

EACO CORP  
Form 10-Q  
April 12, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended February 28, 2019

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. **000-14311**

**EACO CORPORATION**

(Exact name of registrant as specified in its charter)

**Florida**

**59-2597349**

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(State of Incorporation) (I.R.S. Employer Identification No.)

**1500 NORTH LAKEVIEW LOOP**

**ANAHEIM, CALIFORNIA 92807**

(Address of Principal Executive Offices)

**(714) 876-2490**

(Registrant's Telephone No.)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "emerging growth company", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer   
Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of April 12, 2019, 4,861,590 shares of the registrant's common stock were outstanding.

**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****EACO Corporation and Subsidiaries**

## Condensed Consolidated Statements of Income

(in thousands, except for share and per share information)

(Unaudited)

|  | Three Months Ended<br>February 28, |           | Six Months Ended<br>February 28, |           |
|--|------------------------------------|-----------|----------------------------------|-----------|
|  | 2019                               | 2018      | 2019                             | 2018      |
| Revenues   | \$52,559                           | \$45,041  | \$103,345                        | \$87,212  |
| Cost of revenues   | 38,047                             | 32,592    | 74,724                           | 62,584    |
| Gross margin   | 14,512                             | 12,449    | 28,621                           | 24,628    |
| Operating expenses:  |                                    |           |                                  |           |
| Selling, general and administrative expenses                 | 11,720                             | 10,477    | 23,210                           | 20,817    |
| Income from operations                                       | 2,792                              | 1,972     | 5,411                            | 3,811     |
| Other (expense) income:                                      |                                    |           |                                  |           |
| Net (loss) gain on trading securities                        | (126 )                             | 48        | 102                              | 251       |
| Interest and other (expense)                                 | (125 )                             | (130 )    | (202 )                           | (231 )    |
| Total other (expense) income                                 | (251 )                             | (82 )     | (100 )                           | 20        |
| Income before income taxes                                   | 2,541                              | 1,890     | 5,311                            | 3,831     |
| Provision for income taxes                                   | 580                                | 571       | 1,425                            | 1,317     |
| Net income   | 1,961                              | 1,319     | 3,886                            | 2,514     |
| Cumulative preferred stock dividend                          | (19 )                              | (19 )     | (38 )                            | (38 )     |
| Net income attributable to common shareholders               | \$1,942                            | \$1,300   | \$3,848                          | \$2,476   |
| Basic and diluted earnings per share:                        | \$0.40                             | \$0.27    | \$0.79                           | \$0.51    |
| Basic and diluted weighted average common shares outstanding | 4,861,590                          | 4,861,590 | 4,861,590                        | 4,861,590 |

See accompanying notes to unaudited condensed consolidated financial statements.



**EACO Corporation and Subsidiaries**

Consolidated Statements of Comprehensive Income

(in thousands)

(Unaudited)

|  | Three Months Ended<br>February 28, |          | Six Months Ended<br>February 28, |          |
|--|------------------------------------|----------|----------------------------------|----------|
|  | 2019                               | 2018     | 2019                             | 2018     |
| Net income                                   | \$ 1,961                           | \$ 1,319 | \$ 3,886                         | \$ 2,514 |
| Other comprehensive (loss) gain, net of tax: |                                    |          |                                  |          |
| Foreign translation (loss) gain              | 119                                | (81 )    | 277                              | 67       |
| Total comprehensive income                   | \$ 2,080                           | \$ 1,238 | \$ 4,163                         | \$ 2,581 |

See accompanying notes to unaudited condensed consolidated financial statements.

**EACO Corporation and Subsidiaries**

## Condensed Consolidated Balance Sheets

(in thousands, except share information)

(Unaudited)

|   | February 28,<br>2019 | August 31,<br>2018* |
|---|----------------------|---------------------|
| <b>ASSETS</b>   |                      |                     |
| Current Assets:   |                      |                     |
| Cash and cash equivalents   | \$ 3,982             | \$ 2,705            |
| Restricted cash, current  | 818                  | 933                 |
| Trade accounts receivable, net  | 28,148               | 26,277              |
| Inventory, net  | 35,457               | 30,531              |
| Marketable securities, trading  | 1,877                | 2,846               |
| Prepaid expenses and other current assets   | 2,216                | 1,590               |
| Total current assets  | 72,498               | 64,882              |
| Non-current Assets:   |                      |                     |
| Property, equipment and leasehold improvements, net   | 9,674                | 9,847               |
| Other assets  | 1,468                | 1,570               |
| Total assets  | \$ 83,640            | \$ 76,299           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                      |                     |
| Current Liabilities:  |                      |                     |
| Trade accounts payable  | \$ 20,341            | \$ 17,678           |
| Accrued expenses and other current liabilities  | 3,599                | 7,452               |
| Liability for short sales of trading securities   | 818                  | 933                 |
| Current portion of long-term debt   | 148                  | 146                 |
| Total current liabilities   | 24,906               | 26,209              |
| Non-current Liabilities:  |                      |                     |
| Long-term debt  | 12,723               | 8,204               |
| Total liabilities   | 37,629               | 34,413              |
| Shareholders' Equity:   |                      |                     |
| Convertible preferred stock, \$0.01 par value per share; 10,000,000 shares authorized;<br>36,000 shares outstanding (liquidation value \$900) | 1                    | 1                   |
| Common stock, \$0.01 par value per share; 8,000,000 shares authorized; 4,861,590 shares<br>outstanding  | 49                   | 49                  |
| Additional paid-in capital  | 12,378               | 12,378              |
| Accumulated other comprehensive income  | 1,205                | 928                 |
| Retained earnings   | 32,378               | 28,530              |
| Total shareholders' equity  | 46,011               | 41,886              |
| Total liabilities and shareholders' equity  | \$ 83,640            | \$ 76,299           |

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*\*Derived from the Company's audited financial statements included in its Form 10-K for the year ended August 31, 2018 as filed with the U. S. Securities and Exchange Commission on November 28, 2018.*

See accompanying notes to unaudited condensed consolidated financial statements.



**EACO Corporation and Subsidiaries**

## Condensed Consolidated Statement of Shareholders' Equity

(in thousands, except share information)

(Unaudited)

|                               | Convertible         |                 | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Earnings | Total<br>Shareholders'<br>Equity |
|-------------------------------|---------------------|-----------------|------------------------|------------------------|----------------------------------|---|-------------------------|----------------------------------|
|                               | Preferred<br>Shares | Stock<br>Amount |                        |                        |                                  |   |                         |                                  |
| Balance, August 31,<br>2018 * | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 928  | \$ 28,530               | \$ 41,886                        |
| Preferred dividends           | —                   | —               | —                      | —                      | —                                | —   | (19 )                   | (19 )                            |
| Foreign translation gain      | —                   | —               | —                      | —                      | —                                | 158   | —                       | 158                              |
| Net income                    | —                   | —               | —                      | —                      | —                                | —   | 1,925                   | 1,925                            |
| Balance, November 30,<br>2018 | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 1,086  | \$ 30,436               | \$ 43,950                        |
| Preferred dividends           | —                   | —               | —                      | —                      | —                                | —   | (19 )                   | (19 )                            |
| Foreign translation gain      | —                   | —               | —                      | —                      | —                                | 119   | —                       | 119                              |
| Net income                    | —                   | —               | —                      | —                      | —                                | —   | 1,961                   | 1,961                            |
| Balance, February 28,<br>2019 | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 1,205  | \$ 32,378               | \$ 46,011                        |
| Balance, August 31,<br>2017 * | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 747  | \$ 21,657               | \$ 34,832                        |
| Preferred dividends           | —                   | —               | —                      | —                      | —                                | —   | (19 )                   | (19 )                            |
| Foreign translation gain      | —                   | —               | —                      | —                      | —                                | 148   | —                       | 148                              |
| Net income                    | —                   | —               | —                      | —                      | —                                | —   | 1,195                   | 1,195                            |
| Balance, November 30,<br>2017 | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 895  | \$ 22,833               | \$ 36,156                        |
| Preferred dividends           | —                   | —               | —                      | —                      | —                                | —   | (19 )                   | (19 )                            |
| Foreign translation gain      | —                   | —               | —                      | —                      | —                                | (81 )   | —                       | (81 )                            |
| Net income                    | —                   | —               | —                      | —                      | —                                | —   | 1,319                   | 1,319                            |
| Balance, February 28,<br>2018 | 36,000              | \$ 1            | 4,861,590              | \$ 49                  | \$ 12,378                        | \$ 814  | \$ 24,133               | \$ 37,375                        |

