

Steel Connect, Inc.  
Form 10-Q  
March 11, 2019  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended January 31, 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 Number 001-35319**

**Steel Connect, Inc.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**04-2921333**  
**(I.R.S. Employer**  
**Identification No.)**

**1601 Trapelo Road, Suite 170**

**Waltham, Massachusetts**  
**(Address of principal executive offices)**  
**(781) 663-5000**

**02451**  
**(Zip Code)**

**(Registrant's telephone number, including area code)**

**(Former name or former address, if changed since last report.)**

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 pursuant 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, smaller reporting company and emerging growth 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.

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 February 28, 2019, there were 61,797,807 shares issued and outstanding of the registrant's Common Stock, \$0.01 par value per share.



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**STEEL CONNECT, INC.**

**FORM 10-Q**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements**

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**STEEL CONNECT, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

(unaudited)

	January 31, 2019	July 31, 2018
<b>ASSETS</b>		
Cash and cash equivalents	\$ 92,899	\$ 92,138
Accounts receivable, trade, net of allowance for doubtful accounts of \$574 and \$480 at January 31, 2019 and July 31, 2018, respectively	103,359	99,254
Inventories, net	29,431	47,786
Restricted cash	9,308	11,688
Prepaid expenses and other current assets	33,278	13,415
<b>Total current assets</b>	<b>268,275</b>	<b>264,281</b>
Property and equipment, net	100,472	106,632
Goodwill	257,128	254,352
Other intangible assets, net	177,074	192,964
Other assets	8,095	8,821
<b>Total assets</b>	<b>\$ 811,044</b>	<b>\$ 827,050</b>
<b>LIABILITIES, CONTINGENTLY REDEEMABLE PREFERRED STOCK &amp; STOCKHOLDERS EQUITY</b>		
Accounts payable	\$ 84,603	\$ 78,212
Accrued expenses	88,338	88,426
Restricted cash	9,308	11,688
Current portion of long-term debt	5,729	5,727
Other current liabilities	39,605	42,029
Convertible Notes payable	48,626	50,274
<b>Total current liabilities</b>	<b>276,209</b>	<b>276,356</b>
Convertible Notes payable	14,831	14,256
Long-term debt, excluding current portion	380,246	383,111
Other long-term liabilities	10,023	10,507
<b>Total long-term liabilities</b>	<b>405,100</b>	<b>407,874</b>
<b>Total liabilities</b>	<b>681,309</b>	<b>684,230</b>
	35,198	35,192

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Contingently redeemable preferred stock, \$0.01 par value per share. 35,000 shares authorized, issued and outstanding at October 31, 2018 and July 31, 2018

Stockholders' equity:

Preferred stock, \$0.01 par value per share. 4,965,000 shares authorized, issued and outstanding at January 31, 2019 and July 31, 2018

Common stock, \$0.01 par value per share. Authorized 1,400,000,000 shares; 61,797,807 issued and outstanding shares at January 31, 2019; 60,742,859 issued and outstanding shares at July 31, 2018

	618	608
Additional paid-in capital	7,468,628	7,467,855
Accumulated deficit	(7,377,622)	(7,363,569)
Accumulated other comprehensive income	2,913	2,734

Total stockholders' equity	94,537	107,628
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Total liabilities, contingently redeemable preferred stock and stockholders' equity	\$ 811,044	\$ 827,050
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See accompanying notes to unaudited condensed consolidated financial statements

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**STEEL CONNECT, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2019	2018	2019	2018
Net revenue	\$ 206,223	\$ 153,738	\$ 421,356	\$ 256,260
Cost of revenue	168,680	137,915	345,613	231,363
Gross profit	37,543	15,823	75,743	24,897
Operating expenses				
Selling, general and administrative	27,711	30,111	54,276	43,015
Amortization of intangible assets	7,791	4,107	15,890	4,107
Gain on sale of property	(85)	(12,692)	(85)	(12,692)
Total operating expenses	35,417	21,526	70,081	34,430
Operating income (loss)	2,126	(5,703)	5,662	(9,533)
Other income (expense):				
Interest income	172	92	495	256
Interest expense	(10,984)	(6,575)	(22,041)	(8,682)
Other losses, net	(1,662)	(1,717)	(718)	(295)
Total other expense	(12,474)	(8,200)	(22,264)	(8,721)
Loss before income taxes	(10,348)	(13,903)	(16,602)	(18,254)
Income tax expense (benefit)	1,405	(73,521)	2,536	(72,434)
Gains on investments in affiliates, net of tax		(200)	(20)	(401)
Net income (loss)	(11,753)	59,818	(19,118)	54,581
Less: Preferred dividends on redeemable preferred stock	(536)	(270)	(1,073)	(270)
Net income (loss) attributable to common stockholders	\$ (12,289)	\$ 59,548	\$ (20,191)	\$ 54,311
Basic net earnings (loss) per share attributable to common stockholders:	\$ (0.20)	\$ 1.02	\$ (0.33)	\$ 0.96
Diluted net earnings (loss) per share attributable to common stockholders:	\$ (0.20)	\$ 0.78	\$ (0.33)	\$ 0.80



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Weighted average common shares used in:

Basic earnings per share	60,935	58,341	60,974	56,776
Diluted earnings per share	60,935	79,083	60,974	72,883

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents**STEEL CONNECT, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)****(unaudited)**

	<b>Three Months Ended January 31,</b>		<b>Six Months Ended January 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Net income (loss)	\$ (11,753)	\$ 59,818	\$ (19,118)	\$ 54,581
Other comprehensive income (loss):				
Foreign currency translation adjustment	1,952	3,654	332	3,926
Net unrealized holding gain (loss) on securities, net of tax	(74)	29	(89)	16
Pension liability adjustments, net of tax	(469)		(64)	26
Other comprehensive gain	1,409	3,683	179	3,968
Comprehensive income (loss)	\$ (10,344)	\$ 63,501	\$ (18,939)	\$ 58,549

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents**STEEL CONNECT, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(in thousands, except share amounts)

(unaudited)

	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at July 31, 2018	60,742,859	\$ 608	\$ 7,467,855	\$ (7,363,569)	\$ 2,734	\$ 107,628
Net loss				(19,118)		(19,118)
Effect of adoption of accounting standards				6,138		6,138
Preferred dividends				(1,073)		(1,073)
Issuance of common stock pursuant to employee stock purchase plan and stock option exercises	9,405		13			13
Restricted stock grants	1,045,543	10	(10)			
Share-based compensation			770			770
Other comprehensive items					179	179
Balance at January 31, 2019	61,797,807	\$ 618	\$ 7,468,628	\$ (7,377,622)	\$ 2,913	\$ 94,537

	Number of Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at July 31, 2017	55,555,973	\$ 556	\$ 7,457,051	\$ (7,398,949)	\$ 4,313	\$ 62,971
Net loss				54,581		54,581
Preferred dividends				(270)		(270)
Issuance of common stock pursuant to employee stock purchase plan and stock option exercises	2,445		3			3
Restricted stock grants	4,696,910	47				47
Restricted stock forfeitures	(49,382)					
Share-based compensation			7,397			7,397
Other comprehensive items					3,968	3,968
Balance at January 31, 2018	60,205,946	\$ 603	\$ 7,464,451	\$ (7,344,638)	\$ 8,281	\$ 128,697



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**STEEL CONNECT, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>Six Months Ended</b>	
	<b>January 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (19,118)	\$ 54,581
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	10,451	5,656
Amortization of intangible assets	15,890	4,107
Amortization of deferred financing costs	511	392
Accretion of debt discount	2,311	2,117
Impairment of long-lived assets	432	
Share-based compensation	770	7,397
Other (gains) losses, net	718	(12,398)
Gains on investments in affiliates and impairments	(20)	(401)
Changes in operating assets and liabilities		
Accounts receivable, net	(4,618)	20,388
Inventories, net	(2,961)	13,657
Prepaid expenses and other current assets	3,593	(1,915)
Accounts payable, accrued restructuring and accrued expenses	8,129	(15,422)
Refundable and accrued income taxes, net	(1,833)	3,767
Deferred tax assets and liabilities	1,563	(79,918)
Other assets and liabilities	(354)	2,994
Net cash provided by operating activities	15,464	5,002
<b>Cash flows from investing activities:</b>		
Payments to acquire business		(469,221)
Additions to property and equipment	(8,953)	(9,303)
Proceeds from the disposition of property and equipment	14	20,589
Proceeds from the sale of Trading Securities		13,775
Proceeds from investments in affiliates	20	401
Net cash used in investing activities	(8,919)	(443,759)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt		393,000
Proceeds from issuance of preferred stock		35,000

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Proceeds from (payment of) revolving line of credit, net		6,000
Payment of long-term debt	(3,000)	
Payment of deferred financing costs		(1,334)
Payment of preferred dividends	(1,072)	
Purchase of the Company's Convertible Notes	(3,700)	
Repayments on capital lease obligations	(76)	(77)
Proceeds from issuance of common stock	13	3
Net cash provided by (used in) financing activities	(7,835)	432,592
Net effect of exchange rate changes on cash, cash equivalents, and restricted cash	(329)	1,548
Net decrease in cash, cash equivalents, and restricted cash	(1,619)	(4,617)
Cash, cash equivalents, and restricted cash, beginning of period	103,826	124,124
Cash, cash equivalents, and restricted cash, end of period	\$ 102,207	\$ 119,507

See accompanying notes to unaudited condensed consolidated financial statements

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**STEEL CONNECT, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**(1) NATURE OF OPERATIONS**

Steel Connect, Inc. ( Steel Connect or the Company ) together with its consolidated subsidiaries, operates through its wholly owned subsidiaries, ModusLink Corporation and ModusLink PTS, Inc. (together ModusLink or Supply Chain ), and IWCO Direct Holdings, Inc. ( IWCO Direct or IWCO ). The Company was formerly known as ModusLink Global Solutions, Inc. until it changed its name to Steel Connect, Inc. effective February 27, 2018.

ModusLink is a supply chain business process management company serving clients in markets such as consumer electronics, communications, computing, medical devices, software, and retail. ModusLink designs and executes elements in its clients' global supply chains to improve speed to market, product customization, flexibility, cost, quality and service. The Company also produces and licenses an entitlement management solution for activation, provisioning, entitlement subscription and data collection from physical goods (connected products) and digital products.

ModusLink has an integrated network of strategically located facilities with 20 sites operating in 21 languages in various countries, including numerous sites throughout North America, Europe and Asia. The Company previously operated under the names ModusLink Global Solutions, Inc., CMGI, Inc. and CMG Information Services, Inc. and was incorporated in Delaware in 1986.

IWCO Direct delivers data-driven marketing solutions for its customers. Its full range of services includes strategy, creative and execution for omnichannel marketing campaigns, along with postal logistics programs for direct mail. Through its Mail-Gard® division, IWCO Direct also offers business continuity and disaster recovery services to protect against unexpected business interruptions, along with providing print and mail outsourcing services.

IWCO has administrative offices in Chanhassen, MN. and has three facilities in Chanhassen, MN., one facility in Little Falls, MN., one facility in Warminster, PA. and two facilities in Hamburg PA.

Historically, the Company has financed its operations and met its capital requirements primarily through funds generated from operations, the sale of our securities, borrowings from lending institutions, and sale of facilities that were not fully utilized. The Company believes it has access to adequate resources to meet its needs for normal operating costs, capital expenditures, mandatory debt redemptions and working capital for its existing business for at least twelve months from the date of this filing. These resources include cash and cash equivalents, a credit agreement with PNC Bank (the Credit Agreement ) the securitization of trade receivables and the revolving credit facility and cash, if any, provided by operating activities.

At January 31, 2019 and July 31, 2018, the Company had cash and cash equivalents of \$92.9 million and \$92.1 million, respectively. As of January 31, 2019, the Company had a deficiency in working capital which was primarily driven by the reclassification of the Company's convertible notes from long-term to current, accrued pricing liabilities which the Company believes will not require a cash outlay in the next twelve months and the additional liabilities assumed because of the IWCO acquisition. At January 31, 2019, the Company had a readily available borrowing capacity under its revolving credit and security agreement with PNC Bank and National Association of \$4.6 million. At January 31, 2019, IWCO had a readily available borrowing capacity under its revolving credit facility

by and among MLGS Merger Company, Inc. ( MLGS ), Instant Web, LLC and Cerberus Business Finance, LLC of \$25.0 million. Per that certain financing agreement by and among MLGS, Instant Web, LLC, IWCO and Cerberus Business Finance, LLC (the Financing Agreement ) and the credit facilities provided thereunder, IWCO is permitted to make distributions to Steel Connect, an aggregate amount not to exceed \$5.0 million in any fiscal year and pay reasonable documented expenses incurred by Steel Connect. Steel Connect is entitled to receive additional cash remittances under a U.S. Federal Income Tax Sharing Agreement. The Company believes it will generate sufficient cash to meet its debt covenants under the Credit Agreement and the Financing Agreement to which certain of its subsidiaries are a party, to repay or restructure its Notes and that it will be able to obtain cash through its current credit facilities and through securitization of certain trade receivables. The Company's historical operating results and working capital deficit indicate substantial doubt exists related to the Company's ability to continue as a going concern. The Company believes that the actions discussed above are probable of occurring and mitigating the substantial doubt raised by the Company's historical operating results and satisfying the Company's estimated liquidity needs 12 months from the issuance of the financial statements. However, the Company cannot predict, with certainty, the outcome of its actions to generate liquidity, including the availability of additional debt refinancing or factoring of receivables, or whether such actions would generate the expected liquidity as currently planned.

## **(2) BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes



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required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for fair presentation have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended July 31, 2018, which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ) on December 4, 2018. The results for the three and six months ended January 31, 2019 are not necessarily indicative of the results to be expected for the full fiscal year. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

All significant intercompany transactions and balances have been eliminated in consolidation.

The Company considers events or transactions that occur after the balance sheet date but before the issuance of financial statements to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. For the period ended January 31, 2019, the Company evaluated subsequent events for potential recognition and disclosure through the date these financial statements were filed (see note 21).

**(3) RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09, Revenue from Contracts with Customers (Topic 606 or the new standard), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of 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 ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On August 1, 2018, the Company adopted this guidance and all the related amendments using the modified retrospective method for all contracts not completed as of the date of adoption. For contracts that were modified before the effective date, the Company reflected the aggregate effect of all modifications when identifying performance obligations and allocating transaction price in accordance with practical expedient ASC 606-10-65-1-(f)-4, which did not have a material effect on the Company's assessment of the cumulative effect adjustment upon adoption. The Company recognized the cumulative effect of initially applying the new standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

In August 2014, the FASB issued ASU No. 2014-15 Presentation of Financial Statements - Going Concern (Subtopic 205-40), which amends the accounting guidance related to the evaluation of an entity's ability to continue as a going concern. The amendment establishes management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern in connection with preparing financial statements for each annual and interim reporting period. The update also gives guidance to determine whether to disclose information about relevant conditions and events when there is substantial doubt about an entity's ability to continue as a going concern. The Company adopted this guidance as of the first quarter of fiscal year 2018 and has provided additional disclosures in accordance with the new standard.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory (Topic 330), which provides guidance related to inventory measurement. The new standard requires entities to measure inventory at the lower of cost and net realizable value thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The Company adopted this guidance beginning the first quarter of fiscal year 2018. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements

and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to today's accounting. This ASU will be effective for the Company beginning in the first quarter of fiscal year 2020. The Company and its consultants are currently evaluating the effect the guidance will have on the Company's financial statement disclosures, results of operations and financial position.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The Company retrospectively adopted this guidance during the first quarter of fiscal year 2018 by utilizing the modified retrospective transition method. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements and related disclosures.

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In November 2016, the FASB issued ASU No. 2016-18, Restricted Cash. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Entities will also have to disclose the nature of their restricted cash and restricted cash equivalent balances. We adopted this accounting standard update beginning in the first quarter of fiscal year 2019 using a retrospective transition method to each period presented. The restricted cash balance on our consolidated balance sheets represents funds held on the behalf of the Company's clients. The application of this accounting standard update did not have a material impact on our Consolidated Statements of Cash Flows. Prior period information has been retrospectively adjusted due to the adoption of ASU 2016-18, Statement of Cash Flows, Restricted Cash in the beginning of the first quarter of fiscal year 2018.

In March 2017, the FASB issued ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715), which requires that the service cost component of net periodic pension and postretirement benefit cost be presented in the same line item as other employee compensation costs, while the other components be presented separately as non-operating income (expense). This ASU became effective beginning in the first quarter of fiscal year 2019. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements and related disclosures.

**(4) REVENUE RECOGNITION***Adoption of ASC Topic 606, Revenue from Contracts with Customers*

On August 1, 2018, the Company adopted Topic 606 using the modified retrospective method applied to those contracts which were not completed as of August 1, 2018. Results for reporting periods beginning after August 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under Topic 605.

The Company recognizes revenue from its contracts with customers primarily from the sale of supply chain management services and marketing solutions offerings. Revenue is recognized when control of the promised goods or services is transferred to a customer, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. For ModusLink's supply chain management services arrangements and IWCO's marketing solutions offerings, the goods and services are considered to be transferred over time as they are performed. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue.

