rights of the common stockholders and preferred stockholders are based upon the number of shares of convertible preferred stock outstanding. The Company's Restated Certificate of Incorporation provides that the Board of Directors is to consist of one class of Directors if there are less than 600,000 shares Convertible Preferred Stock outstanding. As of December 31, 2018, the number of preferred shares outstanding was 284,612; accordingly, the Board of Directors to be elected at the annual shareholders' meetings will consist of one class of Directors elected by the holders of common stock and convertible preferred stock voting together as one class on a share for share basis.

At December 31, 2018, there were 284,612 shares of common stock reserved for conversion of convertible preferred stock.

6. Net Income Per Common Share

Our basic and diluted earnings per share are computed using the two-class method. The two-class method is an earnings allocation method that determines net income per share for each class of common stock and participating securities according to their participation rights in dividends and undistributed earnings or losses. Convertible preferred stock, whose holders are entitled to a dividend when and if any are declared on the Company's common stock, are considered participating securities. Per share amounts are computed by dividing net income available to common shareholders by the weighted average shares outstanding during each period. Diluted earnings per share reflects, in periods in which they have a dilutive effect, the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock.

For the years ended December 31, 2018 and 2017, convertible preferred stock, convertible into 284,612 shares of common stock were included as common stock equivalents when calculating diluted earnings per share. Convertible notes, in the principal amount of \$100,000, convertible into 33,333 shares of common stock, were not included in the net income per share calculation for the year ended December 31, 2017 because their effect would have been anti-dilutive. The convertible notes were paid in full on September 21, 2017.

A reconciliation of the numerators and denominators of the basic and diluted per share computations follows:

	<u>Year ended December 31,</u>	
	<u>2018</u>	<u>2017</u>
Numerator:		
Net income	\$2,358,267	\$514,407
Less distributed and undistributed income allocated to participating securities	71,104	15,510
Net Income Attributable to Common Shareholders	<u>\$2,287,163</u>	<u>\$498,897</u>
Denominator:		
Weighted average common shares (Basic)	<u>9,154,928</u>	<u>9,154,928</u>
Weighted average common shares including assumed conversions (Diluted)	<u>9,439,540</u>	<u>9,439,540</u>

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7. Income Taxes

The provision for income taxes consists of the following:

	2018			2017		
	Federal	State And Local	Total	Federal	State And Local	Total
Current	\$ 512	\$123,514	\$ 124,026	\$ 24,166	\$81,123	\$105,289
Deferred	<u>(1,099,881)</u>	<u>(131,119)</u>	<u>(1,231,000)</u>	<u>479,077</u>	<u>38,821</u>	<u>517,899</u>
Total tax (benefit) expense	<u><u>\$ (1,099,369)</u></u>	<u><u>\$ (7,605)</u></u>	<u><u>\$ (1,106,974)</u></u>	<u><u>\$503,244</u></u>	<u><u>\$119,944</u></u>	<u><u>\$623,188</u></u>

A reconciliation of the provision for income taxes computed at the Federal statutory rate to the reported provision for income taxes follows:

	<u>2018</u>	<u>2017</u>
Tax provision at Federal statutory rate	21.00 %	34.00 %
State income tax, net of federal benefit	5.09%	4.71%
Change in valuation allowance for deferred tax assets	(83.57)%	(23.45)%
Effect of new tax rates	0.00%	34.98%
Other	0.40%	2.49%
Permanent differences	<u>0.81%</u>	<u>2.05%</u>
Total	<u><u>(56.26)%</u></u>	<u><u>54.78%</u></u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2018 and 2017 are presented below.

	<u>2018</u>	<u>2017</u>
Deferred Tax Assets:		
Federal net operating loss carryforwards	\$ 3,765,834	\$ 3,880,800
State net operating loss carryforwards	65,019	8,054
Allowance for doubtful accounts	167,953	292,576
Additional costs inventoried for tax purposes	361,150	402,322
Compensation	61,160	42,625
Rent	34,411	40,200
Goodwill and intangible assets	14,956	23,879
Depreciation	<u>(9,985)</u>	<u>53,051</u>
Deferred Tax Assets	4,460,498	4,743,507
Less Valuation Allowance	<u>(1,760,498)</u>	<u>(3,061,507)</u>
Net Deferred Tax Assets	<u><u>\$ 2,700,000</u></u>	<u><u>\$ 1,682,000</u></u>
Deferred Tax Liability:		
Goodwill	<u>354,000</u>	<u>567,000</u>
Deferred Tax Liability	<u><u>\$ 354,000</u></u>	<u><u>\$ 567,000</u></u>

Management has determined that based on the cumulative recent history of income and income projections, including the expense related to the amortization of goodwill for tax purposes, that it will be more likely than not that only a portion of the deferred tax asset will be realized. Due to the “Tax Cuts and Jobs Act” signed in December 2017, the Company re-evaluated its deferred tax asset both with updated projections and revised tax rates. Management determined a deferred tax asset of approximately \$1,682,000 will be realized and, accordingly, adjusted the valuation allowance from December 31, 2016 by \$634,500 in total, of which, \$514,500 related to the new law changes in rates. In 2018, based on actual results and updated projections, and the estimated utilization of net operating loss carryforwards, management determined that a deferred tax asset of approximately \$2,700,000 will be realized and, accordingly, released an additional valuation allowance of \$1,018,000.