*Derived from the Company's audited financial statements included in its Form 10-K for the year ended August 31, \*2018 and 2017 as filed with the U. S. Securities and Exchange Commission on November 28, 2018 and 2017, respectively.*

See accompanying notes to unaudited condensed consolidated financial statements.

**EACO Corporation and Subsidiaries**

## Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

|   | Six Months Ended<br>February 28, |          |
|---|----------------------------------|----------|
|   | 2019                             | 2018     |
| Operating activities:   |                                  |          |
| Net income  | \$3,886                          | \$2,514  |
| Adjustments to reconcile net income to net cash used in operating activities: |                                  |          |
| Depreciation and amortization   | 503                              | 498      |
| Bad debt expense  | 18                               | 44       |
| Change in inventory reserve   | 107                              | 123      |
| Net (gain) on trading securities  | (102 )                           | (251 )   |
| (Increase) decrease in:   |                                  |          |
| Trade accounts receivable   | (1,889 )                         | (3,188 ) |
| Inventory   | (5,033 )                         | (1,760 ) |
| Prepaid expenses and other assets   | (524 )                           | (1,030 ) |
| Increase (decrease) in:   |                                  |          |
| Trade accounts payable  | 2,206                            | 2,515    |
| Accrued expenses and other current liabilities                                | (3,853 )                         | (1,161 ) |
| Net cash used in operating activities   | (4,681 )                         | (1,696 ) |
| Investing activities:   |                                  |          |
| Purchase of property, equipment and leasehold improvements                    | (330 )                           | (1,214 ) |
| Sale (purchase) of marketable securities, trading                             | 1,071                            | (338 )   |
| Net change in securities sold short   | (115 )                           | (90 )    |
| Net cash provided by (used in) investing activities                           | 626                              | (1,642 ) |
| Financing activities:   |                                  |          |
| Borrowings on revolving credit facility                                       | 4,593                            | 1,525    |
| Preferred dividend  | (38 )                            | (38 )    |
| Bank overdraft  | 457                              | 1,145    |
| Payments on long-term debt  | (72 )                            | (35 )    |
| Net cash provided by financing activities                                     | 4,940                            | 2,597    |
| Effect of foreign currency exchange rate changes on cash and cash equivalents | 277                              | 67       |
| Net increase (decrease) in cash, cash equivalents, and restricted cash        | 1,162                            | (674 )   |
| Cash, cash equivalents, and restricted cash - beginning of period             | 3,638                            | 4,577    |
| Cash, cash equivalents, and restricted cash - end of period                   | \$4,800                          | \$3,903  |
| Supplemental disclosures of cash flow information:                            |                                  |          |
| Cash paid for interest  | \$201                            | \$243    |
| Cash paid for income taxes  | \$3,059                          | \$2,241  |

See accompanying notes to unaudited condensed consolidated financial statements.

**EACO CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

February 28, 2019

**Note 1. Organization and Basis of Presentation**

EACO Corporation (“EACO”), incorporated in Florida in September 1985, is a holding company primarily comprised of its wholly-owned subsidiary, Bisco Industries, Inc. (“Bisco”). Bisco was incorporated in Illinois in 1974 and is a distributor of electronic components and fasteners with 48 sales offices and seven distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

**Note 2. Significant Accounting Policies and Significant Recent Accounting Pronouncements**

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) 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 periods. These estimates include allowance for doubtful accounts receivable, slow moving and obsolete inventory reserves, recoverability of the carrying value and estimated useful lives of long-lived assets, and the valuation allowance against deferred tax assets. Actual results could differ from those estimates.

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in conformity with GAAP for interim financial information and the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) for interim reporting. In the opinion of management, all adjustments considered necessary in order to make the financial statements not misleading have been included.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations for presentation of interim financial information. Therefore, the condensed consolidated interim financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended August 31, 2018 ("fiscal 2018"). The condensed consolidated balance sheet as of August 31, 2018 and related disclosures were derived from the Company's audited consolidated financial statements as of August 31, 2018. Operating results for the three and six months ended February 28, 2019 are not necessarily indicative of the results that may be expected for future quarterly periods or the entire fiscal year.

### **Principles of Consolidation**

The consolidated financial statements for all periods presented include the accounts of EACO, its wholly-owned subsidiary, Bisco, and Bisco's wholly-owned Canadian subsidiary, Bisco Industries Limited (all of which are collectively referred to herein as the "Company", "we", "us" and "our"). All significant intercompany transactions and balances have been eliminated in consolidation.

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

### **Trade Accounts Receivable, Net**

Trade accounts receivable are carried at original invoice amount, less an estimate for an allowance for doubtful accounts. Management determines the allowance for doubtful accounts by identifying probable credit losses in the Company's accounts receivable and reviewing historical data to estimate the collectability on items not yet specifically identified as problem accounts. Trade accounts receivable are written off when deemed uncollectible. Recoveries of trade accounts receivable previously written off are recorded when received. A trade account receivable is considered past due if any portion of the receivable balance is outstanding if past due more than 30 days. The Company does not charge interest on past due balances. The allowance for doubtful accounts was \$111,000 at February 28, 2019 and August 31, 2018.

### **Inventories, Net**

Inventory consists primarily of electronic fasteners and components, and is stated at the lower of cost or estimated net realizable value. Cost is determined using the average cost method. Inventories are presented net of a reserve for slow moving or obsolete items of \$1,483,000 and \$1,376,000 at February 28, 2019 and August 31, 2018, respectively. The reserve is based upon management's review of inventories on-hand over their expected future utilization and length of time held by the Company.

### **Short Sales of Trading Securities**

Securities sold short represent transactions in which the Company sells a security borrowed from the broker, which the Company is obligated to purchase and deliver back to the broker. The initial value of the underlying borrowed security is recorded as a liability, and is adjusted to market value at each reporting period, with unrealized appreciation or depreciation being recorded for the change in value of the open short position. The Company records a realized gain or loss when the short position is closed. By entering into short sales, the Company bears the market risk of an unfavorable increase in the price of the security sold short in excess of the proceeds received. The market value of open short positions is separately presented as a liability in the consolidated balance sheets.

The Company is required to establish a margin account with the lending broker equal to the market value of open short positions. As the use of such funds is restricted while the short sale is outstanding, the balance of this account is classified as restricted cash, current in the consolidated balance sheets. The restricted cash related to securities sold short was \$818,000 and \$933,000 at February 28, 2019 and August 31, 2018, respectively.

### **Long-Lived Assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of the impairment review, assets are measured by comparing the carrying amount to future net cash flows. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their estimated fair values.