ModusLink's revenue primarily comes from the sale of supply chain management services to its clients. Under the new standard, the majority of these arrangements consist of two distinct performance obligations (i.e. a warehousing and inventory management service and a separate kitting, packaging and assembly service), each of which is recognized over time as services are performed using an input method based on the level of efforts expended. A significant portion of ModusLink's revenue from these arrangements continues to be recognized over time as the services are performed based on an input method of efforts expended which corresponds with the transfer of value to the customer. For the limited population of contracts where the Company previously recognized revenues upon completion of all services and historically recognized revenue at a point in time (generally upon product shipment), the new standard accelerates the recognition of revenue as the Company's performance enhances assets that the customer controls and therefore revenue is recognized over time based on an input method of efforts expended which corresponds with the transfer of value to the customer.

Revenue from the sale of perpetual licenses sold in ModusLink's e-Business operations is now recognized at a point in time upon execution of the relevant license agreement and when delivery has taken place.

Revenue recognized related to the majority of IWCO's marketing solutions offerings, which typically consist of a single integrated performance obligation, is now recognized over time as the Company performs because the products have no alternative use to the Company.

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In accordance with Topic 606, revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods or services, and excludes any sales incentives or taxes collected from customers which are subsequently remitted to government authorities. To achieve this core principle, the Company applies the following five steps:

- 1. Identify the contract(s) with a customer** A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights regarding the goods or services to be transferred and identifies the payment terms related to those goods or services, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for goods or services that are transferred is probable based on the customer's intent and ability to pay the promised consideration. The Company's arrangements with customers are typically documented within a master services agreement (MSA) together with a statement of work (SOW) or business requirements document (BRD). Depending on the nature of the goods and/or services being provided, a contract will be created at the time that the Company and the customer have entered into an MSA and SOW or BRD, and the Company has received some form of authorization or acknowledgment from the customer as to the request for the specified services. For certain goods and/or services, a contract does not exist until the Company receives a firm order to commence the specified activities. The Company applies judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer.
- 2. Identify the performance obligations in the contract** Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the good or service either on its own or together with other resources that are readily available from third parties or from the Company, and are distinct in the context of the contract, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, the Company must apply judgment to determine whether promised goods or services are capable of being distinct and distinct in the context of the contract. If these criteria are not met, the promised goods or services are accounted for as a combined performance obligation.

The Company's contracts typically do not include options that would result in a material right. If options to purchase additional goods or services are included in customer contracts, the Company evaluates the option in order to determine if the Company's arrangement include promises that may represent a material right and needs to be accounted for as a performance obligation in the contract with the customer. The Company did not note any significant provisions within its typical contracts that would create a material right.

- 3. Determine the transaction price** The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods or services to the customer. To the extent the transaction price includes variable consideration, the Company estimates the amount of variable consideration that should be included in the transaction price utilizing either the expected value method or

the most likely amount method depending on the nature of the variable consideration. Variable consideration is included in the transaction price if, in the Company's judgment, it is probable that a significant future reversal of cumulative revenue under the contract will not occur. None of the Company's contracts as of March 31, 2017 contained a significant financing component. Determining the transaction price requires significant judgment

4. **Allocate the transaction price to the performance obligations in the contract** If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation on a relative standalone selling price (SSP) basis unless the transaction price is variable and meets the criteria to be allocated entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation. The Company determines SSP based on the price at which the performance obligation is sold separately. If the SSP is not observable through past transactions, the Company estimates the SSP taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations.
  
5. **Recognize revenue when (or as) the Company satisfies a performance obligation** The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at the time the related performance obligation is satisfied by transferring a promised good or service to a customer.

#### **Disaggregation of Revenue**

The following table presents the Company's revenues disaggregated by major good or service line, timing of revenue recognition, and sales channel (in thousands). The table also includes a reconciliation of the disaggregated revenue with the reportable segments.

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	Three Months Ended January 31, 2019					Consolidated Total
	Americas	Asia	Europe	Direct	e-Business	
				Marketing		
(In thousands)						
<b>Major Goods/Service Lines</b>						
Supply chain management services	\$ 16,709	\$ 44,555	\$ 20,450	\$	\$ 5,452	\$ 87,166
Perpetual software licenses						
Marketing solutions offerings				118,447		118,447
Other					610	610
	\$ 16,709	\$ 44,555	\$ 20,450	\$ 118,447	\$ 6,062	\$ 206,223
<b>Timing of Revenue Recognition</b>						
Goods transferred over time	\$	\$	\$	\$ 118,447	\$	\$ 118,447
Services transferred over time	16,709	44,555	20,450		6,062	87,776
	\$ 16,709	\$ 44,555	\$ 20,450	\$ 118,447	\$ 6,062	\$ 206,223
<b>Total Revenue</b>						
Revenue from contracts with customers	\$ 16,709	\$ 44,555	\$ 20,450	\$ 118,447	\$ 6,062	\$ 206,223
	\$ 16,709	\$ 44,555	\$ 20,450	\$ 118,447	\$ 6,062	\$ 206,223

Over the three month period ended January 31, 2019, the Company had no revenue recognized at a point in time.

	Six Months Ended January 31, 2019					Consolidated Total
	Americas	Asia	Europe	Direct	e-Business	
				Marketing		
(In thousands)						
<b>Major Goods/Service Lines</b>						
Supply chain management services	\$ 34,149	\$ 88,811	\$ 39,971	\$	\$ 10,861	\$ 173,792
Perpetual software licenses						
Marketing solutions offerings				246,541		246,541
Other					1,023	1,023
	\$ 34,149	\$ 88,811	\$ 39,971	\$ 246,541	\$ 11,884	\$ 421,356
<b>Timing of Revenue Recognition</b>						
Goods transferred over time	\$	\$	\$	\$ 246,541	\$	\$ 246,541
Services transferred over time	34,149	88,811	39,971		11,884	174,815
	\$ 34,149	\$ 88,811	\$ 39,971	\$ 246,541	\$ 11,884	\$ 421,356
<b>Total Revenue</b>						
Revenue from contracts with customers	\$ 34,149	\$ 88,811	\$ 39,971	\$ 246,541	\$ 11,884	\$ 421,356
	\$ 34,149	\$ 88,811	\$ 39,971	\$ 246,541	\$ 11,884	\$ 421,356

Over the six month period ended January 31, 2019, the Company had no revenue recognized at a point in time.

Prior period amounts have not been adjusted under the modified retrospective method.

*Supply chain management services.*

ModusLink's revenue primarily comes from the sale of supply chain management services to its clients. Amounts billed to customers under these arrangements include revenue attributable to the services performed as well as for materials procured on the customer's behalf as part of its service to them. The majority of these arrangements consist of two distinct performance obligations (i.e. warehousing/inventory management service and a separate kitting/packaging/assembly service), revenue related to each of which is recognized over time as services are performed using an input method based on the level of efforts expended.

*Perpetual software licenses.*

Revenue from the sale of perpetual software licenses in the Company's e-Business operations is recognized at a point in time upon execution of the relevant license agreement and when delivery has taken place.

*Marketing solutions offerings.*

IWCO's revenue is generated through the provision of data-driven marketing solutions, primarily through providing direct mail products to customers. Revenue related to the majority of IWCO's marketing solutions contracts, which typically consist of a single integrated performance obligation, is recognized over time as the Company performs because the products have no alternative use to the Company.



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### *Other.*

Other revenue consists of cloud-based software subscriptions, software maintenance and support service contracts, and fees for professional services. Revenue related to these arrangements is recognized on a straight-line basis over the term of the agreement or over the term of the agreement in proportion to the costs incurred in satisfying the obligations under the contract.

## **Significant Judgments**

The Company's contracts with customers may include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. For arrangements with multiple performance obligations, the Company allocates revenue to each performance obligation based on its relative standalone selling price. Judgment is required to determine the standalone selling price for each distinct performance obligation. The Company generally determines standalone selling prices based on the prices charged to customers and uses a range of amounts to estimate standalone selling prices when we sell each of the products and services separately and need to determine whether there is a discount that needs to be allocated based on the relative standalone selling prices of the various products and services. The Company typically has more than one range of standalone selling prices for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, the Company may use information such as the type of customer and geographic region in determining the range of standalone selling prices.

The Company may provide credits or incentives to customers, which are accounted for as variable consideration when estimating the transaction price of the contract and amounts of revenue to recognize. The amount of variable consideration to include in the transaction price is estimated at contract inception using either the estimated value method or the most likely amount method based on the nature of the variable consideration. These estimates are updated at the end of each reporting period as additional information becomes available and revenue is recognized only to the extent that it is probable that a significant reversal of any amounts of variable consideration included in the transaction price will not occur.

## **Practical Expedients and Exemptions**

The Company has elected to make the following accounting policy elections through the adoption of the following practical expedients:

### *Right to Invoice*

Where applicable, the Company will recognize revenue from a contract with a customer in an amount that corresponds directly with the value to the customer of the Company's performance completed to date and the amount to which the entity has a right to invoice.

### *Sales and Other Similar Taxes*

The Company will exclude sales taxes and similar taxes from the measurement of transaction price and will ensure that it complies with the disclosure requirements of ASC 235-10-50-1 through 50-6.

### *Significant Financing Component*

The Company will not adjust the promised amount of consideration for the effects of a significant financing component if the Company expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

*Cost to Obtain a Contract*

The Company will recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the Company otherwise would have recognized is one year or less and there are no renewal periods on which the Company does not pay commissions that are not commensurate with those originally paid.

*Promised Goods or Services that are Immaterial in the Context of a Contract*

The Company has elected to assess promised goods or services as performance obligations that are deemed to be immaterial in the context of a contract. As such, the Company will not aggregate and assess immaterial items at the entity level. That is, when determining whether a good or service is immaterial in the context of a contract, the assessment will be made based on the application of ASC 606 at the contract level.

**Table of Contents****Contract Balances**

Timing of revenue recognition may differ from timing of invoicing to customers. The Company records contract assets and liabilities related to its contracts with customers as follows:

Accounts receivable when revenue is recognized prior to receipt of cash payments and if the right to such amounts is unconditional and solely based on the passage of time

Contract asset when the Company recognizes revenue based on efforts expended but the right to such amount is conditional upon satisfaction of another performance obligation. Contract assets are primarily comprised of fees related to marketing solutions offerings and supply chain management services. The Company notes that its contract assets are all short-term in nature and are included in prepaid expenses and other current assets in the Company's condensed consolidated balance sheets

Deferred revenue when cash payments are received or due in advance of performance. Deferred revenue is primarily comprised of fees related to supply chain management services, cloud-based software subscriptions and software maintenance and support service contracts, which are generally billed in advance. Deferred revenue also includes other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. The deferred revenue balance is classified as a component of other current liabilities and other long-term liabilities on the balance sheet.

The opening balance of contract assets was \$24.0 million as of August 1, 2018. As of January 31, 2019, the contract asset balance was \$20.2 million. Contract assets are classified as accounts receivable, trade, upon billing to the customer where such amounts become unconditional.

The opening balance of current deferred revenue and long-term deferred revenue was \$3.7 million and \$0.2 million, respectively, as of August 1, 2018. As of January 31, 2019, current deferred revenue and long-term deferred revenue was \$5.1 million and \$0.2 million, respectively.

Changes in deferred revenue during the six months ended January 31, 2019, were as follows (in thousands):

<b>Six Months Ended January 31, 2019</b>	
Balance at beginning of period	\$ 3,858
Deferral of revenue	2,689
Recognition of deferred amounts upon satisfaction of performance obligation	(1,296)
<b>Balance at end of period</b>	<b>\$ 5,251</b>

We expect to recognize approximately \$5.1 million of the unearned amount over the twelve months ended January 31, 2020 and the remaining \$0.2 million beyond January 31, 2020.

**Assets Recognized from the Costs to Obtain a Contract with a Customer**

Prior to the adoption of Topic 606, the Company expensed incremental costs to obtain a contract, which represented commissions, as the liability was incurred. In accordance with Topic 606, the Company recognizes an asset for the incremental costs of obtaining a contract with a customer if the period over which such costs would be amortized is greater than one year. The Company has determined that certain commissions programs meet the requirements to be capitalized. However, as of August 1, 2018, the total commission expense that had been incurred under the commissions programs identified was not material and therefore, the Company determined that no amounts were required to be capitalized at the date of adoption. For the three and six months ended January 31, 2019, the total commission expense that had been incurred under the commissions programs identified was not material and the Company determined that no amounts were required to be capitalized at January 31, 2019.

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

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The cumulative effect of the changes made to the Company's consolidated August 1, 2018 balance sheet for the adoption of Topic 606 were as follows (in thousands):

**Balance Sheet**

	July 31, 2018	Adjustments Due to ASU 2014-09	August 1, 2018
<b>Assets</b>			
Inventories, net	\$ 47,786	\$ (21,233)	\$ 26,553
Prepaid expenses and other current assets	13,415	24,041	37,456
Total current assets	264,281	2,808	267,089
Total assets	\$ 827,050	\$ 2,808	\$ 829,858
<b>Liabilities</b>			
Other Current Liabilities	\$ 42,125	\$ (3,330)	\$ 38,795
Total current liabilities	276,356	(3,330)	273,026
Total liabilities	684,230	(3,330)	680,900
<b>Stockholders' equity</b>			
Accumulated deficit	(7,363,569)	6,138	(7,357,431)
Total stockholders' equity	107,628	6,138	113,766
Total liabilities, contingently redeemable preferred stock and stockholders' equity	\$ 827,050	\$ 2,808	\$ 829,858

The Company reduced opening accumulated deficit by \$6.1 million as of August 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact attributable to the acceleration of revenue related to ModusLink's supply chain management services arrangements and IWCO's marketing solutions offerings where the Company previously recognized revenues upon completion of all services and historically recognized revenue at a point in time (generally upon product shipment or when the products were complete). The adoption of ASC 606 primarily resulted in an acceleration of revenue as of August 1, 2018, which in turn generated additional deferred tax liabilities that ultimately reduced the Company's net deferred tax asset position. As the Company fully reserves its net deferred tax assets in the jurisdictions impacted by the adoption of Topic 606, this impact was offset by a corresponding reduction to the valuation allowance.

In accordance with the requirements of the new standard, the disclosure of the impact of the adoption on the Company's consolidated balance sheet and statement of operations was as follows (in thousands, except per share amounts):

<b>Balance Sheet:</b>	<b>As Reported</b>	<b>January 31, 2019 Balances without Adoption of ASC 606</b>	<b>Effect of Change Higher/(Lower)</b>
<b>Assets</b>			
Inventories, net	\$ 29,431	\$ 50,317	\$ (20,886)
Prepaid expenses and other current assets	33,278	13,076	20,202

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Total current assets	268,275	268,959	(684)
Total assets	\$ 811,044	\$ 811,728	\$ (684)
<b>Liabilities</b>			
Other Current Liabilities	\$ 39,605	\$ 46,396	\$ (6,791)
Total current liabilities	276,209	283,000	(6,791)
Total liabilities	681,309	688,100	(6,791)
<b>Stockholders equity</b>			
Accumulated deficit	(7,377,622)	(7,383,729)	6,107
Total stockholders equity	94,537	88,430	6,107
Total liabilities, contingently redeemable preferred stock and stockholders equity	\$ 811,044	\$ 811,728	\$ (684)

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<b>Statement of Operations:</b>	<b>Three Months Ended January 31, 2019</b>		
	<b>As Reported</b>	<b>Balances without Adoption of ASC 606</b>	<b>Effect of Change Higher/(Lower)</b>
Net revenue	\$ 206,223	\$ 207,526	\$ (1,303)
Cost of revenue	168,680	169,217	(537)
Gross profit	37,543	38,309	(766)
Loss before income taxes	(10,348)	(9,582)	(766)
Net loss	(11,753)	(10,987)	(766)
Net loss attributable to common stockholders	\$ (12,289)	\$ (11,523)	\$ (766)
Basic and diluted net loss per share attributable to common stockholders:	\$ (0.20)	\$ (0.19)	\$ (0.01)

The impact to revenues for the three month period ended January 31, 2019 was a decrease of \$1.3 million as a result of applying Topic 606 primarily related to the offset of previous quarters acceleration of revenue related to IWCO's marketing solutions arrangements for certain contracts with customers that under Topic 606 are being recognized over time based on an input method of efforts expended which depicts the transfer of value to the customer.

<b>Statement of Operations:</b>	<b>Six Months Ended January 31, 2019</b>		
	<b>As Reported</b>	<b>Balances without Adoption of ASC 606</b>	<b>Effect of Change Higher/(Lower)</b>
Net revenue	\$ 421,356	\$ 421,734	\$ (378)
Cost of revenue	345,613	345,960	(347)
Gross profit	75,743	75,774	(31)
Loss before income taxes	(16,602)	(16,571)	(31)
Net loss	(19,118)	(19,087)	(31)
Net loss attributable to common stockholders	\$ (20,191)	\$ (20,160)	\$ (31)
Basic and diluted net loss per share attributable to common stockholders:	\$ (0.33)	\$ (0.33)	\$ (0.00)

The impact to revenues for the six month period ended January 31, 2019 was a decrease of \$0.4 million as a result of applying Topic 606 primarily related to the offset of previous quarters acceleration of revenue related to ModusLink's supply chain management solutions arrangements for certain contracts with customers that under Topic 606 are being recognized over time based on an input method of efforts expended which depicts the transfer of value to the customer.