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As of December 31, 2018, the Company's pre-tax net operating loss carryforwards available for federal income tax purposes were approximately \$20,450,000. Various amounts of net operating loss carryforwards will expire from 2020 through 2032.

<u>Expiration Year</u>	<u>Net Operating Losses</u>
2020	\$ 39,000
2021	2,737,000
2022	14,532,000
2028	1,010,000
2029	1,878,000
2030	134,000
2031	16,000
2032	104,000
	<u>\$ 20,450,000</u>

The difference between the net operating losses above and the net operating losses used to calculate the deferred tax assets is due to the additional goodwill amortization for tax purposes which will be recognized when realized by the Company.

Section 382 of the Internal Revenue Code ("Section 382") imposes a limitation on a corporation's ability to utilize net operating loss carryforwards ("NOLs") if it experiences an "ownership change." In general, an ownership change may result from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50 percentage points over a three-year period. The Company has not had an ownership change under Section 382. If such a change did occur, a limitation could be placed on the Company's ability to utilize its NOLs.

8. Supplemental Cash Flow Information

The following is supplemental information relating to the consolidated statements of cash flows:

Cash paid during the years for:	<u>2018</u>	<u>2017</u>
Interest	\$751,145	\$638,725
Supplemental disclosure of non-cash financing and investing activities:		
Notes issued for purchase of fixed assets	\$256,673	\$ 51,912

9. Employee Benefit Plans

The Company has a 401(k) plan, which covers substantially all employees. Participants in the plan may contribute a percentage of compensation, but not in excess of the maximum allowed under the Internal Revenue Code. Effective January 2019, the plan provides for 2% matching contributions of employees' qualified wages. In 2017 and 2018, the plan did not provide for matching contributions. In March 2019, the Company retroactively contributed a 2% match of employees' qualified wages for the 2018 calendar year in the amount of \$139,747, which was expensed in 2018. In March 2018, the Company retroactively contributed a 1% match of employees' qualified wages for the 2017 calendar year in the amount of \$58,149, which was expensed in 2017.

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10. Business and Credit Concentrations

The largest supplier accounted for 36% and 28% of the Company's purchases for each of the years 2018 and 2017, respectively. As of December 31, 2018 and 2017, the Company's outstanding balance payable to this supplier was \$2,070,475 and \$1,371,663, respectively. The loss of this supplier could have a material adverse effect upon the Company's business for a short-term period.

11. Commitments and Contingencies

(a) Leases

The Company records lease payments via the straight-line method and, for leases with step rent provisions whereby the rental payments increase over the life of the lease, the Company recognizes the total minimum lease payments on a straight-line basis over the lease term. The Company is obligated under operating leases for warehouse, office facilities and certain office equipment which amounted to \$3,304,316 and \$3,084,351 for the years ended December 31, 2018 and 2017, respectively, and is included in general and administrative expenses. At December 31, 2018, future minimum lease payments in the aggregate and for each of the five succeeding years are as follows:

2019	\$ 3,083,208
2020	2,782,674
2021	2,704,937
2022	1,710,132
2023	1,131,193
Thereafter	<u>4,004,818</u>
Total	<u>\$15,416,962</u>

(b) Litigation

(1) Universal Supply Group, Inc.

Universal Supply Group, Inc., a wholly owned subsidiary of the Company, is a New York corporation ("Universal"). On June 25, 1999, Universal acquired substantially all of the assets of Universal Supply Group, Inc., a New Jersey corporation, including its name, pursuant to the terms of a purchase agreement. Subsequent to the acquisition, Universal Supply Group, Inc. (the selling corporation) changed its name to Hilco, Inc. Hilco, Inc. acquired the assets of Amber Supply Co., Inc., formerly known as Amber Oil Burner Supply Co., Inc., in 1998, prior to Hilco's sale of assets to Universal. Hilco, Inc. is hereinafter referred to as the "Universal Predecessor." The majority shareholders of Hilco, Inc. were John A. Hildebrandt and Paul H. Hildebrandt.

The Company understands that the Universal Predecessor and many other companies have been sued in the Superior Court of New Jersey (Middlesex County) by plaintiffs filing lawsuits alleging injury due to asbestos. As of December 31, 2018, there existed 5 plaintiffs in these lawsuits relating to alleged sales of asbestos products, or products containing asbestos, by the Universal Predecessor. The Company never sold any asbestos related products.