### **Income Taxes**

Deferred taxes on income result from temporary differences between the reporting of income for financial statement and tax reporting purposes. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some or all of the deferred tax asset will not be realized. In making such determination, the Company considers all available positive and negative evidence, including, but not limited to, scheduled reversals of deferred tax liabilities, projected future taxable income (if any), tax planning strategies and recent financial performance.

We provide tax contingencies, if any, for federal, state, local and international exposures relating to audit results, tax planning initiatives and compliance responsibilities. The development of these reserves requires judgments and estimates regarding tax issues, potential outcomes and timing. Actual results could differ from those estimates.



## **Revenue Recognition**

We derive our revenue primarily from product sales. We determine revenue recognition through the following steps: (1) identification of the contract with a customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; (5) recognition of revenue when, or as, we satisfy a performance obligation.

The Company's performance obligations consist solely of product shipped to customers. Revenue from product sales is recognized upon transfer of control of promised products to customers in an amount that reflects the consideration we expect to receive in exchange for these products. Revenue is recognized net of returns and any taxes collected from customers. We offer industry standard contractual terms in our purchase orders.

## **Earnings Per Common Share**

Basic earnings per common share for the three and six months ended February 28, 2019 and 2018 were computed based on the weighted average number of common shares outstanding during each respective period. Diluted earnings per share for those periods have been computed based on the weighted average number of common shares outstanding, giving effect to all potentially dilutive common shares that were outstanding during the respective periods (See Note 4).

## **Foreign Currency Translation and Transactions**

Assets and liabilities recorded in functional currencies other than the U.S. dollar (Canadian dollars for Bisco's Canadian subsidiary) are translated into U.S. dollars at the period-end rate of exchange. Revenue and expenses are translated at the weighted-average exchange rates for the quarters ended February 28, 2019 and 2018. The resulting translation adjustments are charged or credited directly to accumulated other comprehensive income or loss. The average exchange rates of Canadian dollars to U.S. dollars for the six months ended February 28, 2019 and 2018 were \$0.75 and \$0.79, respectively. The average exchange rates of Canadian dollars to U.S. dollars for the six months ended February 28, 2018 2017 were \$0.76 and \$0.80, respectively.

## **Concentrations**

Net sales to customers outside the United States were approximately 9% of revenues for each of the six months ended February 28, 2019 and 2018, and related accounts receivable were approximately 13% and 11% of total accounts receivable for each period at February 28, 2019 and 2018, respectively.

No single customer accounted for more than 10% of revenues and accounts receivable for the three and six months ended February 28, 2019 or 2018.

### **Significant Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 “Revenue from Contracts with Customers” to supersede the previous revenue recognition guidance under current GAAP. This guidance presents steps for comprehensive revenue recognition that requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company adopted the guidance beginning in fiscal 2019 using the modified retrospective approach. The adoption of this guidance did not have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases,” which will require a lessee to recognize assets and liabilities with lease terms of more than 12 months. Both capital and operating leases will need to be recognized on the balance sheet. This guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating this statement and its impact on the Company’s results of operations and financial position.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses,” which will require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating this statement and its impact on the Company’s results of operations and financial position.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows - Restricted Cash (a consensus of the FASB Emerging Issues Task Force).” This standard requires restricted cash and cash equivalents to be included with cash and cash equivalents on the statement of cash flows under a retrospective transition approach. The guidance became effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years with early adoption permitted. The Company has adopted the guidance of this standard effective September 1, 2018 for fiscal year ending August 31, 2019.

### **Note 3. Debt**

The Company currently has a \$10,000,000 line of credit agreement with Citizens Business Bank (the “Bank”). This line of credit was originally held with Community Bank, N.A., which bank was recently acquired by CVB Financial Corp., the parent company of Citizens Business Bank. On July 24, 2018, the Company entered into a Change in Terms Agreement dated July 12, 2018 with the Bank (the “Amendment”). The Amendment modifies the Company’s \$10,000,000 line of credit between the Company and the Bank to: (i) extend the expiration date of the line of credit under the agreement from March 1, 2019 to August 20, 2020; (ii) reduce the default variable interest index rate by .500% (Wall Street Journal Prime Rate less .500%); and (iii) add the following two other interest rate options that the Company may select (subject to the requirements in the Amendment and provided that the Company is not in default under the line of credit agreement): (A) One Hundred Eighty (180) day Libor Rate plus a margin of 1.550%; or (B) the One (1) Year Libor plus a margin of 1.550%, as more fully described in the Amendment. The line of credit agreement contains financial and other covenants that have not been modified by the Amendment. The amounts outstanding under this line of credit as of February 28, 2019 are currently under the default variable interest index rate, which bear interest at the bank’s reference rate, which is the Prime Rate (5.50% at February 28, 2019 and 5.00% at August 31, 2018) less .500%. Borrowings are secured by substantially all of the assets of the Company and its subsidiaries. The amounts outstanding under this line of credit as of February 28, 2019 and August 31, 2018 were \$7,680,000 and \$3,113,000, respectively. The line of credit agreement contains certain nonfinancial and financial covenants, including the maintenance of certain financial ratios. As of February 28, 2019 and August 31, 2018, the Company was in compliance with all such covenants.

On May 15, 2017, the Company entered into a \$5,400,000 loan agreement with the Bank. The proceeds of the loan were used to purchase the building that houses the Company’s corporate headquarters and distribution center located in Anaheim, California (“Lakeview Property”). This loan is payable in 35 regular monthly payments of \$27,142 and one last payment of \$5,001,607 due on the maturity date of the loan on May 16, 2020. The loan is secured by a deed of

trust to the Lakeview Property and bears a variable interest rate that is 1.70% plus one year LIBOR, which is periodically reset based on one year LIBOR no more than once in any 12 month period at the election of the bank. At February 28, 2019 and August 31, 2018, the one year LIBOR was 2.7%. At February 28, 2019 and August 31, 2018, the outstanding balance of this loan was \$5,191,000 and \$5,237,000, respectively. The Company's future principal loan payments for the Fiscal years ending August 31, 2019 and August 31, 2020 are approximately \$74,000 and \$5,117,000, respectively.

**Note 4. Earnings per Share**

The following is a reconciliation of the numerators and denominators of the basic and diluted computations for earnings per common share (in thousands, except per share data):

|   | Three Months Ended<br>February 28, |          | Six Months Ended<br>February 28, |          |
|---|------------------------------------|----------|----------------------------------|----------|
|   | 2019                               | 2018     | 2019                             | 2018     |
| <b>(In thousands, except share and per share amounts)</b> |                                    |          |                                  |          |
| EPS:  |                                    |          |                                  |          |
| Net income  | \$ 1,961                           | \$ 1,319 | \$ 3,886                         | \$ 2,514 |
| Less: accrued preferred stock dividends                   | (19 )                              | (19 )    | (38 )                            | (38 )    |
| Net income available for common shareholders              | \$ 1,942                           | \$ 1,300 | \$ 3,848                         | \$ 2,476 |
| Earnings per common share – basic and diluted             | \$ 0.40                            | \$ 0.27  | \$ 0.79                          | \$ 0.51  |

For the three and six months ended February 28, 2019 and 2018, 40,000 potential common shares (issuable upon conversion of 36,000 shares of the Company's Series A Cumulative Convertible Preferred Stock) have been excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive since the conversion price was greater than the average market price of the common stock.