**(5) INVENTORIES**

Inventories are stated at the lower of cost or net realizable value. Cost is determined by both the moving average and the first-in, first-out methods. Materials that the Company typically procures on behalf of its clients that are included in inventory include materials such as compact discs, printed materials, manuals, labels, hardware accessories, hard disk drives, phone chassis, consumer packaging, shipping boxes and labels, power cords and cables for client-owned electronic devices.





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Inventories, net consisted of the following:

	<b>January 31, 2019</b>	<b>July 31, 2018</b>
	<b>(In thousands)</b>	
Raw materials	\$ 26,705	\$ 23,208
Work-in-process	320	16,147
Finished goods	2,406	8,431
	<b>\$ 29,431</b>	<b>\$ 47,786</b>

The Company continuously monitors inventory balances and records inventory provisions for any excess of the cost of the inventory over its estimated net realizable value. The Company also monitors inventory balances for obsolescence and excess quantities as compared to projected demands. The Company's inventory methodology is based on assumptions about average shelf life of inventory, forecasted volumes, forecasted selling prices, contractual provisions with its clients, write-down history of inventory and market conditions. While such assumptions may change from period to period, in determining the net realizable value of its inventories, the Company uses the best information available as of the balance sheet date. If actual market conditions are less favorable than those projected, or the Company experiences a higher incidence of inventory obsolescence because of rapidly changing technology and client requirements, additional inventory provisions may be required. Once established, write-downs of inventory are considered permanent adjustments to the cost basis of inventory and cannot be reversed due to subsequent increases in demand forecasts. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, gross profit margins may be favorably impacted. IWCO's inventory consists primarily of raw materials (paper) used to produce direct mail packages and work-in-process. Finished goods are generally not a significant element of the inventory as they are generally mailed after the production and sorting process.

**(6) GOODWILL AND INTANGIBLE ASSETS**

The Company's goodwill of \$257.1 million as of January 31, 2019 relates to the Company's Direct Marketing reporting unit. The purchase price allocation, associated with the acquisition of IWCO Direct during December 2017, has been completed during the 12 months from the acquisition date. Adjustments made during the six months ended January 31, 2019 totaled \$2.8 million which primarily related to the re-evaluation of equipment that was idle as of the purchase date.

The following table summarizes the preliminary fair value of assets acquired and liabilities assumed at the date of the acquisition:

	<b>As Originally Reported</b>	<b>Adjustments (In thousands)</b>	<b>As Revised</b>
Accounts receivable	\$ 47,841	\$ (433)	\$ 47,408
Inventory	27,165	5,829	32,994
Other current assets	7,427	3,197	10,624
Property and equipment	87,976	477	88,453

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Intangible assets	210,920	2,330	213,250
Goodwill	259,085	(1,957)	257,128
Other assets	3,040		3,040
Accounts payable	(31,069)		(31,069)
Accrued liabilities and other current liabilities	(35,790)	(30,368)	(66,158)
Customer deposits	(7,829)		(7,829)
Deferred income taxes	(79,918)	2,755	(77,163)
Other liabilities	(19,627)	18,170	(1,457)
<b>Total consideration</b>	<b>\$ 469,221</b>	<b>\$</b>	<b>\$ 469,221</b>

The Company conducts its goodwill impairment test on July 31 of each fiscal year. In addition, if and when events or circumstances change that could reduce the fair value of any of its reporting units below its carrying value, an interim test is performed. In making this assessment, the Company relies on a number of factors including operating results, business plans, economic projections, anticipated future cash flows, and transactions and marketplace data. The Company's goodwill of \$257.1 million as of January 31, 2019 relates to the Company's Direct Marketing reporting unit. There were no indicators of impairment identified related to the Company's Direct Marketing reporting unit during the three months ended January 31, 2019.

Intangible assets, as of January 31, 2019, include trademarks and tradenames with a carrying balance of \$12.8 million and customer relationships of \$164.2 million. The trademarks and tradenames intangible asset are being amortized on a straight line basis over a 3 year estimated useful life. The customer relationship intangible asset is being amortized on a double-declining basis over an estimated useful life of 15 years. Intangible assets deemed to have finite lives are amortized over their estimated useful lives, where the useful life is the period over which the asset is expected to contribute directly, or indirectly, to its future cash flows. Intangible assets are reviewed for impairment on an interim basis when certain events or circumstances exist. For amortizable intangible assets, impairment exists when the carrying amount of the intangible asset exceeds its fair value. An analysis was performed with no indicators of impairment identified for the company's intangible assets at January 31, 2019.

**Table of Contents****(7) ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

The following table reflects the components of Accrued expenses and Other current liabilities :

	<b>January 31, 2019</b>	<b>July 31, 2018</b>
	<b>(In thousands)</b>	
Accrued sales taxes	\$ 21,704	\$ 21,390
Accrued other taxes	6,430	8,414
Accrued compensation	28,029	25,603
Accrued interest	1,192	1,437
Accrued audit, tax and legal	2,977	3,264
Accrued contract labor	2,058	1,932
Accrued worker's compensation	5,292	6,126
Accrued other	20,656	20,260
	<b>\$ 88,338</b>	<b>\$ 88,426</b>

	<b>January 31, 2019</b>	<b>July 31, 2018</b>
	<b>(In thousands)</b>	
Accrued pricing liabilities	\$ 18,882	\$ 18,882
Customer postage deposits	10,440	12,638
Other	10,283	10,509
	<b>\$ 39,605</b>	<b>\$ 42,029</b>

As of January 31, 2019 and July 31, 2018, the Company had accrued pricing liabilities of approximately \$18.9 million. As previously reported by the Company, several principal adjustments were made to its historic financial statements for periods ending on or before January 31, 2012, the most significant of which related to the treatment of vendor rebates in its pricing policies. Where the retention of a rebate or a mark-up was determined to have been inconsistent with a client contract (collectively referred to as pricing adjustments), the Company concluded that these amounts were not properly recorded as revenue. Accordingly, revenue was reduced by an equivalent amount for the period that the rebate was estimated to have been affected. A corresponding liability for the same amount was recorded in that period (referred to as accrued pricing liabilities). The Company believes that it may not ultimately be required to pay all or any of the accrued pricing liabilities based upon the expiration of statutes of limitations or legal relief, and due in part to the nature of the interactions with its clients. The remaining accrued pricing liabilities at January 31, 2019 will be derecognized when there is sufficient information for the Company to conclude that such liabilities are not subject to escheatment and have been extinguished, which may occur through payment, legal release, or other legal or factual determination. The Company has not provided for any provision for interest and or penalties related to escheatment as it has concluded that such is not probable to occur and any potential interest and penalties cannot be reasonably estimated.

**(8) DEBT**

*5.25% Convertible Senior Notes Payable*

On March 18, 2014, the Company entered into an indenture (the Indenture ) with Wells Fargo Bank, National Association, as trustee, relating to the Company's issuance of \$100 million of 5.25% Convertible Senior Notes (the Notes ). The Notes matured on March 1, 2019, at which time the balance due was paid in full (see note 21). The Notes bear interest at the rate of 5.25% per year, payable semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2014.

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The Company valued the debt using similar nonconvertible debt as of the original issuance date of the Notes and bifurcated the conversion option associated with the Notes from the host debt instrument and recorded the conversion option of \$28.1 million in stockholders' equity prior to the allocation of debt issuance costs. The initial value of the equity component, which reflected the equity conversion feature, was equal to the initial debt discount. The resulting debt discount on the Notes was being accreted to interest expense at the effective interest rate over the estimated life of the Notes. The equity component was included in the additional paid-in-capital portion of stockholders' equity on the Company's consolidated balance sheet. In addition, the debt issuance costs of \$3.4 million were allocated between the liability and equity components in proportion to the allocation of the proceeds. The issuance costs allocated to the liability component (\$2.5 million) were capitalized as a reduction of the principal amount of the Notes payable on the Company's balance sheet and amortized, using the effective-interest method, as additional interest expense over the term of the Notes. The issuance costs allocated to the equity component was recorded as a reduction to additional paid-in capital.

During the six months ended January 31, 2019, the Company purchased \$3.7 million in face value of the Notes in the open market at a purchase price of \$3.7 million. The loss of \$0.1 million on this transaction is presented as a component of other gains and losses. The fair value of the Company's Notes payable, calculated as of the closing price of the traded securities, was \$63.9 million and \$66.7 million as of January 31, 2019 and July 31, 2018, respectively. This value does not represent the settlement value of these debt liabilities to the Company. The fair value of the Notes payable could vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The Notes payable are traded and their fair values are based upon traded prices as of the reporting dates. As of January 31, 2019 and July 31, 2018, the net carrying value of the Notes was \$63.5 million and \$64.5 million, respectively. As of January 31, 2019 and July 31, 2018, SPHG Holdings held \$14.9 million principal amount of the Notes.

	<b>January 31, 2019</b>	<b>July 31, 2018</b>
	<b>(In thousands)</b>	
Carrying amount of equity component (net of allocated debt issuance costs)	\$ 26,961	\$ 26,961
Principal amount of Notes	\$ 63,925	\$ 67,625
Unamortized debt discount	(430)	(2,843)
Unamortized debt issuance costs	(38)	(252)
<b>Net carrying amount</b>	<b>\$ 63,457</b>	<b>\$ 64,530</b>

As of January 31, 2019, the remaining period over which the unamortized discount will be amortized is 1 month.

	<b>Three Months Ended January 31, 2019</b>		<b>Six Months Ended January 31, 2019</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
Interest expense related to contractual interest coupon	\$ 856	\$ 913	\$ 1,646	\$ 1,827
Interest expense related to accretion of the discount	1,260	1,076	2,311	2,117

Interest expense related to debt issuance costs	112	95	205	187
	\$ 2,228	\$ 2,084	\$ 4,162	\$ 4,131

During each of the three months ended January 31, 2019 and 2018, the Company recognized interest expense associated with the Notes of \$2.2 million and \$2.1 million, respectively. During the six months ended January 31, 2019 and 2018, the Company recognized interest expense associated with the Notes of \$4.2 million and \$4.1 million, respectively. The effective interest rate on the Notes, including amortization of debt issuance costs and accretion of the discount, is 13.9%. The Notes bear interest of 5.25%.

#### *PNC Bank Credit Facility*

On June 30, 2014, two direct and wholly owned subsidiaries of the Company (the Borrowers ) entered into a Credit Agreement, as borrowers and guarantors, with PNC Bank and National Association, as lender and as agent, respectively.

The Credit Agreement has a five (5) year term which expires on June 30, 2019. It includes a maximum credit commitment of \$50.0 million, is available for letters of credit (with a sublimit of \$5.0 million) and has a \$20.0 million uncommitted accordion feature. The actual maximum credit available under the Credit Agreement varies from time to time and is determined by calculating the applicable borrowing base, which is based upon applicable percentages of the values of eligible accounts receivable and eligible inventory minus reserves determined by the Agent (including other reserves that the Agent may establish from time to time in its permitted discretion), all as specified in the Credit Agreement.

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Generally, borrowings under the Credit Agreement bear interest at a rate per annum equal to, at the Borrowers' option, either (a) LIBOR (adjusted to reflect any required bank reserves) for an interest period equal to one, two or three months (as selected by the Borrowers) plus a margin of 2.25% per annum or (b) a base rate determined by reference to the highest of (1) the base commercial lending rate publicly announced from time to time by PNC Bank, National Association, (2) the sum of the Federal Funds Open Rate in effect on such day plus one half of one percent (0.5%) per annum, or (3) the LIBOR rate (adjusted to reflect any required bank reserves) in effect on such day plus 1.00% per annum. In addition to paying interest on outstanding principal under the Credit Agreement, the Borrowers are required to pay a commitment fee, in respect of the unutilized commitments thereunder, of 0.25% per annum, paid quarterly in arrears. The Borrowers are also required to pay a customary letter of credit fee equal to the applicable margin on revolving credit LIBOR loans and fronting fees.

Obligations under the Credit Agreement are guaranteed by the Borrowers' existing and future direct and indirect wholly-owned domestic subsidiaries, subject to certain limited exceptions; and the Credit Agreement is secured by security interests in substantially all the Borrowers' assets and the assets of each subsidiary guarantor, whether owned as of the closing or thereafter acquired, including a pledge of 100.0% of the equity interests of each subsidiary guarantor that is a domestic entity (subject to certain limited exceptions) and 65.0% of the voting equity interests of any direct first tier foreign entity owned by either Borrower or by a subsidiary guarantor. The Company is not a borrower or a guarantor under the Credit Agreement.

The Credit Agreement contains certain customary negative covenants, which include limitations on mergers and acquisitions, the sale of assets, liens, guarantees, investments, loans, capital expenditures, dividends, indebtedness, changes in the nature of business, transactions with affiliates, the creation of subsidiaries, changes in fiscal year and accounting practices, changes to governing documents, compliance with certain statutes, and prepayments of certain indebtedness. The Credit Agreement also contains certain customary affirmative covenants (including periodic reporting obligations) and events of default, including upon a change of control. The Credit Agreement requires compliance with certain financial covenants providing for maintenance of specified liquidity, maintenance of a minimum fixed charge coverage ratio and/or maintenance of a maximum leverage ratio following the occurrence of certain events and/or prior to taking certain actions, all as more fully described in the Credit Agreement. The Company believes that the Credit Agreement provides greater financial flexibility to the Company and the Borrowers and may enhance their ability to consummate one or several larger and/or more attractive acquisitions and should provide our clients and/or potential clients with greater confidence in the Company's and the Borrowers' liquidity. At January 31, 2019, the Company had a readily available borrowing capacity under its PNC Bank Credit Facility of \$4.6 million. During the three and six months ended January 31, 2019, the Company did not meet the criteria that would cause its financial covenants to be applicable. As of January 31, 2019 and July 31, 2018, the Company did not have any balance outstanding on the PNC Bank credit facility.

#### *Cerberus Credit Facility*

On December 15, 2017, MLGS, a wholly owned subsidiary of the Company, entered into a Financing Agreement (the "Financing Agreement"), by and among the MLGS (as the initial borrower), Instant Web, LLC, a Delaware corporation and wholly owned subsidiary of IWCO (as "Borrower"), IWCO, and certain of IWCO's subsidiaries (together with IWCO, the "Guarantors"), the lenders from time to time party thereto, and Cerberus Business Finance, LLC, as collateral agent and administrative agent for the lenders. MLGS was the initial borrower under the Financing Agreement, but immediately upon the consummation of the IWCO Acquisition, as described above, Borrower became the borrower under the Financing Agreement.

The Financing Agreement provides for \$393.0 million term loan facility (the "Term Loan") and a \$25.0 million revolving credit facility (the "Revolving Facility") (together, the "Cerberus Credit Facility"). Proceeds of the Cerberus

Credit Facility were used (i) to finance a portion of the IWCO Acquisition, (ii) to repay certain existing indebtedness of the Borrower and its subsidiaries, (iii) for working capital and general corporate purposes and (iv) to pay fees and expenses related to the Financing Agreement and the IWCO Acquisition.

The Cerberus Credit Facility has a maturity of five years. Borrowings under the Cerberus Credit Facility bear interest, at the Borrower's option, at a Reference Rate plus 3.75% or a LIBOR Rate plus 6.5%, each as defined the Financing Agreement. The initial interest rate under the Cerberus Credit Facility is at the LIBOR Rate option.

The Term Loan under the Cerberus Credit Facility is repayable in consecutive quarterly installments, each of which will be in an amount equal per quarter of \$1.5 million and each such installment to be due and payable, in arrears, on the last day of each calendar quarter commencing on March 31, 2018 and ending on the earlier of (a) December 15, 2022 and (b) upon the payment in full of all obligations under the Financing Agreement and the termination of all commitments under the Financing Agreement. Further, the Term



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Loan would be permanently reduced pursuant to certain mandatory prepayment events including an annual excess cash flow sweep of 50% of the consolidated excess cash flow, with a step-down to 25% when the Leverage Ratio (as defined in the Financing agreement) is below 3.50:1.00; provided that, in any calendar year, any voluntary prepayments of the Term Loan shall be credited against the Borrower's excess cash flow prepayment obligations on a dollar-for-dollar basis for such calendar year.

Borrowings under the Financing Agreement are fully guaranteed by the Guarantors and are collateralized by substantially all the assets of the Borrower and the Guarantors and a pledge of all of the issued and outstanding equity interests of each of IWCO's subsidiaries.