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Of the existing plaintiffs as of December 31, 2018, 2 filed actions in 2017, 2 filed actions in 2015 and 1 filed an action in 2014. There are 221 other plaintiffs that have had their actions dismissed and 19 other plaintiffs that have settled as of December 31, 2018 for a total of \$3,770,000 paid by defendants other than Universal. There has been no judgment against the Universal Predecessor.

The Company's Universal subsidiary was previously named by 42 plaintiffs; of these, 2 filed actions in 2017, 1 filed an action in 2016, 1 filed an action in 2014, 1 filed an action in 2012, 1 filed an action in 2010, 11 filed actions in 2007, 6 filed actions in 2006, 11 filed actions in 2005, 5 filed actions in 2001, 1 filed an action in 2000, and 2 filed actions in 1999. Thirty-seven plaintiffs naming Universal have had their actions dismissed and, of the total \$3,364,500 of settled actions, 3 plaintiffs naming Universal have settled for \$27,500. No money was paid by Universal in connection with any settlement. Following these dismissed and settled actions there were 2 plaintiffs that named Universal as of December 31, 2018.

As set forth in more detail below, the Company has been indemnified against asbestos-based claims, and insurance companies are defending the interests of the Universal Predecessor and the Company in these cases.

Based on advice of counsel, the Company believes that none of the litigation that was brought against the Company's Universal subsidiary is material, and that the only material litigation that was brought against the Universal Predecessor to date was *Rhodes v. A.O. Smith Corporation*, filed on April 26, 2004 in the Superior Court of New Jersey, Law Division, Middlesex County, Docket Number MID-L-2979-04AS. The Company was advised that the *Rhodes* case was settled for \$3,250,000 ("Settlement") under an agreement reached in connection with a \$10,000,000 jury verdict that was rendered on August 5, 2005. The Company was not a defendant in the *Rhodes* case.

The Company believes that *Rhodes* differed from the other lawsuits in that plaintiff established that he contracted mesothelioma as a result of his occupational exposure to asbestos dust and fibers and that a predecessor of the Company was a major supplier of the asbestos containing products that allegedly caused his disease.

(1)(a) Indemnification

John A. Hildebrandt, Paul H. Hildebrandt and the Universal Predecessor have jointly and severally agreed to indemnify the Company's Universal subsidiary from and against any and all damages, liabilities and claims due to exposure to asbestos at any time prior to the June 25, 1999 closing of the purchase agreement referred to earlier. These agreements are set forth in the purchase agreement.

The indemnitors may use their own counsel to defend these claims. The indemnitors are not liable for any settlement effected without their consent. The indemnitors may settle and pay money claims without the consent of the Company. There is no indemnification unless claims aggregate \$50,000; once this trigger point is reached, indemnification is required for all claims, including the first \$50,000, but excluding claims of less than \$10,000. The indemnification requirement survives at least until 30 days after the running of any relevant statutes of limitation.

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The obligation of the indemnitors is joint and several, so that the Company can have recourse against any one or more of these indemnitors, whether or not any other indemnitor has previously defaulted on its obligation to us. There are no other limitations to the Company's rights to indemnification. The Company cannot be certain that the indemnitors have the financial wherewithal to meet their obligations to indemnify the Company.

(1)(b) Insurance

The assets that the Universal Predecessor sold to the Company included its insurance policies and other agreements and contracts. The policies provide coverage for liability accruing during the periods for which premiums were paid. The Universal Predecessor was formed in 1940. Copies of policies are available for each year beginning in 1970 and ending with the closing under the purchase agreement in 1999. Copies of policies for the period from 1940 to 1969 are not available.

Insurance companies acknowledge coverage for potential asbestos claims under certain of these policies. Insurance companies under additional policies have reserved their right to deny coverage but have continued to defend and indemnify the Universal Predecessor and the Company under the contested policies.

There are periods during the years from 1940 to 1999 in which the Universal Predecessor did not have coverage for potential asbestos claims. Subject to litigation, insurance companies may maintain that the existence of these periods' results in coverage for only a portion of a particular injury that varies with the period during which there was asbestos coverage relating to the injury, and that the balance of any settlement or judgment is to be paid by the insured. As of December 31, 2018, no insurance company has claimed any contribution for a gap in coverage except for a claim for \$160 made by one insurance company to the Universal Predecessor in 1995. The Universal Predecessor asserted that it had no obligation to pay this amount and did not make any payment.

Insurance companies have, as of December 31, 2018, defended the Company and the Universal Predecessor, and have paid all settlement amounts and defense costs. Except for \$160 referred to above, the insurance companies have not requested any payments from the Company or from the Universal Predecessor.