**Note 5. Related Party Transactions**

The Company leases its Chicago area sales office and distribution center located in Glendale Heights, Illinois under an operating lease agreement (the "Lease") from a grantor trust (the "Trust") that is beneficially owned by the Company's majority shareholder, who is also the Company's Chairman and CEO. The Lease is a ten year lease with an initial monthly rental rate of \$22,600, which is subject to annual rent increases of approximately 2.5% as set forth in the Lease. During the three months ended February 28, 2019 and 2018, the Company incurred approximately \$68,000 and \$45,000 of expense related to this lease.

Within the next 10 months, the Company plans to relocate its corporate headquarters and Anaheim distribution center to an 80,000 square foot facility in Anaheim, California that is owned by the Trust. The Company plans to enter into a new lease with the Trust in the near future concerning such facility.

**Note 6. Income Taxes**

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Management evaluates the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered, and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is “more likely than not” that some or all of the deferred tax assets will not be realized. Management has determined that other than deferred tax assets associated with certain state net operating losses and capital losses, net deferred tax assets will more likely than not be utilized. Therefore, a valuation allowance totaling \$498,000 has been established against only those assets related to state net operating losses and capital losses.

The Tax Cuts and Jobs Act (the “Jobs Act”) was enacted on December 22, 2017. The Jobs Act reduces the US federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. We previously completed our accounting for the tax effects of enactment of the Jobs Act and have determined no additional tax liability due to offsetting foreign tax credits. For the federal corporate rate differential for the year ended August 31, 2018, we recognized an amount of \$184,000, which was included as a component of income tax expense from continuing operations. The Company is subject to taxation in the US, Canada and various states. We have elected to account for Global Intangible Low-Taxed Income (GILTI) in the year the tax is incurred.

During the three and six months ended February 28, 2019, the Company recorded an income tax provision of \$580,000 and \$1,425,000, respectively resulting in an effective tax rate of 22.8% and 26.8%, respectively. For the three and six months ended February 28, 2018, the Company recorded income tax provision of \$571,000 and \$1,317,000, respectively, resulting in an effective tax rate of 30.2% and 34.4%, respectively. The current period effective tax rate differs from the current statutory rate of 21% primarily due to the state tax rates and valuation allowances against certain deferred tax assets and permanent book tax differences.

Accounting for uncertainty in income taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. For the three and six months ended February 28, 2019, the Company did not have a liability for any unrecognized tax benefit. The Company has elected to classify interest and penalties as a component of its income tax provision. For the three and six months ended February 28, 2019, the Company did not have a liability for penalties or interest. The Company does not expect any changes to its unrecognized tax benefit for the next six months that would materially impact its consolidated financial statements.

The Company's tax years for 2014, 2015, 2016, and 2017 are subject to examination by the taxing authorities. With few exceptions, the Company is no longer subject to U.S. federal, state, local or foreign examinations by taxing authorities for years before 2014.

#### **Note 7. Commitments and Contingencies**

From time to time, we may be subject to legal proceedings and claims which arise in the normal course of our business. Any such matters and disputes could be costly and time consuming, subject us to damages or equitable remedies, and divert our management and key personnel from our business operations. We currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

#### **Note 8. Subsequent Events**

Management has evaluated events subsequent to February 28, 2019, through the date that these unaudited condensed consolidated financial statements are being filed with the SEC, for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Cautionary Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will" and similar words or expressions. Forward-looking statements include, but are not limited to, statements regarding our anticipated revenue, expenses, profits and capital needs. These statements are based on our current expectations, estimates, projections, and the impact of certain accounting pronouncements, and are subject to a number of risks and uncertainties that could cause our actual results to differ materially from those projected or estimated, including but not limited to adverse economic conditions, competitive pressures, unexpected costs and losses from operations or investments, increases in costs and overhead, our ability to maintain an effective system of internal controls over financial reporting, potential losses from trading in securities, our ability to retain key personnel and good relationships with suppliers, the willingness of lenders to extend financing commitments and the availability of capital resources, and the other risks set forth in "Risk Factors" in Part II, Item 1A of this report or identified from time to time in our other filings with the SEC and in public announcements. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. The inclusion of forward looking statements in this Quarterly Report should not be regarded as a representation by management or any other person that the objectives or plans of the Company will be achieved.



## Overview

The condensed consolidated financial statements comprise the accounts of EACO and its wholly-owned subsidiary, Bisco and Bisco's wholly-owned Canadian subsidiary, Bisco Industries Limited.

EACO is a holding company primarily comprised of its wholly-owned subsidiary, Bisco. Bisco is a distributor of electronic components and fasteners with 48 sales offices and seven distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

Revenues derived from the Bisco and its subsidiary represent 100% of our total revenues and are expected to continue to represent all of the Company's total revenues for the foreseeable future.

## Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon its condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

Within the context of these critical accounting policies, the Company is not currently aware of any reasonably likely events or circumstances that would result in materially different amounts being reported.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, issued as a new Topic, ASC Topic 606 ("ASU 2014-09"). The new revenue recognition standard provides a step analysis of transactions to determine when and how revenue is recognized. The premise of the standard is that a Company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company adopted the guidance beginning in fiscal 2019 using the modified retrospective approach. The adoption of this guidance did not have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which will require lessees to recognize almost all leases on their balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Classification will be based on criteria that are largely similar to those applied in current lease accounting, but without explicit bright lines. Lessor accounting is similar to the current model, but updated to align with certain changes to the lessee model and the new revenue recognition standard. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the potential impact this standard will have on its condensed consolidated financial statements and related disclosures.

Management does not believe any other recently issued but not yet effective accounting pronouncements, if adopted, would have a material effect on the Company's present or future condensed consolidated financial statements.

There have been no changes to the Company's critical accounting policies for the three and six months ended February 28, 2019, except for the adoption of ASC 606 referenced above. Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended August 31, 2018 as filed with the SEC on November 28, 2018.

## Results of Operations

### *Comparison of the Three Months Ended February 28, 2019 and 2018*

#### *Revenues and Gross Profit (\$ in thousands)*

|                     | Three Months Ended<br>February 28, |          | \$<br>Change | %<br>Change |   |
|---------------------|------------------------------------|----------|--------------|-------------|---|
|                     | 2019                               | 2018     |              |             |   |
| Revenues            | \$52,559                           | \$45,041 | \$7,518      | 16.7        | % |
| Cost of revenues    | 38,047                             | 32,592   | 5,455        | 16.7        | % |
| Gross margin        | \$14,512                           | \$12,449 | \$2,063      | 16.6        | % |
| Percent of revenues | 27.6 %                             | 27.6 %   | -            | -           | % |

Revenues consist primarily of sales of component parts and fasteners, but also include, to a lesser extent, kitting charges and special order fees, as well as freight charged to customers. The increase in revenues in the three months ended February 28, 2019 (“Q2 2019”) as compared to the three months ended February 28, 2018 (“Q2 2018”) was largely due to a higher volume of product sales, increased sales department headcount over prior year quarter, and increased productivity from the Company’s employees. Revenues have also increased due to the Company continuing to focus on relationship building programs with current and potential customers and vendors, which resulted in additional new authorized distributorships in the current period. The gross margins remained consistent at 27.6% for both Q2 2019 and Q2 2018.