The Financing Agreement contains certain representations, warranties, events of default, mandatory prepayment requirements, as well as certain affirmative and negative covenants customary for financing agreements of this type. These covenants include restrictions on borrowings, investments and dispositions, as well as limitations on the ability of the Borrower and the Guarantors to make certain capital expenditures and pay dividends. Upon the occurrence and during the continuation of an event of default under the Financing Agreement, the lenders under the Financing Agreement may, among other things, terminate all commitments and declare all or a portion of the loans under the Financing Agreement immediately due and payable and increase the interest rate at which loans and obligations under the Financing Agreement bear interest.

At January 31, 2019, IWCO had a readily available borrowing capacity under its Revolving Facility of \$25.0 million. As of January 31, 2019 and July 31, 2018, the Company did not have an outstanding balance on the Revolving Facility. As of January 31, 2019 and July 31, 2018, the principal amount outstanding on the Term Loan was \$387.0 million and \$390.0 million, respectively. As of January 31, 2019 and July 31, 2018, the current and long-term net carrying value of the Term Loan was \$386.0 million and \$388.8 million, respectively.

	<b>January 31, 2019</b>	<b>July 31, 2018</b>
	<b>(In thousands)</b>	
Principal amount outstanding on the Term Loan	\$ 387,000	\$ 390,000
Unamortized debt issuance costs	(1,025)	(1,162)
<b>Net carrying value of the Term Loan</b>	<b>\$ 385,975</b>	<b>\$ 388,838</b>

**(9) CONTINGENCIES**

On April 13, 2018, a purported shareholder, Donald Reith, filed a verified complaint, *Reith v. Lichtenstein, et al.*, 2018-0277 (Del. Ch.) in the Delaware Court of Chancery. The complaint alleges class and derivative claims for breach of fiduciary duty and/or aiding and abetting breach of fiduciary duty and unjust enrichment against the Company's Board of Directors (the Board), Warren Lichtenstein, Glen Kassan, William T. Fejes, Jack L. Howard, Jeffrey J. Fenton, Philip E. Lengyel and Jeffrey S. Wald; and stockholders Steel Holdings, Steel Partners, L.P., SPHG Holdings, Handy & Harman Ltd. and WHX CS Corp. (collectively, Steel Parties) in connection with the acquisition of \$35 million of the Series C Preferred Stock by SPHG Holdings and equity grants made to Lichtenstein, Howard and Fejes on December 15, 2017 (collectively, Challenged Transactions). The Company is named as a nominal defendant. The complaint alleges that although the Challenged Transactions were approved by a Special Committee consisting of the independent members of the Board (Messrs. Fenton, Lengyel and Wald), the Steel Parties dominated and controlled the Special Committee, who approved the Challenged Transactions in breach of their fiduciary duty.

Plaintiff alleges that the Challenged Transactions unfairly diluted shareholders and therefore unjustly enriched Steel Holdings, SPHG Holdings and Messrs. Lichtenstein, Howard and Fejes. The complaint also alleges that the Board made misleading disclosures in the Company's proxy statement for the 2017 meeting in connection with seeking approval to amend the 2010 Incentive Award Plan to authorize the issuance of additional shares to accommodate certain shares underlying the equity grants. Remedies requested include rescission of the Series C Convertible Preferred Stock and equity grants, disgorgement of any unjustly obtained property or compensation and monetary damages.

On June 18, 2018, defendants moved to dismiss the complaint for failure to plead demand futility and failure to state a claim. The motions are fully briefed, and argument was held March 5, 2019. On March 5, 2019, the Court of Chancery heard oral argument on (i) the motion to dismiss the Reith complaint and (ii) Ladjevardian's (see below) motion to intervene and stay. The Court took the motion to dismiss under advisement. Discovery is stayed pending a decision on the motions to dismiss. Because the litigation is at an early stage and motions to dismiss are pending, we are unable at this time to provide a calculation of potential damages or litigation loss that is probable or estimable. Although there can be no assurance as to the ultimate outcome, the Company believes it has meritorious defenses, has denied liability, and intends to defend this litigation vigorously.

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On January 18, 2019, Mohammad Ladjevardian, a purported shareholder, filed a verified complaint pursuant to 8 Del. C. § 220. The complaint seeks previously demanded books and records concerning the matters in Ladjevardian's letters dated January 29, 2018, and August 21, 2018. The complaint does not seek money damages, but does request an award of reasonable attorneys' fees and costs incurred in pursuing the action. Steel Connect filed an Answer on February 7, 2019. On February 20, 2019, the Court entered a scheduling order. Trial in this matter is scheduled for June 26, 2019. Ladjevardian moved to intervene in the Reith matter. On March 5, 2019, the Court took the motion under advisement and denied Ladjevardian's motion to intervene.

**(10) STOCKHOLDERS' EQUITY***Preferred Stock*

The Company's Board of Directors (the Board) has the authority, subject to any limitations prescribed by Delaware law, to issue shares of preferred stock in one or more series and to fix and determine the designation, privileges, preferences and rights and the qualifications, limitations and restrictions of those shares, including dividend rights, conversion rights, voting rights, redemption rights, terms of sinking funds, liquidation preferences and the number of shares constituting any series or the designation of the series, without any further vote or action by the stockholders. Any shares of the Company's preferred stock so issued may have priority over its common stock with respect to dividend, liquidation and other rights. The Company's board of directors may authorize the issuance of preferred stock with voting rights or conversion features that could adversely affect the voting power or other rights of the holders of its common stock. Although the issuance of preferred stock could provide us with flexibility in connection with possible acquisitions and other corporate purposes, under some circumstances, it could have the effect of delaying, deferring or preventing a change of control.

On December 15, 2017, the Company entered into a Preferred Stock Purchase Agreement (the Purchase Agreement) with SPH Group Holdings LLC (SPHG Holdings), pursuant to which the Company issued 35,000 shares of the Company's newly created Series C Convertible Preferred Stock, par value \$0.01 per share (the Preferred Stock), to SPHG Holdings at a price of \$1,000 per share, for an aggregate purchase consideration of \$35.0 million (the Preferred Stock Transaction). The terms, rights, obligations and preferences of the Preferred Stock are set forth in a Certificate of Designations, Preferences and Rights of Series C Convertible Preferred Stock of the Company (the Series C Certificate of Designations), which has been filed with the Secretary of State of the State of Delaware.

Under the Series C Certificate of Designations, each share of Preferred Stock can be converted into shares of the Company's common stock, par value \$0.01 per share (the Common Stock), at an initial conversion price equal to \$1.96 per share, subject to appropriate adjustments for any stock dividend, stock split, stock combination, reclassification or similar transaction. Holders of the Preferred Stock will also receive dividends at 6% per annum payable in cash or Common Stock. If at any time the closing bid price of the Company's Common Stock exceeds 170% of the conversion price for at least five consecutive trading days (subject to appropriate adjustments for any stock dividend, stock split, stock combination, reclassification or similar transaction), the Company has the right to require each holder of Preferred Stock to convert all, or any whole number, of shares of the Preferred Stock into Common Stock.

Upon the occurrence of certain triggering events such as a liquidation, dissolution or winding up of the Company, either voluntary or involuntary, or the merger or consolidation of the Company or significant subsidiary, or the sale of substantially all of the assets or capital stock of the Company or a significant subsidiary, the holders of the Preferred Stock are entitled to receive, prior and in preference to any distribution of any of the assets or funds of the Company to the holders of other equity or equity equivalent securities of the Company other than the Preferred Stock by reason of their ownership thereof, an amount per share in cash equal to the sum of (i) one hundred percent (100%) of the stated value per share of Preferred Stock (initially \$1,000 per share) then held by them (as adjusted for any stock split,

stock dividend, stock combination or other similar transactions with respect to the Preferred Stock), plus (ii) 100% of all declared but unpaid dividends, and all accrued but unpaid dividends on each such share of Preferred Stock, in each case as the date of the triggering event. On or after December 15, 2022, each holder of Preferred Stock can also require the Company to redeem its Preferred Stock in cash at a price equal to the Liquidation Preference (as defined in Series C Certificate of Designations).

Each holder of Preferred Stock has a vote equal to the number of shares of Common Stock into which its Preferred Stock would be convertible as of the record date, provided that the number of shares voted is based upon a conversion price which is no less than the greater of the book or market value of the Common Stock on the closing date of the purchase of the Preferred Stock. In addition, for so long as the Preferred Stock remains outstanding, the Company will not, directly or indirectly, and including in each case with respect to any significant subsidiary, without the affirmative vote of the holders of a majority of the Preferred Stock (i) liquidate, dissolve or wind up the Company or any significant subsidiary; (ii) consummate any transaction that would constitute or result in a Liquidation Event (as defined in the Series C Certificate of Designations); (iii) effect or consummate any Prohibited Issuance (as defined in the Series C Certificate of Designations); or (iv) create, incur, assume or suffer to exist any Indebtedness (as defined in the Series C Certificate of Designations) of any kind, other than certain existing Indebtedness of the Company and any replacement financing thereto, unless any such replacement financing be on substantially similar terms as such existing Indebtedness.

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The Purchase Agreement provides that the Company will use its commercially reasonable efforts to effect the piggyback registration of the Common Stock issuable on the conversion of the Preferred Stock and any securities issued or issuable upon any stock split, dividend or other distribution, recapitalization or similar event with respect to the foregoing, with the Securities and Exchange Commission in all states reasonably requested by the holder in accordance with certain enumerated conditions. The Purchase Agreement also contains other representations, warranties and covenants, customary for an issuance of Preferred Stock in a private placement of this nature.

The Preferred Stock Transaction was approved and recommended to the Board by a special committee of the Board (the Special Committee ) consisting of independent directors not affiliated with Steel Partners Holdings GP Inc. ( Steel Holdings GP ), which controls the power to vote and dispose of the securities held by SPHG Holdings and its affiliates.

*Common Stock*

Each holder of the Company's common stock is entitled to:

one vote per share on all matters submitted to a vote of the stockholders, subject to the rights of any preferred stock that may be outstanding;

dividends as may be declared by the Company's board of directors out of funds legally available for that purpose, subject to the rights of any preferred stock that may be outstanding; and

a pro rata share in any distribution of the Company's assets after payment or providing for the payment of liabilities and the liquidation preference of any outstanding preferred stock in the event of liquidation.

Holders of the Company's common stock have no cumulative voting rights, redemption rights or preemptive rights to purchase or subscribe for any shares of its common stock or other securities. All of the outstanding shares of common stock are fully paid and nonassessable. The rights, preferences and privileges of holders of its common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any existing series of preferred stock and any series of preferred stock that the Company may designate and issue in the future. There are no redemption or sinking fund provisions applicable to the Company's common stock.

On March 12, 2013, stockholders of the Company approved the sale of 7,500,000 shares of newly issued Common Stock to Steel Partners Holdings L.P. ( Steel Holdings ), an affiliate of SPHG Holdings, at a price of \$4.00 per share, resulting in aggregate proceeds of \$30.0 million before transaction costs. The Company incurred \$2.3 million of transaction costs, which consisted primarily of investment banking and legal fees, resulting in net proceeds from the sale of \$27.7 million. In addition, as part of the transaction, the Company issued Steel Holdings a warrant to acquire an additional 2,000,000 shares at an exercise price of \$5.00 per share (the Warrant ). These warrants were to expire after a term of five years after issuance. On December 15, 2017, contemporaneously with the closing of the Preferred Stock Transaction, the Company entered into a Warrant Repurchase Agreement (the Warrant Repurchase Agreement ) with Steel Holdings pursuant to which the Company repurchased the Warrant for \$100. The Warrant was terminated by the Company upon repurchase.

**Table of Contents****(11) OTHER GAINS (LOSSES), NET**

The following table reflects the components of Other gains (losses), net :

	<b>Three Months Ended January 31, 2019      2018</b>		<b>Six Months Ended January 31, 2019      2018</b>	
	<b>(In thousands)</b>			
Foreign currency exchange losses	\$ (1,484)	\$ (1,436)	\$ (568)	\$ (2,071)
Gains, net on Trading Securities				1,876
Other, net	(178)	(281)	150	(100)
	\$ (1,662)	\$ (1,717)	\$ (718)	\$ (295)

The Company recorded foreign exchange losses of approximately \$1.5 million and \$1.4 million during the three months ended January 31, 2019 and 2018, respectively. For the three months ended January 31, 2019, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(1.1) million, \$(0.9) million and \$0.5 million in Corporate, Asia and Europe, respectively. For the three months ended January 31, 2018, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(2.3) million, \$1.3 million and \$(0.7) million in Corporate, Europe and Asia, respectively.

The Company recorded foreign exchange losses of approximately \$0.6 million and \$2.1 million during the six months ended January 31, 2019 and 2018, respectively. For the six months ended January 31, 2019, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$0.6 million, \$(0.5) million and \$(0.5) million in Corporate, Asia and Europe, respectively. For the six months ended January 31, 2018, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(2.2) million, \$1.0 million and \$(1.1) million in Corporate, Europe and Asia, respectively.

During the six months ended January 31, 2018, the Company recognized \$2.7 million in net non-cash losses associated with its Trading Securities. During the six months ended January 31, 2018, the Company recognized \$4.6 million in net cash gains associated with its Trading Securities.

**(12) INCOME TAXES**

The Company operates in multiple taxing jurisdictions, both within and outside of the United States. For the six months ended January 31, 2019, the Company was profitable in certain jurisdictions, resulting in an income tax expense using enacted rates in those jurisdictions. As of January 31, 2019, the total amount of the liability for unrecognized tax benefits related to federal, state and foreign taxes was approximately \$1.7 million. As of July 31, 2018, the total amount of the liability for unrecognized tax benefits related to federal, state and foreign taxes was approximately \$1.6 million.

*Uncertain Tax Positions*

In accordance with the Company's accounting policy, interest related to unrecognized tax benefits is included in the provision of income taxes line of the Condensed Consolidated Statements of Operations. As of January 31, 2019 and July 31, 2018, the liabilities for interest expense related to uncertain tax positions were \$0.1 million. The Company has accrued \$0.2 million for penalties related to income tax positions. The Company does not expect any unrecognized tax benefits to reverse in the next twelve months. The Company is subject to U.S. federal income tax and various state, local and international income taxes in numerous jurisdictions. The federal and state tax returns are generally subject to tax examinations for the tax years ended July 31, 2013 through July 31, 2018. To the extent the Company has tax attribute carryforwards, the tax year in which the attribute was generated may still be adjusted upon examination by the Internal Revenue Service or state tax authorities to the extent utilized in a future period. In addition, a number of tax years remain subject to examination by the appropriate government agencies for certain countries in the Europe and Asia regions. In Europe, the Company's 2009 through 2017 tax years remain subject to examination in most locations, while the Company's 2005 through 2017 tax years remain subject to examination in most Asia locations.

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**Table of Contents***Net Operating Loss*

The Company has certain deferred tax benefits, including those generated by net operating losses and certain other tax attributes (collectively, the Tax Benefits ). The Company's ability to use these Tax Benefits could be substantially limited if it were to experience an ownership change, as defined under Section 382 of the Internal Revenue Code of 1986, as amended (the Code ). In general, an ownership change would occur if there is a greater than 50-percentage point change in ownership of securities by stockholders owning (or deemed to own under Section 382 of the Code) five percent or more of a corporation's securities over a rolling three-year period.

*Tax Benefits Preservation Plan*

On March 6, 2018, the Board, subject to approval by the Company's stockholders, approved an amendment to the Company's Restated Certificate of Incorporation designed to protect the tax benefits of the Company's net operating loss carryforwards by preventing certain transfers of our securities that could result in an ownership change (as defined under Section 382 of the Code) (the Protective Amendment ). The Protective Amendment was approved and adopted by the Company's stockholders at the 2017 Meeting and was filed with the Secretary of State of the State of Delaware on April 12, 2018.

The Company had net operating loss carryforwards for federal and state tax purposes of approximately \$2.1 billion and \$150.6 million, respectively, as of January 31, 2019. The Company's ability to use its Tax Benefits would be substantially limited if the Company undergoes an ownership change (within the meaning of Section 382 of the Internal Revenue Code). The Tax Plan is intended to prevent an ownership change of the Company that would impair the Company's ability to utilize its Tax Benefits.

As part of the Tax Plan, the Board declared a dividend of one right (a Right ) for each share of Common Stock then outstanding. The dividend was payable to holders of record as of the close of business on January 29, 2018. Any shares of Common Stock issued after January 29, 2018, will be issued together with the Rights. Each Right initially represents the right to purchase one one-thousandth of a share of newly created Series D Junior Participating Preferred Stock.

Initially, the Rights will be attached to all certificates representing shares of Common Stock then outstanding and no separate rights certificates will be distributed. In the case of book entry shares, the Rights will be evidenced by notations in the book entry accounts. Subject to certain exceptions specified in the Plan, the Rights will separate from the Common Stock and a distribution date (the Distribution Date ) will occur upon the earlier of (i) ten (10) business days following a public announcement that a stockholder (or group) has become a beneficial owner of 4.99-percent or more of the shares of Common Stock then outstanding and (ii) ten (10) business days (or such later date as the Board determines) following the commencement of a tender offer or exchange offer that would result in a person or group becoming a 4.99-percent stockholder.