The Company's Universal subsidiary has not engaged in the sale of asbestos products since its formation in 1997. Its product liability policies for all years since 1998 exclude asbestos claims.

(2) The RAL Supply Group, Inc.

The RAL Supply Group, Inc., a wholly owned subsidiary of the Company, is a New York corporation ("RAL"), formerly known as RAL Purchasing Corp. On September 30, 2003, RAL acquired substantially all of the assets of The RAL Supply Group, Inc., formerly known as The LAR Acquisition Corp., also a New York corporation, including its name, pursuant to the terms of a purchase agreement. Subsequent to the acquisition, The RAL Supply Group, Inc. (the selling corporation) changed its name to RSG, Inc. RSG, Inc. is hereinafter referred to as the "RAL Predecessor." The RAL Predecessor acquired certain assets from Dyson-Kissner-Moran Corporation ("RSG Predecessor") in 1993, prior to the RAL Predecessor's sale of assets to RAL.

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The Company understands that the RAL Predecessor and many other companies have been sued in the Supreme Court of New York (New York County) and the Superior Court of New Jersey (Middlesex County) by plaintiffs filing lawsuits alleging injury due to asbestos. As of December 31, 2018, there were 4 plaintiffs in these lawsuits relating to alleged sales of asbestos products, or products containing asbestos, by the RAL Predecessor. The Company never sold any asbestos related products.

The Company's RAL subsidiary was previously named by 8 plaintiffs; of these, 1 filed an action in 2018, 3 filed actions in 2017, 1 filed an action in 2016, 1 filed an action in 2015, 1 filed an action in 2013 and 1 filed an action in 2008. Three plaintiffs naming RAL had their actions dismissed and 1 plaintiff naming RAL settled for \$25,000. Following these dismissed and settled actions there were 4 plaintiffs that named RAL as of December 31, 2018.

The RAL Predecessor agreed in the RAL purchase agreement to indemnify and hold harmless the Company's RAL subsidiary from and against, among other things, damages that relate to products sold or manufactured or services performed or other actions taken or omitted by the RAL Predecessor prior to the closing of the acquisition. The Company cannot be certain that the indemnitor has the financial wherewithal to meet its obligations to indemnify the Company.

The lawsuits alleged injury due to asbestos prior to RAL Predecessor's acquisition of assets from the RSG Predecessor and RAL's acquisition of assets from the RAL Predecessor. The Company never sold any asbestos related products.

(3) General

Regardless of indemnification and insurance coverage, management does not in any event consider the Company to be liable for the asbestos-based lawsuits that name the Company or for any other claim that arises as a result of actions or omissions by the Universal Predecessor or RAL Predecessor companies. The Company expressly disclaimed the assumption of any liabilities when the Company purchased the assets of the Universal Predecessor and RAL Predecessor. It is the opinion of management that asbestos litigation will not have a material adverse effect on the Company. Nevertheless, the Company could be materially and adversely affected if it is held liable for substantial asbestos claims or if it incurs substantial legal or settlement costs. This material and adverse effect would occur if indemnitors fail to honor their indemnification agreements and insurance is not available either because policy limits are exceeded, or because insurance companies successfully deny coverage or claim limitations on their liabilities by reason of gaps in coverage or otherwise.

Since management regards as remote the potential payment of any asbestos-based claim, no amounts have been accrued for any period relating to asbestos claims.

(4) Other Litigation

The Company is periodically involved in other litigation in the ordinary course of business. The Company vigorously defends all matters in which the Company or its subsidiaries are named defendants and, for insurable losses, maintains significant levels of insurance to protect against adverse judgments, claims or assessments. Although the adequacy of existing insurance coverage or the outcome of any legal proceedings cannot be predicted with certainty, the Company does not believe the ultimate liability associated with any claims or litigation will have a material impact to its financial condition or results of operations.

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12. Related Party Transactions

- (a) The Company leases five warehouses and stores from related parties. The Company paid these related parties rent expense of \$1,027,579 and \$1,029,490 for the years ended December 31, 2018 and 2017, respectively.
- (b) A related party provided legal services to the Company in the amount of \$1,550 and \$8,625 for the years ended December 31, 2018 and 2017, respectively.
- (c) During the year ended December 31, 2017, Goldman Associates of New York, Inc. (“Goldman Associates”) made short term loans to the Company aggregating \$2,000,000 in principal amount, all of which have been repaid with interest aggregating \$17,623 in 2017.
- (d) During the year ended December 31, 2018, Goldman Associates made short term loans to the Company aggregating \$1,500,000 in principal amount, all of which have been repaid with interest aggregating \$11,041 in 2018.
- (e) Please refer to Note 4. Notes Payable, above, for additional information pertaining to notes payable to related parties and related party entities at each of the years ended December 31, 2018 and 2017.