#### *Selling, General and Administrative Expenses (\$ in thousands)*

|  | Three Months Ended<br>February 28, |          | \$<br>Change | %<br>Change |    |
|--|------------------------------------|----------|--------------|-------------|----|
|  | 2019                               | 2018     |              |             |    |
| Selling, general and administrative expenses | \$11,720                           | \$10,477 | \$1,243      | 11.9        | %  |
| Percent of revenues                          | 22.3 %                             | 23.3 %   |              | (1.0)       | )% |

Selling, general and administrative expense (“SG&A”) consists primarily of payroll and related expenses for the Company’s sales and administrative staff, professional fees including accounting, legal and technology costs and expenses, and sales and marketing costs. SG&A in Q2 2019 increased from Q2 2018 largely due to an increase in

employee headcount, annual raises, and to a lesser extent, due to rent escalation in leased properties, increases in IT consulting fees, and depreciation expense. SG&A as a percent of revenue in Q2 2019 decreased from Q2 2018 primarily due to the Company being able to increase sales with current and new customers at a rate greater than SG&A expenses increased.

*Other (Expense) Income, Net (\$ in thousands)*

|                                       | Three Months Ended<br>February 28, |          | \$        | %         |
|---------------------------------------|------------------------------------|----------|-----------|-----------|
|                                       | 2019                               | 2018     | Change    | Change    |
| Other (expense) income:               |                                    |          |           |           |
| Net (loss) gain on trading securities | \$ (126 )                          | \$ 48    | \$ (174 ) | (362.5 )% |
| Interest and other (expense), net     | (125 )                             | (130 )   | 5         | 3.8 %     |
| Other (expense) income, net           | \$ (251 )                          | \$ (82 ) | \$ (169 ) | (206.1 )% |
| Percent of revenues                   | 0.5 %                              | 0.2 %    |           |           |

Other (expense) income, net primarily consists of income or losses on trading in short-term marketable equity securities of publicly-held corporations and interest related to the Company's debt obligations. The Company's strategy consists of both long and short positions, as well as utilizing options designed to improve returns. During Q2 2019, the Company recognized a net loss of \$126,000 as compared to a net gain of \$48,000 in Q2 2018 in net realized and unrealized gains. The decrease in trading securities in Q2 2019 was primarily due to timing of sales and purchases and general market climate of short and long positions during the period.

Interest and other expense decreased in Q2 2019 compared to Q2 2018 due to an overall decrease in the Company's line of credit balance with the Bank during the period.

*Income Tax Provision (\$ in thousands)*

|                           | Three Months Ended<br>February 28, |        | \$     | %       |
|---------------------------|------------------------------------|--------|--------|---------|
|                           | 2019                               | 2018   | Change | Change  |
| Income tax provision      | \$ 580                             | \$ 571 | \$ 9   | 1.6 %   |
| Percent of pre-tax income | 22.8 %                             | 30.2 % |        | (7.4 )% |

The provision for income taxes increased by \$9,000 in Q2 2019 over the prior year period. This increase was primarily due to higher taxable income in the current quarter as compared to the prior year period. The percent of pre-tax income decreased from 30.2% at Q2 2018 to 22.8% for Q2 2019. The decrease in the rate was primarily due to the Tax Cut and Jobs Act becoming effective as of January 1, 2018, during the prior year period, which enacted significant changes to U.S. tax and related laws. Some of the provisions of the new tax law affecting corporations include, but are not limited to, a reduction of the federal corporate income tax rate from 35% to 21%, limiting the interest expense deduction, expensing of cost of acquired qualified property and eliminating the domestic production

activities deduction. See Note 6.

*Comparison of the Six Months Ended February 28, 2019 and 2018*

*Revenues and Gross Profit (\$ in thousands)*

|                     | Six Months Ended<br>February 28, |          | \$       | %      |    |
|---------------------|----------------------------------|----------|----------|--------|----|
|                     | 2019                             | 2018     | Change   | Change |    |
| Revenues            | \$103,345                        | \$87,212 | \$16,133 | 18.5   | %  |
| Cost of revenues    | 74,724                           | 62,584   | 12,140   | 19.4   | %  |
| Gross margin        | \$28,621                         | \$24,628 | \$3,993  | 16.2   | %  |
| Percent of revenues | 27.7                             | % 28.2   |          | (0.5)  | )% |

The increase in revenues in the six months ended February 28, 2019 as compared to the six months ended February 28, 2018 was largely due to increased unit sales in the current period compared to the prior year period, resulting from the Company focusing on improving and expanding its supply chain team, which has enabled the Company to effectively target and purchase inventory with higher turnover rates. Further, the increase was due to a higher volume of product sales, and increased sales department headcount over the prior year period. Revenues have also increased due to the Company continuing to focus on relationship building programs with current and potential customers and vendors.

The gross margin as a percent of revenue remained relatively consistent with the prior year period, decreasing slightly by 0.5%. The decrease in gross margins in the six months ended February 28, 2019 as compared to the six months ended February 28, 2018 is primarily due to the mix of products sold in each respective period.

*Selling, General and Administrative Expenses (\$ in thousands)*

|  | Six Months Ended     |          | \$      | %    |    |
|--|----------------------|----------|---------|------|----|
|  | February 28,<br>2019 | 2018     |         |      |    |
| Selling, general and administrative expenses | \$23,210             | \$20,817 | \$2,393 | 11.5 | %  |
| Percent of revenues                          | 22.5 %               | 23.9 %   |         | (1.4 | )% |

SG&A in the six months ended February 28, 2019 increased from the prior year period largely due to an increase in annual employee wage raises and bonuses, increase in employee headcount, and to a lesser extent, due to larger leased properties which had rent escalations. SG&A as a percent of revenue in Q2 2019 decreased from Q2 2018 primarily due to the Company being able to increase sales with current and new customers at a rate greater than SG&A expenses increased.

*Other Income (Expense), Net (\$ in thousands)*

|                                | Six Months Ended     |        | \$        | %       |    |
|--------------------------------|----------------------|--------|-----------|---------|----|
|                                | February 28,<br>2019 | 2018   |           |         |    |
| Other income:                  |                      |        |           |         |    |
| Net gain on trading securities | \$ 102               | \$ 251 | \$ (149 ) | (59.4   | )% |
| Interest expense, net          | (202 )               | (231 ) | 29        | 12.6    | %  |
| Other income, net              | \$ (100 )            | \$ 20  | \$ (120 ) | (600.0) | %  |
| Percent of revenues            | -%                   | -%     |           |         |    |

During the six months ended February 28, 2019, the Company recognized a net gain of \$102,000 as compared to a net gain of \$251,000 in the six months ended February 28, 2018 in net realized and unrealized gains. The increase in trading securities for the current six month period was primarily due to timing of sales and purchases and general market climate of short and long positions during the period.

Interest and other expense decreased in the six months ended February 28, 2019 compared to the prior year period due to an overall lower balance in the Company's line of credit with the Bank in the current period when compared to the prior year period.

*Income Tax Provision (\$ in thousands)*

|                           | Six Months Ended |          | \$     | %      |   |
|---------------------------|------------------|----------|--------|--------|---|
|                           | February 28,     | 2018     | Change | Change |   |
|                           | 2019             |          |        |        |   |
| Income tax provision      | \$ 1,425         | \$ 1,317 | \$ 108 | 8.2    | % |
| Percent of pre-tax income | 26.8 %           | 34.4 %   |        | (7.6)  | % |

The provision for income taxes increased by \$108,000 in the six month period ended February 28, 2019 over the prior year period. This was primarily the result of higher taxable net income in the current period as compared to the prior year period. The percent of pre-tax income decreased from 34.4% to 26.8% when comparing the six months ended February 28, 2018 to February 28, 2019. The decrease in the rate was primarily due to the Tax Cut and Jobs Act becoming effective as of January 1, 2018, during the prior year period, which enacted significant changes to U.S. tax and related laws. Further, the decrease in the rate is due to an increase in deferred tax assets and permanent deductible expense items during the six months ended February 28, 2019.