Pursuant to the Tax Plan and subject to certain exceptions, if a stockholder (or group) becomes a 4.99-percent stockholder after adoption of the Tax Plan, the Rights would generally become exercisable and entitle stockholders (other than the 4.99-percent stockholder or group) to purchase additional shares of the Company at a significant discount, resulting in substantial dilution in the economic interest and voting power of the 4.99-percent stockholder (or group). In addition, under certain circumstances in which the Company is acquired in a merger or other business combination after a non-exempt stockholder (or group) becomes a 4.99-percent stockholder, each holder of the Right (other than the 4.99-percent stockholder or group) would then be entitled to purchase shares of the acquiring company's common stock at a discount.



The Rights are not exercisable until the Distribution Date and will expire at the earliest of (i) 11:59 p.m. on the date that the votes of the stockholders of the Company with respect to the Company's next annual meeting or special meeting of stockholders are certified (which date will be no later than January 18, 2019 - the annual meeting or special meeting of stockholders did not take place prior to this date), unless the continuation of the Tax Plan is approved by the affirmative vote of the majority of shares of Common Stock present at such meeting of stockholders (in which case clause (ii) will govern); (ii) 11:59 p.m., on January 18, 2021; (iii) the time at which the Rights are redeemed or exchanged as provided in the Tax Plan; and (iv) the time at which the Board determines that the Tax Plan is no longer necessary or desirable for the preservation of Tax Benefits.

*Protective Amendment*

On March 6, 2018, the Board, subject to approval by the Company's stockholders, approved the Protective Amendment to the Company's Restated Certificate of Incorporation designed to protect the tax benefits of the Company's net operating loss carryforwards by preventing certain transfers of our securities that could result in an ownership change (as defined under Section 382 of the Code). The Protective Amendment was approved and adopted by the Company's stockholders at the 2017 meeting and was filed with the Secretary of State of the State of Delaware on April 12, 2018.

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*The Tax Cuts and Jobs Act*

In December 2017, the Tax Cuts and Jobs Act, or the Tax Act ( TCJA ), was signed into law. Among other things, the Tax Act permanently lowers the corporate federal income tax rate to 21% from the existing maximum rate of 35%, effective for tax years including or commencing January 1, 2018. As a result of the reduction of the corporate federal income tax rate to 21%, U.S. GAAP requires companies to revalue their deferred tax assets and deferred tax liabilities as of the date of enactment, with the resulting tax effects accounted for in the reporting period of enactment. This revaluation resulted in a provision of \$280.4 million to income tax expense in continuing operations and a corresponding reduction in the valuation allowance. As a result, there was no impact to the Company's income statement as a result of reduction in tax rates. The total provision of \$280.4 million included a provision of \$305.9 million to income tax expense for the Company and a benefit of \$25.5 million to income tax expense for IWCO. As noted above, the net tax expense of \$280.4 was offset completely by a corresponding reduction in the valuation allowance.

Beginning on January 1, 2018, the TCJA also requires a minimum tax on certain future earnings generated by foreign subsidiaries while providing for future tax-free repatriation of such earnings through a 100% dividends-received deduction.

The TCJA also requires a Transition Tax on any net accumulated earnings and profits as of the two required measurement dates, November 2, 2017 and December 31, 2017. As such, as of July 31, 2018, all of the Company's accumulated earnings and profits are deemed repatriated. Therefore, there is no deferred tax liability for earnings overseas that have not been remitted. The Company will utilize NOLs to offset any Transition Tax assessed.

In December 2017, the SEC staff issued SAB 118 to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of H.R.1. The Company did not record any adjustments in the year ended December 31, 2018 to provisional amounts that were material to its financial statements. As of December 31, 2018, the Company's accounting treatment is complete.

**Table of Contents****(15) EARNINGS (LOSS) PER SHARE**

The Company calculates earnings per share in accordance with ASC Topic 260, Earnings per Share. The following table reconciles earnings per share for the three and six months ended January 31, 2019 and 2018:

	<b>Three Months Ended January 31,</b>		<b>Six Months Ended January 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(In thousands, except per share data)</b>			
Net income (loss)	\$ (11,753)	\$ 59,818	\$ (19,118)	\$ 54,581
Less: Preferred dividends on redeemable preferred stock	(536)	(270)	(1,073)	(270)
Net income (loss) attributable to common stockholders	(12,289)	59,548	(20,191)	54,311
Effect of dilutive securities:				
5.25% Convertible Senior Notes		1,748		3,459
Redeemable preferred stock		259		259
Net income (loss) attributable to common stockholders after assumed conversions	\$ (12,289)	\$ 61,555	\$ (20,191)	\$ 58,029
Weighted average common shares outstanding	60,935	58,341	60,974	56,776
Weighted average common equivalent shares arising from dilutive stock options, restricted stock, convertible notes and convertible preferred stock		20,742		16,107
Weighted average number of common and potential common shares	60,935	79,083	60,974	72,883
Basic net earnings (loss) per share attributable to common stockholders:	\$ (0.20)	\$ 1.02	\$ (0.33)	\$ 0.96
Diluted net earnings (loss) per share attributable to common stockholders:	\$ (0.20)	\$ 0.78	\$ (0.33)	\$ 0.80

Basic earnings per common share is calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings per common share, if any, gives effect to diluted stock options (calculated based on the treasury stock method), non-vested restricted stock shares purchased under the employee stock purchase plan and shares issuable upon debt or preferred stock conversion (calculated using an as-if converted method).

For both the three and six months ended January 31, 2019, approximately 28.9 million, common stock equivalent shares were excluded from the denominator in the calculation of diluted earnings per share as their inclusion would have been antidilutive.

For both the three and six months ended January 31, 2018, approximately 0.5 million common stock equivalent shares were excluded from the denominator in the calculation of diluted earnings per share as their inclusion would have been antidilutive.

**Table of Contents****(16) SHARE-BASED PAYMENTS**

The following table summarizes share-based compensation expense related to employee stock options, employee stock purchases and non-vested shares for the three and six months ended January 31, 2019 and 2018, which was allocated as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>January 31,</b>		<b>January 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(In thousands)</b>			
Cost of revenue	\$	\$ 1	\$	\$ 12
Selling, general and administrative	(22)	7,104	770	7,385
	\$ (22)	\$ 7,105	\$ 770	\$ 7,397

During December 2017, the Board, upon the recommendation of the Special Committee and the Human Resources and Compensation Committee of the Board (the Compensation Committee), approved equity grants to certain members of the Board, in each case effective upon the closing of the IWCO Acquisition and in consideration for current and future services to the Company.

At January 31, 2019, there was an immaterial amount unrecognized compensation cost related to Stock Options issued under the Company's plans. At January 31, 2019, there was approximately \$0.7 million of total unrecognized compensation cost related to non-vested share-based compensation awards under the Company's plans.

**(17) COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) combines net income (loss) and other comprehensive items. Other comprehensive items represent certain amounts that are reported as components of stockholder's equity in the accompanying condensed consolidated balance sheets.

Accumulated other comprehensive items consist of the following:

	<b>Foreign</b>	<b>Pension</b>	<b>Unrealized</b>	<b>Total</b>
	<b>currency</b>	<b>items</b>	<b>gains</b>	
	<b>items</b>		<b>(losses) on</b>	
			<b>securities</b>	
	<b>(In thousands)</b>			
Accumulated other comprehensive income (loss) at July 31, 2018	\$ 6,348	\$ (3,795)	\$ 181	\$ 2,734
Foreign currency translation adjustment	332			332
Net unrealized holding gain on securities			(89)	(89)
Pension liability adjustments		(64)		(64)
Net current-period other comprehensive income (loss)	332	(64)	(89)	179

Accumulated other comprehensive income (loss) at January 31, 2019	\$ 6,680	\$ (3,859)	\$ 92	\$ 2,913
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**(18) SEGMENT INFORMATION**

The Company has five operating segments: Americas; Asia; Europe; Direct Marketing; and e-Business. Based on the information provided to the Company's chief operating decision-maker ( CODM ) for purposes of making decisions about allocating resources and assessing performance and quantitative thresholds, the Company has determined that it has five reportable segments: Americas, Asia, Europe, Direct Marketing and e-Business. The Company also has Corporate-level activity, which consists primarily of costs associated with certain corporate administrative functions such as legal, finance, share-based compensation and acquisition costs which are not allocated to the Company's reportable segments. The Corporate-level balance sheet information includes cash and cash equivalents, Notes payables and other assets and liabilities which are not identifiable to the operations of the Company's operating segments. All significant intra-segment amounts have been eliminated.

Management evaluates segment performance based on segment net revenue, operating income (loss) and adjusted operating income (loss) , which is defined as the operating income (loss) excluding net charges related to depreciation, amortization of intangible assets, long-lived asset impairment, share-based compensation and restructuring. These items are excluded because they may be considered to be of a non-operational or non-cash nature. Historically, the Company has recorded significant impairment and restructuring charges and therefore management uses adjusted operating income to assist in evaluating the performance of the Company's core operations.

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Summarized financial information of the Company's continuing operations by operating segment is as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>January 31,</b>		<b>January 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(In thousands)</b>			
<b>Net revenue:</b>				
Americas	\$ 16,709	\$ 13,764	\$ 34,149	\$ 28,603
Asia	44,555	36,290	88,811	79,802
Europe	20,450	37,893	39,971	76,283
Direct Marketing	118,447	59,532	246,541	59,532
e-Business	6,062	6,259	11,884	12,040
	\$ 206,223	\$ 153,738	\$ 421,356	\$ 256,260
<b>Operating income (loss):</b>				
Americas	\$ (3,193)	\$ (2,287)	\$ (4,019)	\$ (4,486)
Asia	5,367	15,723	10,495	19,892
Europe	(1,354)	(3,459)	(2,826)	(6,319)
Direct Marketing	6,695	(3,952)	11,462	(3,952)
e-Business	(961)	(1,346)	(2,109)	(2,791)
Total Segment operating income (loss)	6,554	4,679	13,003	2,344
Corporate-level activity	(4,428)	(10,382)	(7,341)	(11,877)
Total operating income (loss)	2,126	(5,703)	5,662	(9,533)
Total other expense	(12,474)	(8,200)	(22,264)	(8,721)
Loss before income taxes	\$ (10,348)	\$ (13,903)	\$ (16,602)	\$ (18,254)

For the three and six months ended January 31, 2018, the net revenue and operating loss associated with Direct Marketing is for the period from December 15, 2017 to January 31, 2018. For this period, the Direct Marketing operating loss includes certain purchase accounting adjustments associated with the IWCO acquisition.

	<b>January 31,</b>	<b>July 31,</b>
	<b>2019</b>	<b>2018</b>
	<b>(In thousands)</b>	
<b>Total assets:</b>		
Americas	\$ 21,886	\$ 22,820
Asia	42,475	44,322
Europe	37,026	37,223
Direct Marketing	620,036	642,820
e-Business	15,266	15,758

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Sub-total segment assets	736,689	762,943
Corporate	74,355	64,107
	\$ 811,044	\$ 827,050



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Summarized financial information of the Company's net revenue from external customers by group of services is as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>January 31,</b>		<b>January 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(In thousands)</b>			
Supply chain services	\$ 81,714	\$ 87,947	\$ 162,931	\$ 184,688
e-Business services	6,062	6,259	11,884	12,040
Direct Marketing	118,447	59,532	246,541	59,532
	\$ 206,223	\$ 153,738	\$ 421,356	\$ 256,260

As of January 31, 2019, approximately \$95.2 million of the Company's long-lived assets were located in the U.S.A. As of July 31, 2018, approximately \$101.8 million of the Company's long-lived assets were located in the U.S.A.

For the three months ended January 31, 2019, the Company's net revenues within U.S.A., China and Netherlands were \$136.3 million, \$37.9 million and \$14.4 million, respectively. For the three months ended January 31, 2018, the Company's net revenues within U.S.A., China and Netherlands were \$72.0 million, \$28.2 million and \$16.5 million, respectively.

For the six months ended January 31, 2019, the Company's net revenues within U.S.A., China and Netherlands were \$282.4 million, \$74.5 million and \$29.3 million, respectively. For the six months ended January 31, 2018, the Company's net revenues within U.S.A., China and Netherlands were \$87.1 million, \$63.0 million and \$31.8 million, respectively.

**(19) RELATED PARTY TRANSACTIONS**

As of January 31, 2019, SPHG Holdings and its affiliates beneficially owned approximately 52% of our outstanding capital stock which includes restricted stock held by Warren G. Lichtenstein, our Interim Chief Executive Officer and the Executive Chairman of our Board, is also the Executive Chairman of Steel Holdings GP. Glen Kassan, a Director and our Vice Chairman of the Board and former Chief Administrative Officer, is also affiliated with Steel Holdings GP. Jack L. Howard and William T. Fejes, Jr., directors of the Company, are also affiliated with Steel Holdings GP.

As of January 31, 2019, and July 31, 2018, SPHG Holdings held \$14.9 million principal amount of the Company's 5.25% Convertible Senior Notes. On February 28, 2019, the Company issued a 7.5% Convertible Senior Unsecured Note in the amount of \$14.9 million to SPHG Holdings (see note 21).

*Preferred Stock Transaction and Warrant Repurchase*

On December 15, 2017, the Company entered into a Preferred Stock Purchase Agreement with SPHG Holdings, pursuant to which the Company issued 35,000 shares of the Company's newly created Series C Convertible Preferred Stock, par value \$0.01 per share, to SPHG Holdings at a price of \$1,000 per share, for an aggregate purchase consideration of \$35.0 million. The terms, rights, obligations and preferences of the Preferred Stock are set forth in a Certificate of Designations, Preferences and Rights of Series C Convertible Preferred Stock of the Company (the a Series C Certificate of Designations), which has been filed with the Secretary of State of the State of Delaware.

The Preferred Stock Transaction was approved and recommended to the Board by the Special Committee of the Board. Each member of the Special Committee was independent and not affiliated with Steel Holdings GP, which controls the power to vote and dispose of the securities held by SPHG Holdings and its affiliates.

On December 15, 2017, contemporaneously with the closing of the Preferred Stock Transaction, the Company entered into a Warrant Repurchase Agreement with Steel Holdings, an affiliate of SPHG Holdings, pursuant to which the Company repurchased for \$100 the warrant to acquire 2,000,000 shares of the Common Stock that the Company had previously issued to Steel Holdings. The Warrant, which was to expire in 2018, was terminated by the Company upon repurchase.

*Management Services Agreement*

On December 24, 2014, the Company entered into a Management Services Agreement with SP Corporate Services LLC ( SP Corporate ), effective as of January 1, 2015 (as amended, the Management Services Agreement ). SP Corporate was at the time of signing an indirect wholly owned subsidiary of Steel Partners Holdings L.P. and was a related party. Pursuant to the Management Services Agreement, SP Corporate provided the Company and its subsidiaries with the services of certain employees, including certain executive officers, and other corporate services.

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On September 1, 2017, the Company entered into a Third Amendment to the Management Services Agreement, with Steel Services Ltd. ( Steel Services ) a related party, which reduced the fixed monthly fee paid by the Company to Steel Services under the Management Services Agreement from \$175,000 per month to \$95,641 per month. The monthly fee is subject to review and adjustment by agreement between the Company and Steel Services for periods commencing in fiscal 2016 and beyond. Additionally, the Company may be required to reimburse Steel Services and its affiliates for all reasonable and necessary business expenses incurred on our behalf in connection with the performance of the services under the Management Services Agreement, including travel expenses. The Management Services Agreement provides that, under certain circumstances, the Company may be required to indemnify and hold harmless Steel Services and its affiliates and employees from any claims or liabilities by a third party in connection with activities or the rendering of services under the Management Services Agreement. Total expenses incurred related to this agreement for the three months ended January 31, 2019 and 2018 were \$0.4 million and \$0.5 million, respectively. Total expenses incurred related to this agreement for the six months ended January 31, 2019 and 2018 were \$0.7 million and \$0.8 million, respectively. As of January 31, 2019 and July 31, 2018, amounts due to Steel Services were \$0.1 million and \$0.2 million, respectively.

The Related Party Transactions Committee of the Board (the Related Party Transactions Committee ) approved the entry into the Management Services Agreement (and the first two amendments thereto) and the Transfer Agreement. The Audit Committee of the Board of Directors (the Audit Committee ) approved the third amendment to the Management Services Agreement. The Related Party Transactions Committee held the responsibility to review, approve and ratify related party transactions from November 20, 2014, until October 11, 2016. On October 11, 2016, the Board adopted a Related Person Transaction Policy that is administered by the Audit Committee and applies to all related party transactions. As of October 11, 2016, the Audit Committee reviews all related party transactions on an ongoing basis and all such transactions must be approved or ratified by the Audit Committee.

On December 15, 2017, the Board, upon the recommendation of the Special Committee and the Compensation Committee, approved restricted stock grants and market performance based restricted stock grants to non-employee directors Messrs. Howard, Fejes and Lichtenstein, the Executive Chairman of the Board, in each case effective upon the closing of the IWCO Acquisition (the Grant Date ) and in consideration for current and future services to the Company. Messrs. Howard and Lichtenstein are affiliated with Steel Holdings GP, which is a wholly-owned subsidiary of Steel Holdings. Mr. Fejes is currently affiliated with Steel Services, an indirect wholly owned subsidiary of Steel Holdings. These awards were measured based on the fair market value on the Grant Date.