## Liquidity and Capital Resources

The Company has historically been funded from positive cash flow generated from its operations. As of February 28, 2019 and August 31, 2018, the Company held approximately \$3,982,000 and \$2,705,000 of unrestricted cash and cash equivalents, respectively.

In addition, the Company currently has a \$10,000,000 line of credit agreement with the Bank, which bank was recently acquired by CVB Financial Corp., the parent company of Citizens Business Bank. On July 24, 2018, the Company entered into a Change in Terms Agreement dated July 12, 2018 with the Bank (the "Amendment"). The Amendment modifies the Company's \$10,000,000 line of credit between the Company and the Bank to: (i) extend the expiration date of the line of credit under the agreement from March 1, 2019 to August 20, 2020; (ii) reduce the default variable interest index rate by .500% (Wall Street Journal Prime Rate less .500%); and (iii) add the following two other interest rate options that the Company may select (subject to the requirements in the Amendment and provided that the Company is not in default under the line of credit agreement): (A) One Hundred Eighty (180) day Libor Rate plus a margin of 1.550%; or (B) the One (1) Year Libor plus a margin of 1.550%, as more fully described in the Amendment. The amounts outstanding under this line of credit as of February 28, 2019 is currently all under the default variable interest index rate. The line of credit agreement contains financial and other covenants that have not been modified by the Amendment. Borrowings under this agreement bear interest at the bank's reference rate, which is the Prime Rate (5.50% at February 28, 2019 and 5.00% at August 31, 2018) less .500%. Borrowings are secured by substantially all of the assets of the Company and its subsidiaries. The amounts outstanding under this line of credit as of February 28, 2019 and 2018 were \$7,680,000 and \$8,485,000, respectively. The line of credit agreement contains certain nonfinancial and financial covenants, including the maintenance of certain financial ratios. As of February 28, 2019 and August 31, 2018, the Company was in compliance with all such covenants.

On May 15, 2017, the Company entered into a \$5,400,000 loan agreement with the Bank. The proceeds of the loan were used to purchase the Lakeview Property located in Anaheim, California Lakeview Property. This loan is payable in 35 regular monthly payments of \$27,142 and one last payment of \$5,001,607 due on the maturity date of the loan on May 16, 2020. The loan is secured by a deed of trust to the Lakeview Property and bears a variable interest rate that is 1.70% plus one year LIBOR, which is periodically reset based on one year LIBOR no more than once in any 12 month period at the election of the bank. At February 28, 2019 and August 31, 2018, the one year LIBOR was 2.7%. At February 28, 2019, the outstanding balance of this loan was \$5,191,000.

EACO has also entered into a business loan agreement (and related \$100,000 promissory note) with the Bank in order to obtain a \$100,000 letter of credit as security for the Company's worker's compensation requirements.

The Company plans to move its corporate headquarters within the next 12 months to a significantly larger facility owned by the Trust in Anaheim, California. In preparation for this move, the Company expects to incur higher capital

expenses during the next years for capital costs for tenant improvements to modify this facility to meet the Company's requirements.

The Company also held \$1,877,000 and \$2,846,000 of marketable securities at February 28, 2019 and August 31, 2018, respectively, which could be liquidated, if necessary.

### ***Cash Flows from Operating Activities***

Cash used in operating activities was \$1,696,000 for the six months ended February 28, 2018 as compared with cash used in operations of \$4,681,000 for the six months ended February 28, 2019. The increase in current period cash used by operating activities was primarily due to the increase in trade accounts receivable, inventory, and prepaid expenses and other current assets in the current period, which was largely related to an increase in becoming an authorized product lines distributor through various vendors and increased revenues in the six months ended February 28, 2019. This was partially offset by an increase in net income and accrued expenses in the current period. The prior year cash used in operating activities was primarily due to an increase in accounts receivables, inventory, and expenses and other current assets.

### ***Cash Flows from Investing Activities***

Cash used in investing activities was \$1,642,000 for the six months ended February 28, 2018 as compared with cash provided in such activities of \$626,000 for the six months ended February 28, 2019. The increase in cash flow from investing activities in the current year period compared to the prior year period was primarily due to the Company's sale of marketable securities of \$1,071,000 and decreased spending on equipment and leasehold improvements in the six months ending February 28, 2019. The prior year cash used in investing activities was primarily due to the Company's purchases in Q1 2018 of equipment and leasehold improvements and marketable securities.

### ***Cash Flows from Financing Activities***

Cash provided by financing activities for the six months ended February 28, 2018 was \$2,597,000 as compared with cash provided of \$4,940,000 for the six months ended February 28, 2019. The increase in cash provided by financing activities comparing the current period to the prior year period is primarily due to larger borrowing of \$4,593,000 on the Company's line of credit, partially offset by a lower bank overdraft for the current year period. The increase in borrowing on the line of credit in current period was primarily due to an increase in purchasing of inventory. Cash provided by financing activities in the prior year period is primarily due to borrowings of \$1,525,000 on the Company's revolving line of credit and a change in bank overdraft of \$1,145,000 due to timing of when purchases were paid.

### **Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements that are reasonably likely to have a material current or future effect on the Company's financial position, revenues, results of operations, liquidity or capital expenditures.

### **Contractual Financial Obligations**

In addition to using cash flow from operations, the Company finances its operations through borrowings under its line of credit. These financial obligations are recorded in accordance with accounting rules applicable to the underlying transactions, with the result being that amounts owed under debt agreements and capital leases are recorded as liabilities on the consolidated balance sheets while lease obligations recorded as operating leases are disclosed in the notes to the consolidated financial statements and management's discussion and analysis of financial condition and results of operations in the Company's annual report on Form 10-K for the year ended August 31, 2018 as filed with the SEC on November 28, 2018.

Within the next 10 months, the Company plans to relocate its corporate headquarters and Anaheim distribution center to an 80,000 square foot facility in Anaheim, California that is owned by the Trust. The Company has not executed a lease for such facility, however, but plans to enter into a new lease with the Trust in the near future.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this item.

### **Item 4. Controls and Procedures**

**Evaluation of disclosure controls and procedures.** As required by Rule 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's Chief Executive Officer, who also serves as the Company's principal financial officer. Based upon that evaluation, the Company's Chief Executive Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered in this report.

**Changes in internal control over financial reporting.** There have been no changes in internal control over financial reporting during the fiscal quarter covered by this report that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

From time to time, we may be subject to legal proceedings and claims which arise in the normal course of our business. Any such matters and disputes could be costly and time consuming, subject us to damages or equitable remedies, and divert our management and key personnel from our business operations. We currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

#### **Item 1A. Risk Factors**

*Our business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this report and in our other filings with the SEC, including our Annual Report on Form 10-K and subsequent reports on Forms 10-Q and 8-K. If any of the risks actually occur, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price for shares of our common stock may decline, and you could lose all or part of your investment.*

#### **Changes and uncertainties in the economy have harmed and could continue to harm our operating results.**

As a result of the continuing economic uncertainties, our operating results, and the economic strength of our customers and suppliers, are increasingly difficult to predict. Sales of our products are affected by many factors, including, among others, general economic conditions, interest rates, inflation, liquidity in the credit markets, unemployment trends, geopolitical events, and other factors. Although we sell our products to customers in a broad range of industries, any significant weakening of economic conditions on a global scale has in the past caused, and may in the future cause, some of our customers to experience a slowdown, which could adversely effect our sales and operating results. Changes and uncertainties in the economy also increase the risk of uncollectible accounts receivable. The pricing we receive from suppliers may also be impacted by general economic conditions. Continued and future changes and uncertainties in the economic climate in the United States and elsewhere could have a similar negative impact on the rate and amounts of purchases by our current and potential customers, create price inflation for our products, or otherwise have a negative impact on our expenses, gross margins and revenues, and could hinder our growth.

**The Company's Chairman and CEO holds almost all of our voting stock and can control the election of directors and significant corporate actions.**

As of February 28, 2019, Glen Ceiley, our Chairman and CEO, beneficially owned or controlled approximately 97% of our outstanding voting stock. As a result, Mr. Ceiley is able to exert significant influence over the outcome of almost all corporate matters, including significant corporate transactions requiring a stockholder vote, such as a merger or a sale of the Company or our assets. This concentration of ownership and influence in management and board decision-making could also harm the price of our common stock by, among other things, discouraging a potential acquirer from seeking to acquire shares of our common stock (whether by making a tender offer or otherwise) or otherwise attempting to obtain control of the Company.

**We generally do not have long-term supply agreements or guaranteed price or delivery arrangements with the majority of our suppliers.**

In most cases, we have no guaranteed price or delivery arrangements with our suppliers. Consequently we may experience inventory shortages on certain products or higher prices for inventory from time to time. Furthermore, our industry occasionally experiences significant product supply shortages and customer order backlogs due to the inability of certain manufacturers to supply products as needed. We cannot assure you that our suppliers will maintain an adequate supply of products to fulfill our orders on a timely basis, at a recoverable cost, or at all, or that we will be able to obtain particular products on favorable terms or at all. Additionally, we cannot assure you that product lines currently offered by suppliers will continue to be available to us. A decline in the supply or continued availability of the products of our suppliers, or a significant increase in the price of those products, could reduce our sales, harm our reputation and negatively affect our operating results.

**We rely on third party suppliers for most of our products, and may not be able to identify and procure relevant new products and products lines that satisfy our customers' needs on favorable terms and prices, or at all.**

We currently rely on a large number of third party suppliers for most of our products. Since we do not manufacture our products, we rely on these suppliers to provide quality products on a timely basis that are in demand by our customers. Our success depends in part on our ability to develop product expertise and continue to identify and provide future high quality products and product lines that complement our existing products and product lines and that respond to our customers' needs. We may not be able to compete effectively unless we can continue to offer a broad range of high quality, reliable products that address the trends in the markets in which we compete.

**Our supply agreements are typically terminable at the suppliers' discretion.**

Substantially all of our agreements with suppliers, including our authorized distributor agreements, are terminable by some suppliers with little or no notice and without any penalty. Suppliers that currently sell their products through us could decide to sell, or increase their sales of, their products directly or through other distributors or channels. Any termination, interruption or adverse modification of our relationship with a key supplier or a significant number of other suppliers would likely adversely affect our operating income, cash flow and future prospects.

**We generally do not have long-term sales contracts with our customers.**

Most of our sales are made on a purchase order basis, rather than through long-term sales contracts. As such, our customers typically do not have any obligation to purchase any products from us. A variety of conditions, both specific to each customer and generally affecting each customer's industry, may cause customers to reduce, cancel or delay orders that were either previously made or anticipated. In addition, customers may go bankrupt or fail, or default on their payments. Significant or numerous cancellations, reductions, delays in orders by customers, losses of customers, and/or customer defaults on payment could materially adversely affect our business and revenues.

**If we fail to maintain an effective system of internal controls over financial reporting or experience additional material weaknesses in our system of internal controls, we may not be able to report our financial results accurately or timely or detect fraud, which could have a material adverse effect on the market price of our common stock and our business.**



We have, from time to time, had material weaknesses in our internal controls over financial reporting due to a variety of issues, including, without limitation, significant deficiencies in the process related to the preparation of our financial statements, segregation of duties, sufficient control in the area of financial reporting oversight and review, and appropriate personnel to ensure the complete and proper application of GAAP as it relates to certain routine accounting transactions. Although we believe we have addressed these material weaknesses, we may experience material weaknesses or significant deficiencies in the future and may fail to maintain a system of internal control over financial reporting that complies with the reporting requirements applicable to public companies in the United States. Our failure to address any deficiencies or weaknesses in our internal control over financial reporting or to properly maintain an effective system of internal control over financial reporting could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly, in accordance with GAAP, our financial condition and results of operations. The existence of any such deficiencies and/or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

**We rely heavily on our internal information systems, which, if not properly functioning, could materially and adversely affect our business.**

Our information systems have been in place for many years, and are subject to system failures as well as problems caused by human error, which could have a material adverse effect on our business. Many of our systems consist of a number of legacy or internally developed applications, which can be more difficult to upgrade to commercially available software. It may be time consuming and costly for us to retrieve data that is necessary for management to evaluate our systems of control and information flow. In the future, management may decide to convert our information systems to a single enterprise solution. Such a conversion, while it would enhance the accessibility and reliability of our data, could be expensive and would not be without risk of data loss, delay or business interruption. Maintaining and operating these systems requires continuous investments. Failure of any of these internal information systems or material difficulties in upgrading these information systems could have material adverse effects on our business and our timely compliance with our reporting obligations.

**We have incurred significant losses in the past from trading in securities, and we may incur such losses in the future, which may also cause us to be in violation of covenants under our loan agreement.**

Bisco has historically supplemented its capital resources from cash generated by trading in marketable domestic equity securities. Bisco's investment strategy includes taking both long and short positions, as well as utilizing options to maximize return. This strategy can lead, and has led, to significant losses based on market conditions and trends. We may continue to incur losses in future periods from such trading activities, which could materially and adversely affect our liquidity and financial condition.

In addition, unanticipated losses from our trading activities may cause Bisco to be in violation of certain covenants under its line of credit agreement with the Bank. The agreement is secured by substantially all of Bisco's assets and is guaranteed by EACO. The loan agreement contains covenants which require that, on a quarterly basis, Bisco's losses from trading in securities not exceed its pre-tax operating income. We cannot assure you that unanticipated losses from our trading activities will not cause us to violate our covenants in the future or that the bank will grant a waiver for any such default or that it will not exercise its remedies, which could include the refusal to allow additional borrowings on the line of credit or the acceleration of the obligation's maturity date and foreclosure on Bisco's assets, with respect to any such noncompliance, which could have a material adverse effect on our business and operations.

**The unauthorized access to, or theft or destruction of, customer or employee personal, financial or other data or of our proprietary or confidential information that is stored in our information systems or by third parties on our behalf could impact our reputation and brand and expose us to potential liability and loss of revenues.**

The protection of customer, employee and company data is critical to us. We are subject to laws relating to information security, privacy, cashless payments, consumer credit and fraud. Additionally, an increasing number of government and industry groups have established laws and standards for the protection of personal information. The regulatory environment surrounding information security and privacy is increasingly demanding, with the frequent imposition of new and constantly changing requirements. Compliance with these requirements may result in cost increases due to necessary system changes and the development of new administrative processes. If we fail to comply with laws and regulations regarding privacy and security, we could be subject to significant fines, and become subject to investigations, litigation and the disruption of our operations.

In the ordinary course of business, we receive and maintain credit card and other personal information from our customers, employees and vendors. Customers and employees have a high expectation that we will adequately protect their personal information. Third parties may have the technology or know-how to breach the security of this customer information, and our security measures and those of our technology vendors may not effectively prohibit others from obtaining improper access to this information. A number of retailers have experienced security breaches in which credit and debit card information may have been stolen. While we have not experienced a cyber attack, we are in the process of working with a third party vendor to assist us in safeguarding our systems and protecting the personal information of our customers, employees and vendors. We are still at an early stage in this analysis and may not be able to adequately address or remedy the potential harm, which could result in the assessment against us for large remedial costs and other penalties, and could damage our reputation and adversely impact our customers.