Mutual Securities, Inc. ( Mutual Securities ) serves as the broker and record-keeper for all the transactions associated with the Trading Securities. Mr. Howard, a director of the Company, is a registered principal of Mutual Securities. Commissions charged by Mutual Securities are generally commensurate with commissions charged by other institutional brokers, and the Company believes its use of Mutual Securities is consistent with its desire to obtain best price and execution. During the three and six months ended January 31, 2019 and 2018, Mutual Securities received an immaterial amount in commissions associated with these transactions.

**(20) FAIR VALUE MEASUREMENT OF ASSETS AND LIABILITIES**

ASC Topic 820 provides that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 requires the Company to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

Level 3: Unobservable inputs for which there is little or no market data and which require the Company to develop its own assumptions about how market participants would price the assets or liabilities

The carrying value of cash and cash equivalents, accounts receivable, restricted cash, accounts payable, current liabilities and the revolving line of credit approximate fair value because of the short maturity of these instruments. We believe that the carrying value of our long-term debt approximates fair value because the stated interest rates of this debt is consistent with current market rates. The carrying value of capital lease obligations approximates fair value, as estimated by using discounted future cash flows based on

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the Company's current incremental borrowing rates for similar types of borrowing arrangements. The defined benefit plans have 100% of their assets invested in bank-managed portfolios of debt securities and other assets. Conservation of capital with some conservative growth potential is the strategy for the plans. The Company's pension plans are outside the United States, where asset allocation decisions are typically made by an independent board of trustees. Investment objectives are aligned to generate returns that will enable the plans to meet their future obligations. The Company acts in a consulting and governance role in reviewing investment strategy and providing a recommended list of investment managers for each plan, with final decisions on asset allocation and investment manager made by local trustees.

*Assets and Liabilities that are Measured at Fair Value on a Recurring Basis*

The following tables present the Company's financial assets measured at fair value on a recurring basis as of January 31, 2019 and July 31, 2018, classified by fair value hierarchy:

(In thousands)	Fair Value Measurements at Reporting Date Using			
	January 31, 2019	Level 1	Level 2	Level 3
<u>Assets:</u>				
Money market funds	\$ 29,653	\$ 29,653	\$	\$

(In thousands)	Fair Value Measurements at Reporting Date Using			
	July 31, 2018	Level 1	Level 2	Level 3
<u>Assets:</u>				
Money market funds	\$ 47,186	\$ 47,186	\$	\$

There were no transfers between Levels 1, 2 or 3 during any of the periods presented.

When available, quoted prices were used to determine fair value. When quoted prices in active markets were available, investments were classified within Level 1 of the fair value hierarchy. When quoted prices in active markets were not available, fair values were determined using pricing models, and the inputs to those pricing models were based on observable market inputs. The inputs to the pricing models were typically benchmark yields, reported trades, broker-dealer quotes, issuer spreads and benchmark securities, among others.

*Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis*

The Company reviews the carrying amounts of these assets whenever certain events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recognized when the carrying amount of the asset group or reporting unit is not recoverable and exceeds its fair value. The Company estimated the fair values of assets subject to impairment based on the Company's own judgments about the assumptions that market participants would use in pricing the assets and on observable market data, when available.

*Fair Value of Financial Instruments*

The Company's financial instruments not measured at fair value on a recurring basis include cash and cash equivalents, accounts receivable, customer deposits, accounts payable, restricted cash and debt, and are reflected in the financial statements at cost. With the exception of the Notes payable and long-term debt, cost approximates fair value for these items due to their short-term nature. We believe that the carrying value of our long-term debt approximates fair value

because the stated interest rates of this debt is consistent with current market rates.

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Included in cash and cash equivalents in the accompanying balance sheet are money market funds. These are valued at quoted market prices in active markets.

The following table presents the Company's Notes payable not carried at fair value:

	January 31, 2019		July 31, 2018		Fair Value Hierarchy
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	
Notes payable	\$ 63,457	\$ 63,936	\$ 64,530	\$ 66,658	Level 1

The fair value of the Company's Notes payable represents the value at which its lenders could trade its debt within the financial markets, and does not represent the settlement value of these debt liabilities to us. The fair value of the Notes payable could vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The Notes payable are traded and their fair values are based upon traded prices as of the reporting dates.

**(21) SUBSEQUENT EVENTS**

On March 18, 2014, the Company entered an indenture with Wells Fargo Bank, National Association, as trustee relating to the Company's issuance of \$100 million of 5.25% Convertible Senior Notes (the Notes). The Notes matured on March 1, 2019, with a balance due of \$65.603 million, including interest to the March 1, 2019 maturity date. Included in the balance due was a Note held by SPHG Holdings in the principal amount of \$14.9 million. The total \$65.6 million balance due was paid in full by the Company from available cash on-hand, including the \$14.9 million from the proceeds of the Steel Note Transaction entered into on February 28, 2019, and described below.

*Steel Note Transaction*

On February 28, 2019, the Company entered into that certain 7.50% Convertible Senior Note Due 2024 Purchase Agreement (the Steel Note Purchase Agreement) with SPHG Holdings, whereby SPHG Holdings agreed to loan the Company \$14.9 million in exchange for a 7.50% Convertible Senior Note due 2024 (the Steel Note) (the Steel Note Transaction).

On February 28, 2019, the Company issued the Steel Note in the amount of \$14.9 million to SPHG Holdings. The Steel Note bears interest at the rate of 7.50% per year, payable semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2019. The Steel Note will mature on March 1, 2024 (the Steel Note Maturity Date), unless earlier repurchased by the Company or converted by the holder in accordance with their terms prior to such maturity date.

The Company has the right to prepay the Steel Note at any time, upon 10 days' prior written notice, in whole or in part, without penalty or premium, at a price equal to 100% of the then outstanding principal amount of the Steel Note plus accrued and unpaid interest. The Steel Note is an unsecured and unsubordinated obligation of the Company, and will rank equal in right of payment with the Company's other unsecured and unsubordinated indebtedness, but will be effectively subordinated in right of payment to any existing and future secured indebtedness and liabilities to the extent of the value of the collateral securing those obligations, and structurally subordinated to the indebtedness and other liabilities of the Company's subsidiaries. The Steel Note contains other customary terms and conditions, including customary events of default.

At its election, the Company may pay some or all of the interest due on each Interest Payment Date by increasing the principal amount of the Steel Note in the amount of such interest due or any portion thereof (such payment of interest by increasing the principal amount of the Steel Note referred to as ( PIK Interest ), with the remaining portion of the interest due on such Interest Payment Date (or, at the Company's election, the entire amount of interest then due) to be paid in cash by the Company. Following an increase in the principal amount of the Steel Note as a result of a payment of PIK Interest, the Steel Note will bear interest on such increased principal amount from and after the date of such payment of PIK Interest.

SPHG Holdings has the right to require the Company to repurchase the Steel Note upon the occurrence of certain fundamental changes, subject to certain conditions, at a repurchase price equal to 100% of the principal amount of the Steel Note plus accrued and unpaid interest. The Company will have the right to elect to cause the mandatory conversion of the Steel Note in whole, and not in part, at any time on or after March 6, 2022, subject to certain conditions including that the stock price of the Company exceeds a certain threshold.



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SPHG Holdings has the right, at its option, prior to the close of business on the business day immediately preceding the Steel Note Maturity Date, to convert the Steel Note or a portion thereof that is \$1,000 or an integral multiple thereof, into shares of common stock (if the Company has not received a required stockholder approval) or cash, shares of common stock or a combination of cash and shares of common stock, as applicable (if the Company has received a required stockholder approval), at an initial conversion rate of 421.2655 shares of common stock, which is equivalent to an initial conversion price of approximately \$2.37 per share (subject to adjustment as provided in the Steel Note) per \$1,000 principal amount of the Steel Note (the Conversion Rate )(subject to, and in accordance with, the settlement provisions of the Steel Note).

For any conversion of the Steel Note, if the Company is required to obtain and has not received approval from its stockholders in accordance with NASDAQ Stock Market Rule 5635 to issue 20% or more of the total shares of common stock outstanding upon conversion (including upon any mandatory conversion) of the Steel Note prior to the relevant conversion date (or, if earlier, the 45th Scheduled trading day immediately preceding the Steel Note Maturity Date), the Company shall deliver to the converting holder, in respect of each \$1,000 principal amount of Steel Note being converted, a number of shares of common stock determined by reference to the Conversion Rate, together with a cash payment, if applicable, in lieu of delivering any fractional share of common stock based on the volume weighted average price (VWAP) of its common stock on the relevant conversion date, on the third Business Day immediately following the relevant conversion date.

The Company's Board of Directors established a special committee (the Special Committee ), consisting solely of independent directors not affiliated with SPHG Holdings, to review and consider a financing transaction including SPHG Holdings. The terms and conditions of the Steel Note Transaction were determined by the Special Committee to be fair and in the best interests of the Company, and the Special Committee recommended that the Board approve the Steel Note Transaction and the transactions contemplated thereby. The Board approved such transactions. Warren G. Lichtenstein, our Interim Chief Executive Officer and the Executive Chairman of our Board, is also the Executive Chairman of Steel Holdings GP. Jack L. Howard and William T. Fejes, Jr., directors of the Company, are also affiliated with Steel Holdings GP. Glen Kassin, a Director and our Vice Chairman of the Board and former Chief Administrative Officer, is also affiliated with Steel Holdings GP.

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**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The matters discussed in this report contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the Securities Act of 1933, as amended that involve risks and uncertainties. All statements other than statements of historical information provided herein may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. Factors that could cause actual results to differ materially from those reflected in the forward-looking statements include, but are not limited to, those discussed in Part II Item 1A below and elsewhere in this report and the risks discussed in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on December 4, 2018. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis, judgment, belief or expectation only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof, except as required by applicable securities laws and regulations.

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

***Overview***

Steel Connect, Inc. (Steel Connect or the Company) is a diversified holding company with two wholly-owned subsidiaries, ModusLink Corporation (ModusLink) and IWCO Direct Holdings, Inc. (IWCO or IWCO Direct), that have market-leading positions in supply chain management and direct marketing.

ModusLink provides comprehensive physical and digital supply chain optimization services (the Supply Chain business) that are designed to improve clients' revenue, cost, sustainability and customer experience objectives. We provide services to leading companies across a wide spectrum of industries, including consumer electronics, communications, computing, medical devices, software, and retail, among others. The Supply Chain business operations are supported by a global footprint that includes more than 20 sites across North America, Europe, and the Asia Pacific region.

We operate an integrated physical and digital supply chain system infrastructure that extends from front-end order management through distribution and returns management. This end-to-end solution enables clients to link supply and demand in real-time, improve visibility and performance throughout the supply chain, and provide real-time access to information for greater collaboration and making informed business decisions. We believe that our clients can benefit from our global integrated business solution, especially given the increased usage of connected devices and digitalized solutions.

Historically, a significant portion of our revenue from our Supply Chain business has been generated from clients in the computer and software markets. These markets, while large in size, are mature and, as a result, gross margins in these markets tend to be lower than other markets the Company operates in. To address this, in addition to the computer and software markets, we have expanded our sales focus to include additional markets such as communications and consumer electronics, with a long-term focus on expanding in growth industries, such as the connected home, and connected healthcare, among others. We believe these markets, and other verticals we operate in, may experience faster growth than our historical markets, and represent opportunities to realize higher gross margins on the services we offer. Companies in these markets often have significant need for a supply chain partner who will be an extension to their business models. We believe the scope of our service offerings, including

value-added warehousing and distribution, repair and recovery, aftersales, returns management, financial management, entitlement management, contact center support, material planning and factory supply, and e-Business will increase the overall value of the supply chain solutions we deliver to our existing clients and to new clients.

As a large portion of the Supply Chain business revenue comes from outsourcing services provided to clients such as retail products and consumer electronics companies, our operating performance has been and may continue to be adversely affected by declines in the overall performance within these sectors and uncertainty affecting the world economy. In addition, the drop in consumer demand for products of certain clients has had and may continue to have the effect of reducing our volumes and adversely affecting our revenue, gross margin and overall operating performance. Additionally, the markets for our supply chain services are generally very competitive, though we believe we have a compelling and differentiated offering due to the value-added services we provide, our commitment to client management, and our global reach. We also face pressure from our clients to continually realize efficiency gains in order to help our clients maintain their profitability objectives. Increased competition and client demands for efficiency improvements may result in price reductions, reduced gross margins and, in some cases, loss of market share. In addition, our profitability varies based on the types of services we provide and the regions in which we perform them. Therefore, the mix of revenue derived from our various services and locations can impact our gross margin results. Also, form factor changes, which we describe as the reduction in the amount of materials and product components used in our clients' completed packaged product, can also have the effect of reducing our revenue and gross margin opportunities. As a result of these competitive and client pressures the gross margins in our supply chain business are low.

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Many of the Supply Chain's business clients' products are subject to seasonal consumer buying patterns. As a result, the services we provide to our clients are also subject to seasonality, with higher revenue and operating income typically being realized from handling our clients' products during the first half of our fiscal year, which includes the holiday selling season.

As a leading provider of data-driven direct marketing solutions, IWCO Direct's products and services help clients create more effective marketing offers and communications across all marketing channels to create new and more loyal customers. With a nearly 50-year legacy of printing and mailing services, the Company's full range of expanded marketing services includes strategy, creative, and execution for omnichannel marketing campaigns, along with one of the industry's most sophisticated postal logistics strategies for direct mail. Through Mail-Gar®, IWCO Direct offers business continuity and disaster recovery services to protect against unexpected business interruptions, along with providing print and mail outsourcing services.

IWCO Direct's services include (a) development of direct mail and omnichannel marketing strategies (b) creative services to design direct mail, email, and online marketing (c) printing and compiling of direct mail pieces into envelopes ready for mailing (d) commingling services to sort mail produced for various customers, by destination to achieve optimized postal savings (e) and business continuity and disaster recovery services for critical communications to protect against unexpected business interruptions. The major markets served by IWCO Direct include financial services, Multiple-System Operations (MSO) (cable or direct-broadcast satellite TV systems), insurance and to a lesser extent subscription/services, healthcare, travel/hospitality and other. Direct mail is a critical piece of marketing for most of its current customers who use direct mail to acquire new customers. Management believes that direct mail will remain an important part of its customer's budgets for the foreseeable future, based on its proven ability to enhance results when used as part of an omnichannel marketing strategy.

The printing, mailing, and marketing services industries are highly competitive and are expected to remain so. The printing industry has more than 40,000 companies in the U.S. and IWCO Direct is the largest printer in the direct mail category, according to the December 2017 PI 400, an annual ranking of all printers by industry trade publication, Printing Impressions. While the printing industry as a whole is experiencing a shift from paper-based to digital content, direct mail continues to drive the highest response rate for campaigns designed to acquire new customers, according to the Data and Marketing Association's (DMA) 2018 Response Rate Report. IWCO Direct is expanding its services to provide omnichannel marketing solutions to leverage its leadership role in acquisition marketing for direct mail to include digital marketing campaigns that complement direct mail to drive a higher response across all channels. Significant downward pricing pressure, a significant shift from paper-based to digital marketing for acquisition marketing, availability of paper and price increases for this raw material, the ability to acquire and retain a skilled work force and/or regulatory issues that impact use of consumer data for marketing could adversely affect IWCO Direct's earnings. IWCO Direct's business is not typically subject to seasonal buying patterns.

IWCO is ISO/IEC 27001 Information Security Management System (ISMS) certified through BSI, reflecting its commitment to data security. IWCO has administrative offices in Chanhassen, MN. and has three facilities in Chanhassen MN., one facility in Little Falls, MN., one facility in Warminster, PA. and two facilities in Hamburg, PA.

Management evaluates operating performance based on net revenue, operating income (loss) and net income (loss) and a measure that we refer to as Adjusted EBITDA, defined as net income (loss) excluding net charges related to interest income, interest expense, income tax expense, depreciation, amortization of intangible assets, strategic consulting and other related professional fees, executive severance and employee retention, restructuring, non-cash charge related to a fair value step-up to work-in-process inventory, share-based compensation, impairment, unrealized foreign exchange gains and losses, net, other non-operating gains and losses, net, and gains and losses on investments in affiliates and impairments. Among the key factors that will influence our performance are successful execution and

implementation of our strategic initiatives, global economic conditions, especially in the technology sector, financial services, MSO and insurance.