**We may not be able to attract and retain key personnel.**

Our future performance will depend to a significant extent upon the efforts and abilities of certain key management and other personnel, including Glen Ceiley, our Chairman and CEO, as well as other executive officers and senior management. The loss of service of one or more of our key management members could have a material adverse effect on our business.

**The competitive pressures we face could have a material adverse effect on our business.**

The market for our products and services is very competitive. We compete for customers with other distributors, who sell similar or something identical products, as well as with many of our suppliers. A failure to maintain and enhance our competitive position could adversely affect our business and prospects. Furthermore, our efforts to compete in the marketplace could cause deterioration of gross profit margins and, thus, overall profitability. Some of our competitors may have greater financial, personnel, capacity and other resources or a more extensive customer base than we do.

**Our strategy of expanding into new geographic areas could be costly and may not expand our revenues.**

One of our primary growth strategies is to grow our business through the opening of sales offices in new geographic markets. This strategy requires continued investment, both financially as well as management's efforts to get the new offices operational and profitable. Based on our analysis of demographics in the United States, Canada and Mexico, we currently estimate there is potential market opportunity in North America to support additional sales offices. We cannot guarantee that our estimates are accurate or that we will open enough offices to capitalize on the full market opportunity or that any new offices will be successful or profitable in the near future, or at all. In addition, a particular local market's ability to support a sales office may change because of a change due to competition or local economic conditions.

**We may be unable to meet our goals regarding new office openings.**

Our growth, in part, is primarily dependent on our ability to attract new customers. Historically, our most effective way to attract new customers has been opening new sales offices in additional geographic regions or new markets. Our current business strategy focuses on opening a specified number of new sales offices each year, and quickly growing each new sales office. Given the recent economic uncertainty, we may not be able to open or grow new offices at our projected or desired rates or hire the qualified sales personnel necessary to make such new offices

successful. Failure to do so could negatively impact our long-term growth and market share.

**Opening sales offices in new markets presents increased risks that may prevent us from being profitable in these new locations, and/or may adversely affect our operating results.**

Our new sales offices do not typically achieve operating results comparable to our existing offices until after several years of operation. The added expenses relating to payroll, occupancy, and transportation costs can impact our ability to generate earnings. In addition, offices in new geographic areas face additional challenges to achieving profitability. In new markets, we have less familiarity with local customer preferences and customers in these markets are less familiar with our name and capabilities. Entry into new markets may also bring us into competition with new, unfamiliar competitors. These challenges associated with opening new offices in new markets may have an adverse effect on our business and operating results.

**Our ability to successfully attract and retain qualified sales personnel is uncertain.**

Our success depends in large part on our ability to attract, motivate, and retain a sufficient number of qualified sales employees, who understand and appreciate our strategy and culture and are able to adequately represent us to our customers. Qualified individuals of the requisite caliber and number needed to fill these positions may be in short supply in some areas, and the turnover rate in the industry is high. If we are unable to hire and retain personnel capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and product knowledge, our sales could be materially adversely affected. Additionally, competition for qualified employees could require us to pay higher wages to attract a sufficient number of employees. An inability to recruit and retain a sufficient number of qualified individuals in the future may also delay the planned openings of new offices. Any such delays, material increases in existing employee turnover rates, or increases in labor costs, could have a material adverse effect on our business, financial condition or operating results.

**Increases in the costs of energy, shipping and raw materials used in our products could impact our cost of goods and distribution and occupancy expenses, which would result in lower operating margins.**

Costs of raw materials used in our products and energy costs have been rising during the last several years, which has resulted in increased production costs for our suppliers. These suppliers typically pass their increased costs along to us through price increases. The shipping costs for our products have risen as well and may continue to rise. While we typically try to pass increased supplier prices and shipping costs through to our customers or to modify our activities to mitigate the impact, we may not be successful. Failure to fully pass these increased prices and costs through to our customers or to modify our activities to mitigate the impact would have an adverse effect on our operating margins and could make our products less competitive, either of which could adversely impact our margins and results of operations.

**We may not have adequate or cost-effective liquidity or capital resources.**

Our ability to satisfy our cash needs depends on our ability to generate cash from operations and to access our line of credit and the capital markets, which are subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our cash and cash equivalents at February 28, 2019 was approximately \$4 million. The total outstanding on our line of credit as of February 28, 2019 was approximately \$7.7 million, which the line of credit is secured by substantially all of Bisco's assets. Our ability to continue to draw on our line of credit is subject to our satisfaction of certain covenants contained in such agreement. As such, we may need to pursue additional debt or equity financing, which funding may not be available on acceptable terms, on a timely basis or at all. The securities to be issued in any future equity financing may have rights, preferences, and privileges that are senior to our common stock. Our failure to obtain such funding could adversely impact our ability to execute our business plan and our financial condition and results of operations.

**Sales of our common stock by Glen Ceiley could cause the price of our common stock to decline.**

There is currently no established trading market for our common stock, and the volume of any stock sales has generally been low. As of February 28, 2019, the number of shares held by non-affiliates of Mr. Ceiley was less than 150,000 shares. If Mr. Ceiley or any other shareholder sells or seeks to sell a substantial number of his shares of our common stock in the future, the market price of our common stock could decline. The perception among investors that these sales may occur could produce the same effect. Due to the limited available public float, certain investors may not be able or willing to invest in the Company's securities, which could also impact the market price of our common stock.

**Inclement weather and other disruptions to the transportation network could impact our distribution system.**

Our ability to provide efficient shipment of products to our customers is an integral component of our overall business strategy. Disruptions at distribution centers or shipping ports have in the past, and may in the future, affect our ability to both maintain core products in inventory and deliver products to our customers on a timely basis, which may in turn adversely affect our relationship with our customers, our reputation, and our results of operations. In addition, severe weather conditions could adversely impact demand for our products in particularly hard hit regions.

**Our advertising and marketing efforts may be costly and may not achieve desired results.**

We expect to continue to incur substantial expense in connection with our advertising and marketing efforts. Postage represents a significant advertising expense for us because we generally mail fliers to current and potential customers through the U.S. Postal Service. Any future increases in postal rates will increase our mailing expenses and could have a material adverse effect on our business, financial condition and results of operations.

**We are exposed to foreign currency exchange rate risk, and changes in foreign exchange rates could increase our costs to procure products and impact our foreign sales.**

Because the functional currency related to our Canadian operations and certain of our foreign vendor purchases is the applicable local currency, we are exposed to foreign currency exchange rate risk arising from transactions in the normal course of business. Fluctuations in the relative strength of foreign economies and their related currencies could adversely impact our ability to procure products overseas at competitive prices and our foreign sales. Historically, our primary exchange rate exposure has been with the Canadian dollar.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.



**Item 5. Other Information**

None.

**Item 6. Exhibits**

The following exhibits are filed as part of this report on Form 10-Q.

| <b>No.</b>  | <b>Exhibit</b>   |
|-------------|--|
| <u>31.1</u> | <u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.1</u> | <u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.</u>   |
| 101.INS     | XBRL Instance Document   |
| 101.SCH     | XBRL Taxonomy Extension Schema Document  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document   |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**EACO CORPORATION**  
(Registrant)

Date: April 12, 2019 /s/ **Glen Ceiley**  
Glen Ceiley  
Chief Executive Officer  
(Principal Executive Officer & Principal Financial Officer)

/s/ **Michael Narikawa**  
Michael Narikawa  
Controller  
(Principal Accounting Officer)

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