We have developed plans and will continue to monitor plans to address process improvements and realize other efficiencies throughout our global footprint with a goal to reduce cost, remove waste and improve our overall gross margins. There can be no assurance that these actions will improve gross margins. For the three months ended January 31, 2019 and 2018, our gross margin percentage was 18.2% and 10.3%, respectively. Increased competition as well as industry consolidation and/or low demand for our clients' products and services may hinder our ability to maintain or improve our gross margins, profitability and cash flows. We must continue to focus on margin improvement, through implementation of our strategic initiatives, cost reductions and asset and employee productivity gains in order to improve the profitability of our business and maintain our competitive position. We generally manage margin and pricing pressures in several ways, including efforts to target new markets, expand and enhance our service offerings, improve the efficiency of our processes and to lower our infrastructure costs. We seek to lower our cost to service clients by moving work to lower-cost venues, consolidating and leveraging our global facility footprint, drive process and efficiency reforms and other actions designed to improve the productivity of our operations.

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Historically, a limited number of key clients had accounted for a significant percentage of our revenue. For the three months ended January 31, 2019, the Company's ten largest clients accounted for approximately 48.5% of consolidated net revenue. One client from the computing market accounted for more than 10% of the Company's consolidated net revenue for the three months ended January 31, 2019. In general, we do not have any agreements which obligate any client to buy a minimum amount of services from us or designate us as an exclusive service provider. Consequently, our net revenue is subject to demand variability by our clients. The level and timing of orders placed by our clients vary for a variety of reasons, including seasonal buying by end-users, the introduction of new technologies and general economic conditions. By diversifying into new markets and improving the operational support structure for our clients, we expect to offset the adverse financial impact such factors may bring about.

For the three months ended January 31, 2019, the Company reported net revenue of \$206.2 million, operating income of \$2.1 million, loss before income taxes of \$10.3 million and net loss of \$11.8 million. For the six months ended January 31, 2019, the Company reported net revenue of \$421.4 million, operating income of \$5.7 million, loss before income taxes of \$16.6 million and net loss of \$19.1 million. For the three months ended January 31, 2018, the Company reported net revenue of \$153.7 million, operating loss of \$5.7 million, loss before income taxes of \$13.9 million and net income of \$59.8 million. For the six months ended January 31, 2018, the Company reported net revenue of \$256.3 million, operating loss of \$9.5 million, loss before income taxes of \$18.3 million and net income of \$54.6 million. At January 31, 2019, we had cash and cash equivalents of \$92.9 million, and working capital of \$(7.9) million.

***Basis of Presentation***

The Company presents its financial information in accordance with accounting principles generally accepted in the United States, U.S. GAAP (or GAAP). The Company has five operating segments: Americas; Asia; Europe; Direct Marketing; and e-Business. Based on the information provided to the Company's chief operating decision-maker for purposes of making decisions about allocating resources and assessing performance and quantitative thresholds, the Company has determined that it has five reportable segments: Americas, Asia, Europe, Direct Marketing and e-Business. The Company also has Corporate-level activity, which consists primarily of costs associated with certain corporate administrative functions such as legal, finance, share-based compensation and acquisition costs which are not allocated to the Company's reportable segments. The Corporate-level balance sheet information includes cash and cash equivalents, notes payables and other assets and liabilities which are not identifiable to the operations of the Company's operating segments.

All significant intercompany transactions and balances have been eliminated in consolidation.

***Results of Operations***

*Three months ended January 31, 2019 compared to the three months ended January 31, 2018*

***Net Revenue:***

	As a % of		As a % of		
Three Months Ended January 31, 2019	Total Net Revenue	Three Months Ended January 31, 2018	Total Net Revenue	\$ Change	% Change

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(In thousands)

Americas	\$ 16,709	8.1%	\$ 13,764	9.0%	\$ 2,945	21.4%
Asia	44,555	21.6%	36,290	23.6%	8,265	22.8%
Europe	20,450	9.9%	37,893	24.6%	(17,443)	(46.0%)
Direct Marketing	118,447	57.4%	59,532	38.7%	58,915	99.0%
e-Business	6,062	3.0%	6,259	4.1%	(197)	(3.1%)
Total	\$ 206,223	100.0%	\$ 153,738	100.0%	\$ 52,485	34.1%

Net revenue increased by approximately \$52.5 million during the three months ended January 31, 2019, as compared to the same period in the prior year. The change in net revenue was driven by the increase in revenue associated with the acquisition of IWCO in December 2017, offset primarily by decreased revenues from a client in the consumer electronics industry. Fluctuations in foreign currency exchange rates had an insignificant impact on net revenues for the quarter ended January 31, 2019 as compared to the same period in the prior year.

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During the three months ended January 31, 2019, net revenue in the Americas region increased by approximately \$2.9 million. This increase in net revenue was primarily driven by clients in the computing market, offset partially by a decrease in revenue from clients in the consumer electronics market. Within the Asia region, the net revenue increase of approximately \$8.3 million primarily resulted from higher revenues from programs in the computing and consumer electronics markets, offset partially by lower revenues from other clients in the consumer electronics industries. Within the Europe region, net revenue decreased by approximately \$17.4 million primarily due to a client loss in the consumer electronics industry. The loss of this client did not have a significant negative affect on income from operations. Net revenue for e-Business remained consistent for the three-month period.

**Cost of Revenue:**

	<b>Three Months Ended January 31, 2019</b>	<b>As a % of Segment Net Revenue</b>	<b>Three Months Ended January 31, 2018</b>	<b>As a % of Segment Net Revenue</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(In thousands)</b>					
Americas	\$ 18,506	110.8%	\$ 14,332	104.1%	\$ 4,174	29.1%
Asia	35,453	79.6%	28,942	79.8%	6,511	22.5%
Europe	19,490	95.3%	37,787	99.7%	(18,297)	(48.4%)
Direct Marketing	89,930	75.9%	51,251	86.1%	38,679	75.5%
e-Business	5,301	87.4%	5,603	89.5%	(302)	(5.4%)
<b>Total</b>	<b>\$ 168,680</b>	<b>81.8%</b>	<b>\$ 137,915</b>	<b>89.7%</b>	<b>\$ 30,765</b>	<b>22.3%</b>

Cost of revenue consists primarily of expenses related to the cost of materials purchased in connection with the provision of supply chain management and direct marketing services as well as costs for salaries and benefits, contract labor, consulting, paper for direct mailing, fulfillment and shipping, and applicable facilities costs. Cost of revenue for the three months ended January 31, 2019 included materials procured on behalf of our supply-chain clients of \$50.4 million, as compared to \$55.0 million for the same period in the prior year, a decrease of \$4.6 million. Total cost of revenue increased by \$30.8 million for the three months ended January 31, 2019, as compared to the same period in the prior year, primarily due to the increase in cost of revenue associated with the acquisition of IWCO, partially offset by lower material and labor costs associated with lower volume from clients in the consumer electronics and consumer products industries. Gross margin percentage for the current quarter increased to 18.2% from 10.3% in the prior year quarter, primarily due to the acquisition of IWCO. For the three months ended January 31, 2019, the Company's gross margin percentages within the Americas, Asia, Europe and Direct Marketing segments were -10.8%, 20.4%, 4.7% and 24.1%, respectively, as compared to gross margin percentages within the Americas, Asia, Europe and Direct Marketing segments of -4.1%, 20.2%, 0.3% and 13.9%, respectively, for the same period of the prior year. Fluctuations in foreign currency exchange rates had an insignificant impact on gross margin for the quarter ended January 31, 2019.

In the Americas, the 6.7 percentage point decrease in gross margin, from -4.1% to -10.8%, was primarily due to a favorable shift in volumes offset by an increase in material and labor costs and certain client exit costs. In Asia, the 0.2 percentage point increase in gross margin, from 20.2% to 20.4%, was primarily due to product mix. In Europe, the 4.4 percentage point increase in gross margin, from 0.3% to 4.7%, was attributable to a decline in the cost of materials associated with a client loss in the consumer electronics industry. Direct Marketing's gross margins increased by 10.2 percentage points, from 13.9% to 24.1%, primarily due to a \$7.0 million non-cash charge related to a fair value



step-up to work-in-process inventory which was recorded during the three months ended January 31, 2018. The gross margin for e-Business was 12.6% for the three months ended January 31, 2019 as compared to 10.5% for the same period of the prior year. This increase of 2.1 percentage points was due to a favorable revenue mix.

**Table of Contents*****Selling, General and Administrative Expenses:***

	<b>Three Months As a % Ended of Segment January 31, Net 2019 Revenue</b>		<b>Three Months As a % Ended of Segment January 31, Net 2018 Revenue</b>		<b>\$ Change</b>	<b>% Change</b>
	<b>(In thousands)</b>					
Americas	\$ 1,396	8.4%	\$ 1,719	12.5%	\$ (323)	(18.8%)
Asia	3,820	8.6%	4,317	11.9%	(497)	(11.5%)
Europe	2,314	11.3%	3,565	9.4%	(1,251)	(35.1%)
Direct Marketing	14,031	11.8%	8,126	13.6%	5,905	72.7%
e-Business	1,722	28.4%	2,002	32.0%	(280)	(14.0%)
Sub-total	23,283	11.3%	19,729	12.8%	3,554	18.0%
Corporate-level activity	4,428		10,382		(5,954)	(57.3%)
<b>Total</b>	<b>\$ 27,711</b>	<b>13.4%</b>	<b>\$ 30,111</b>	<b>19.6%</b>	<b>\$ (2,400)</b>	<b>(8.0%)</b>

Selling, general and administrative expenses consist primarily of compensation and employee-related costs, sales commissions and incentive plans, information technology expenses, travel expenses, facilities costs, consulting fees, fees for professional services, depreciation expense, marketing expenses, share-based compensation expense, transaction costs and public reporting costs. Selling, general and administrative expenses during the three months ended January 31, 2019 decreased by approximately \$2.4 million compared to the three months period ended January 31, 2018, primarily due to lower share-based compensation expense (\$7.1 million) which was recorded as part of Corporate-level-activity, lower professional fees (\$1.1 million), lower employee related costs (\$0.4 million), offset by the additional selling, general and administrative expenses associated with the Direct Marketing segment (\$5.9 million), as well as other general and administrative costs. Direct Marketing expenses represent three months of expenses for January 31, 2019 as opposed to 1.5 months in fiscal year 2018, as the acquisition of IWCO was completed December 15, 2017. Fluctuations in foreign currency exchange rates had an insignificant impact on selling, general and administrative expenses for the quarter ended January 31, 2019.

***Amortization of Intangible Assets:***

The intangible asset amortization of \$7.8 million and \$4.1 million, respectively, during the three months ended January 31, 2019 and 2018, relates to amortizable intangible assets acquired by the Company in connection with its acquisition of IWCO. Acquired intangible assets include trademarks, tradenames and customer relationships. The trademarks and tradenames intangible asset are being amortized on a straight line basis over a 3 year estimated useful life. The customer relationship intangible asset are being amortized on a double-declining basis over an estimated useful life of 15 years.

***Interest Income/Expense:***

During the three months ended January 31, 2019 and 2018, interest expense totaled approximately \$11.0 million and \$6.6 million, respectively. The increase in interest expense is primarily due to the additional debt associated with the acquisition of IWCO.

***Other Gains (Losses), net:***

The Company recorded foreign exchange losses of approximately \$(1.5) million and \$(1.4) million during the three months ended January 31, 2019 and 2018, respectively. For the three months ended January 31, 2019, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(1.1) million, \$(0.9) million and \$0.5 million in Corporate, Asia and Europe, respectively. For the three months ended January 31, 2018, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(2.3) million, \$1.3 million and \$(0.7) million in Corporate, Europe and Asia, respectively.

***Income Tax Expense:***

During the three months ended January 31, 2019, the Company recorded income tax expense of approximately \$1.4 million, as compared to income tax benefit of \$73.5 million for the same period in the prior fiscal year. The income tax benefit in the prior year quarter is related to the reduction of the Company's valuation allowance associated with the IWCO acquisition of approximately \$79.9 million, partially offset by income tax expense in certain jurisdictions where the Company operates, using the enacted tax rates in those jurisdictions.

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The Company provides for income tax expense related to federal, state, and foreign income taxes. The Company continues to maintain a full valuation allowance against its deferred tax assets in the U.S. and certain of its foreign subsidiaries due to the uncertainty of realizing such benefits.

**Results of Operations**

Six months ended January 31, 2019 compared to the six months ended January 31, 2018

**Net Revenue:**

	<b>Six Months Ended January 31, 2019</b>	<b>As a % of Total Net Revenue</b>	<b>Six Months Ended January 31, 2018</b>	<b>As a % of Total Net Revenue</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(In thousands)</b>					
Americas	\$ 34,149	8.1%	\$ 28,603	11.2%	\$ 5,546	19.4%
Asia	88,811	21.1%	79,802	31.1%	9,009	11.3%
Europe	39,971	9.5%	76,283	29.8%	(36,312)	(47.6%)
Direct Marketing	246,541	58.5%	59,532	23.2%	187,009	314.1%
e-Business	11,884	2.8%	12,040	4.7%	(156)	(1.3%)
<b>Total</b>	<b>\$ 421,356</b>	<b>100.0%</b>	<b>\$ 256,260</b>	<b>100.0%</b>	<b>\$ 165,096</b>	<b>64.4%</b>

Net revenue increased by approximately \$165.1 million during the six months ended January 31, 2019, as compared to the same period in the prior year. The change in net revenue was driven by the increase in revenue associated with the acquisition of IWCO in December 2017, offset primarily by decreased revenues from a client in the consumer electronics industry, which did not have a significant negative affect on income from operations. Fluctuations in foreign currency exchange rates had an insignificant impact on net revenues for the six months ended January 31, 2019 as compared to the same period in the prior year.

During the six months ended January 31, 2019, net revenue in the Americas region increased by approximately \$5.5 million. This increase in net revenue was primarily driven by clients in the computing market, offset partially by a decrease in revenue from clients in the consumer electronics market. Within the Asia region, the net revenue increase of approximately \$9.0 million primarily resulted from higher revenues from programs in the computing and consumer electronics markets, offset partially by lower revenues from other clients in the consumer electronics industries. Within the Europe region, net revenue decreased by approximately \$36.3 million primarily due to a client loss in the consumer electronics industry. Net revenue for e-Business remained consistent for the three month period.

**Cost of Revenue:**

	<b>Six Months Ended</b>	<b>As a % of Segment Net</b>	<b>Six Months Ended</b>	<b>As a % of Segment Net</b>	<b>\$ Change</b>	<b>% Change</b>
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	<b>January 31, Revenue 2019</b>		<b>January 31, Revenue 2018 (In thousands)</b>			
Americas	\$ 35,371	103.6%	\$ 29,634	103.6%	\$ 5,737	19.4%
Asia	70,948	79.9%	63,967	80.2%	6,981	10.9%
Europe	38,178	95.5%	75,515	99.0%	(37,337)	(49.4%)
Direct Marketing	190,611	77.3%	51,251	86.1%	139,360	271.9%
e-Business	10,505	88.4%	10,996	91.3%	(491)	(4.5%)
Total	\$ 345,613	82.0%	\$ 231,363	90.3%	\$ 114,250	49.4%

Cost of revenue consists primarily of expenses related to the cost of materials purchased in connection with the provision of supply chain management and direct marketing services as well as costs for salaries and benefits, contract labor, consulting, paper for direct mailing, fulfillment and shipping, and applicable facilities costs. Cost of revenue for the six months ended January 31, 2019 included materials procured on behalf of our supply-chain clients of \$99.3 million, as compared to \$115.6 million for the same period in the prior year, a decrease of \$16.3 million. Total cost of revenue increased by \$114.3 million for the six months ended January 31,

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2019, as compared to the same period in the prior year, primarily due to the increase in cost of revenue associated with the acquisition of IWCO, partially offset by lower material and labor costs associated with lower volume from clients in the consumer electronics and consumer products industries. Gross margin percentage for the current quarter increased to 18.0% from 9.7% in the prior year quarter, primarily due to the acquisition of IWCO. For the six months ended January 31, 2019, the Company's gross margin percentages within the Americas, Asia, Europe and Direct Marketing segments were -3.6%, 20.1%, 4.5% and 22.7%, respectively, as compared to gross margin percentages within the Americas, Asia, Europe and Direct Marketing segments of -3.6%, 19.8%, 1.0% and 13.9%, respectively, for the same period of the prior year. Fluctuations in foreign currency exchange rates had an insignificant impact on gross margin for the quarter ended January 31, 2019.

In the Americas, the gross margin remained consistent, which was primarily due to a favorable shift in volumes offset by an increase in material, labor and certain client exit costs. In Asia, the 0.3 percentage point increase in gross margin, from 19.8% to 20.1%, was primarily due to product mix. In Europe, the 3.5 percentage point increase in gross margin, from 1.0% to 4.5%, was attributable to a decline in the cost of materials associated with a client loss in the consumer electronics industry. Direct Marketing's gross margins increased by 8.8 percentage points, from 13.9% to 22.7%, primarily due to a \$7.0 million non-cash charge related to a fair value step-up to work-in-process inventory which was recorded during the six months ended January 31, 2018. The gross margin for e-Business was 11.6% for the six months ended January 31, 2019 as compared to 8.7% for the same period of the prior year. This increase of 2.9 percentage points was due to a favorable reduction in labor costs.

***Selling, General and Administrative Expenses:***

	<b>Six Months Ended January 31, 2019</b>	<b>As a % of Segment Net Revenue</b>	<b>Six Months Ended January 31, 2018</b>	<b>As a % of Segment Net Revenue</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(In thousands)</b>					
Americas	\$ 2,797	8.2%	\$ 3,455	12.1%	\$ (658)	(19.0%)
Asia	7,453	8.4%	8,635	10.8%	(1,182)	(13.7%)
Europe	4,619	11.6%	7,087	9.3%	(2,468)	(34.8%)
Direct Marketing	28,578	11.6%	8,126	13.6%	20,452	251.7%
e-Business	3,488	29.4%	3,835	31.9%	(347)	(9.0%)
Sub-total	46,935	11.1%	31,138	12.2%	15,797	50.7%
Corporate-level activity	7,341		11,877		(4,536)	(38.2%)
Total	\$ 54,276	12.9%	\$ 43,015	16.8%	\$ 11,261	26.2%

Selling, general and administrative expenses consist primarily of compensation and employee-related costs, sales commissions and incentive plans, information technology expenses, travel expenses, facilities costs, consulting fees, fees for professional services, depreciation expense, marketing expenses, share-based compensation expense, transaction costs and public reporting costs. Selling, general and administrative expenses during the six months ended January 31, 2019 increased by approximately \$11.3 million compared to the six months period ended January 31, 2018, primarily due to additional selling, general and administrative expenses associated with the Direct Marketing segment (\$20.5 million), offset by lower share-based compensation expense (\$6.6 million) which was recorded as part

of Corporate-level-activity, lower professional fees (\$2.1 million), lower employee related costs (\$1.1 million), as well as other general and administrative costs. Direct Marketing expenses represent of a full six months of expenses in fiscal year 2019 as opposed to 1.5 months in fiscal year 2018. Fluctuations in foreign currency exchange rates had an insignificant impact on selling, general and administrative expenses for the quarter ended January 31, 2019.

***Amortization of Intangible Assets:***

The intangible asset amortization of \$15.9 million and \$4.1 million, respectively, during the six months ended January 31, 2019 and 2018, relates to amortizable intangible assets acquired by the Company in connection with its acquisition of IWCO on December 15, 2017. Acquired intangible assets include trademarks, tradenames and customer relationships. The trademarks and tradenames intangible asset are being amortized on a straight-line basis over a 3 year estimated useful life. The customer relationship intangible asset is being amortized on a double-declining basis over an estimated useful life of 15 years.

***Interest Income/Expense:***

During the six months ended January 31, 2019 and 2018, interest income was \$0.5 million and \$0.3 million, respectively.

During the six months ended January 31, 2019 and 2018, interest expense totaled approximately \$22.0 million and \$8.7 million, respectively. The increase in interest expense primarily due to the additional debt associated with the acquisition of IWCO.

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**Table of Contents*****Other Gains (Losses), net:***

The Company recorded foreign exchange losses of approximately \$0.6 million and \$2.1 million during the six months ended January 31, 2019 and 2018, respectively. For the six months ended January 31, 2019, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$0.6 million, \$(0.5) million and \$(0.5) million in Corporate, Asia and Europe, respectively. For the six months ended January 31, 2018, the net losses primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$(2.2) million, \$1.0 million and \$(1.1) million in Corporate, Europe and Asia, respectively.

During the six months ended January 31, 2018, the Company recognized \$2.7 million in net non-cash losses associated with its Trading Securities. During the six months ended January 31, 2018, the Company recognized \$4.6 million in net cash gains associated with its Trading Securities.

***Income Tax Expense:***

During the six months ended January 31, 2019, the Company recorded income tax expense of approximately \$2.5 million. During the six months ended January 31, 2018, the Company recorded income tax benefit of approximately \$72.4 million. The income tax benefit during the six months ended January 31, 2018 is related to the reduction of the Company's valuation allowance associated with the IWCO acquisition of approximately \$79.9 million partially offset by income tax expense in certain jurisdictions where the Company operates, using the enacted tax rates in those jurisdictions.

The Company provides for income tax expense related to federal, state, and foreign income taxes. The Company continues to maintain a full valuation allowance against its deferred tax assets in the U.S. and certain of its foreign subsidiaries due to the uncertainty of realizing such benefits.

***Liquidity and Capital Resources***

Historically, the Company has financed its operations and met its capital requirements primarily through funds generated from operations, the sale of our securities, borrowings from lending institutions and sale of facilities that were not fully utilized. As of January 31, 2019, the Company's primary sources of liquidity consisted of cash and cash equivalents of \$92.9 million. The Company's ModusLink Corporation subsidiary has undistributed earnings from its foreign subsidiaries of approximately \$11.6 million at January 31, 2019, of which approximately \$2.4 million is considered to be permanently reinvested due to certain restrictions under local laws as well as the Company's plans to reinvest such earnings for future expansion in certain foreign jurisdictions. Due to the changes reflected in the new tax law there is no U.S. tax payable upon repatriating the undistributed earnings of foreign subsidiaries considered not subject to permanent investment. Foreign withholding taxes would range from 0% to 10% on any repatriated funds.

For the Company, earnings and profits have been calculated at each subsidiary. The Company's foreign subsidiaries are in an overall net deficit for earnings and profits purposes. As such, no adjustment has been made to U.S. taxable income in 2018 relating to this aspect of the new tax law. In future years, under the new tax law the Company will be able to repatriate its foreign earnings without incurring additional U.S. tax as a result of a 100% dividends received deduction. The Company believes that any future withholding taxes or state taxes associated with such a repatriation would be minor.

On June 30, 2014, two direct and wholly owned subsidiaries of the Company (the ModusLink Borrowers) entered into a revolving credit and security agreement (the Credit Agreement), as borrowers and guarantors, with PNC Bank and



National Association, as lender and as agent, respectively. The Credit Agreement has a five (5) year term which expires on June 30, 2019. It includes a maximum credit commitment of \$50.0 million, is available for letters of credit (with a sublimit of \$5.0 million) and has a \$20.0 million uncommitted accordion feature (the PNC Bank Credit Facility ). The actual maximum credit available under the Credit Agreement varies from time to time and is determined by calculating the applicable borrowing base, which is based upon applicable percentages of the values of eligible accounts receivable and eligible inventory minus reserves determined by the Agent (including other reserves that the Agent may establish from time to time in its permitted discretion), all as specified in the Credit Agreement.

The Credit Agreement contains certain customary negative covenants, which include limitations on mergers and acquisitions, the sale of assets, liens, guarantees, investments, loans, capital expenditures, dividends, indebtedness, changes in the nature of business, transactions with affiliates, the creation of subsidiaries, changes in fiscal year and accounting practices, changes to governing documents, compliance with certain statutes, and prepayments of certain indebtedness. The Credit Agreement also contains certain customary affirmative covenants (including periodic reporting obligations) and events of default, including upon a change of control. The Credit Agreement requires compliance with certain financial covenants providing for maintenance of specified liquidity, maintenance of a minimum fixed charge coverage ratio and/or maintenance of a maximum leverage ratio following the occurrence of

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certain events and/or prior to taking certain actions. For greater clarity, if the undrawn availability, as more fully described in the Credit Agreement, is either equal to or less than \$10.0 million, or the aggregate principal balance of the loans plus the undrawn amount of all letters of credit in each case outstanding on any date is equal to or greater than \$30.0 million; then compliance with the minimum fixed charge coverage ratio is required. If triggered, the minimum fixed charge coverage ratio to be maintained, as of the end of each fiscal month, for the trailing period of twelve consecutive fiscal months then ended, would be not less than 1.0 to 1.0. During the quarter ended January 31, 2019, the Company did not meet the criteria that would cause its financial covenants to be applicable. As of January 31, 2019 and July 31, 2018, the Company did not have any balance outstanding on the PNC Bank credit facility. At January 31, 2019, the Company had a readily available borrowing capacity under its PNC Bank Credit Facility of \$4.6 million.

On March 18, 2014, the Company entered into an indenture (the *Indenture*) with Wells Fargo Bank, National Association, as trustee (the *Trustee*), relating to the Company's issuance of \$100 million of 5.25% Convertible Senior Notes (the *Notes*). The Notes bore interest at the rate of 5.25% per year, payable semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2014. The Notes matured on March 1, 2019, at which time the balance due was paid in full.

During the six months ended January 31, 2019, the Company purchased \$3.7 million in face value of the Notes in the open market at a purchase price of \$3.7 million. The loss of \$0.1 million on this transaction is presented as a component of other gains and losses. As of January 31, 2019 and July 31, 2018, the net carrying value of the Notes was \$63.5 million and \$64.5 million, respectively. As of January 31, 2019 and July 31, 2018, SPHG Group Holdings LLC ( *SPHG Holdings* ) held \$14.9 million principal amount of the Notes.

As previously mentioned the Notes matured on March 1, 2019. The balance due was \$65.6 million including interest to the March 1st date. Included in the balance due was a Note held by SPH Group Holdings LLC in the principal amount of \$14.9 million. The total amount was paid in full from available cash on hand including the \$14.9 million from the proceeds of the SPHG Holdings Note.

On December 15, 2017, MLGS Merger Company, Inc., a Delaware corporation and newly formed wholly-owned subsidiary of the Company ( *MLGS* ), entered into a Financing Agreement (the *Financing Agreement*), by and among the MLGS (as the initial borrower), Instant Web, LLC, a Delaware corporation and wholly owned subsidiary of IWCO (as Borrower), IWCO, and certain of IWCO's subsidiaries (together with IWCO, the *Guarantors*), the lenders from time to time party thereto, and Cerberus Business Finance, LLC, as collateral agent and administrative agent for the lenders. MLGS was the initial borrower under the Financing Agreement, but immediately upon the consummation of the acquisition of IWCO, as described above, Borrower became the borrower under the Financing Agreement

The Financing Agreement provides for \$393.0 million term loan facility (the *Term Loan*) and a \$25.0 million revolving credit facility (the *Revolving Facility*) (together, the *Cerberus Credit Facility*). Proceeds of the Cerberus Credit Facility were used (i) to finance a portion of the IWCO Acquisition, (ii) to repay certain existing indebtedness of the Borrower and its subsidiaries, (iii) for working capital and general corporate purposes and (iv) to pay fees and expenses related to the Financing Agreement and the IWCO Acquisition. The Cerberus Credit Facility has a maturity of five years. Borrowings under the Cerberus Credit Facility bear interest, at the Borrower's option, at a Reference Rate plus 3.75% or a LIBOR Rate plus 6.5%, each as defined the Financing Agreement. The initial interest rate under the Cerberus Credit Facility is at the LIBOR Rate option. The Term Loan under the Cerberus Credit Facility is repayable in consecutive quarterly installments, each of which will be in an amount equal per quarter of \$1.5 million and each such installment to be due and payable, in arrears, on the last day of each calendar quarter commencing on March 31, 2018 and ending on the earlier of (a) December 15, 2022 and (b) upon the payment in full of all obligations under the Financing Agreement and the termination of all commitments under the Financing Agreement. Further, the

Term Loan would be permanently reduced pursuant to certain mandatory prepayment events including an annual excess cash flow sweep of 50% of the consolidated excess cash flow, with a step-down to 25% when the Leverage Ratio (as defined in the Financing Agreement) is below 3.50:1.00; provided that, in any calendar year, any voluntary prepayments of the Term Loan shall be credited against the Borrower's excess cash flow prepayment obligations on a dollar-for-dollar basis for such calendar year. Borrowings under the Financing Agreement are fully guaranteed by the Guarantors and are collateralized by substantially all the assets of the Borrower and the Guarantors and a pledge of all of the issued and outstanding equity interests of each of IWCO's subsidiaries. The Financing Agreement contains certain representations, warranties, events of default, mandatory prepayment requirements, as well as certain affirmative and negative covenants customary for financing agreements of this type. These covenants include restrictions on borrowings, investments and dispositions, as well as limitations on the ability of the Borrower and the Guarantors to make certain capital expenditures and pay dividends. Upon the occurrence and during the continuation of an event of default under the Financing Agreement, the lenders under the Financing Agreement may, among other things, terminate all commitments and declare all or a portion of the loans under the Financing Agreement immediately due and payable and increase the interest rate at which loans and obligations under the Financing Agreement bear interest. During the twelve month ended January 31, 2019, the Company did not trigger any of these covenants. During the first quarter of fiscal year 2017, the Company adopted ASU No. 2015-03. As such, the debt issuance costs are capitalized as a reduction of

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the principal amount of Term Loan on the Company's balance sheet and amortized, using the effective-interest method, as additional interest expense over the term of the Term Loan. As of January 31, 2019 and July 31, 2018, the Company did not have an outstanding balance on the Revolving Facility. As of January 31, 2019 and July 31, 2018, the principal amount outstanding on the Term Loan was \$387.0 million and \$390.0 million, respectively. As of January 31, 2019 and July 31, 2018, the current and long-term net carrying value of the Term Loan was \$386.0 million and \$388.8 million, respectively.

Consolidated working capital (deficit) was \$(7.9) million at January 31, 2019, compared with \$(12.1) million at July 31, 2018. Included in working capital were cash and cash equivalents of \$92.9 million at January 31, 2019 and \$92.1 million at July 31, 2018. The working capital deficit is driven by classification of the Company's convertible notes as current liabilities.

Net cash provided by operating activities was \$15.5 million for the six months ended January 31, 2019, as compared to net cash provided by operating activities of \$5.0 million for the six months ended January 31, 2018. The \$10.5 million increase in net cash provided by operating activities as compared with the same period in the prior year was primarily due to the cash provided by the operating activities of IWCO subsequent to its acquisition, as well as, a reduction in the cash used in the operating activities of ModusLink Corporation. During the six months ended January 31, 2019, non-cash items within net cash provided by operating activities included depreciation expense of \$10.5 million, amortization of intangible assets of \$15.9 million, amortization of deferred financing costs of \$0.5 million, accretion of debt discount of \$2.3 million, impairment of long-lived assets of \$0.4 million, share-based compensation of \$0.8 million and other losses, net, of \$0.7 million. During the six months ended January 31, 2018, non-cash items within net cash provided by operating activities included depreciation expense of \$5.6 million, amortization of intangible assets of \$4.1, amortization of deferred financing costs of \$0.4 million, accretion of debt discount of \$2.1 million, share-based compensation of \$7.4 million, non-cash gains, net, of \$12.4 million and gains on investments in affiliates of \$0.4 million.

The Company believes that its cash flows related to operating activities of continuing operations are dependent on several factors, including profitability, accounts receivable collections, effective inventory management practices, and optimization of the credit terms of certain vendors of the Company. Our cash flows from operations are also dependent on several factors including the overall performance of the technology sector, the market for outsourcing services and the continued positive operations of IWCO.

Investing activities used cash of \$8.9 million and \$443.8 million during the six months ended January 31, 2019 and 2018, respectively. The \$8.9 million of cash used in investing activities during the six months ended January 31, 2019 was primarily comprised of \$9.0 million in capital expenditures. The \$443.8 million of cash used in investing activities during the six months ended January 31, 2018 was primarily comprised of \$469.2 in payments associated with the acquisition of IWCO, \$9.3 million in capital expenditures, offset by \$20.6 million in proceeds associated with the sale of property and equipment, \$13.8 in proceeds from the sale of Trading Securities and \$0.4 million in proceeds from investments in affiliates.

Financing activities provided (used) cash of \$(7.8) million and \$432.6 million during the six months ended January 31, 2019 and 2018, respectively. The \$7.8 million of cash used in financing activities during the six months ended January 31, 2019 was primarily comprised of \$3.0 million in payments of long-term debt, \$1.1 million in payment of preferred dividends and \$3.7 million in purchase of the Company's Convertible Notes. The \$432.6 million of cash provided by financing activities during the six months ended January 31, 2018 was primarily comprised of \$393.0 million in net proceeds from the Term Loan associated with the IWCO Acquisition, \$35.0 million in proceeds associated with the issuance of convertible preferred stock and \$6.0 million in proceeds from the revolving line of credit.

At January 31, 2019 and July 31, 2018, the Company had cash and cash equivalents of \$92.9 million and \$92.1 million, respectively. At January 31, 2019, the Company had a readily available borrowing capacity under its PNC Bank Credit Facility of \$4.6 million. At January 31, 2019, IWCO had a readily available borrowing capacity under its Revolving Facility of \$25.0 million. Per the Cerberus Credit Facility, IWCO is permitted to make distributions to the Parent, Steel Connect, Inc., an aggregate amount not to exceed \$5.0 million in any fiscal year and pay reasonable documented expenses incurred by the Parent. The Parent is entitled to receive additional cash remittances under a U.S. Federal Income Tax Sharing Agreement. As of January 31, 2019, the Company believes it will generate sufficient cash to meet its debt covenants under the Credit Agreement with PNC Bank and the Financing Agreement to which certain of its subsidiaries are a party, to repay or restructure its the Notes, and that it will be able to obtain cash through its current credit facilities and through securitization of certain trade receivables.

The Company believes that it has adequate cash and available resources to meet its obligations for one year from the date of this filing. In order to obtain funding for strategic initiatives, which may include capital expenditures or acquisitions, we may seek to raise additional funds through divestitures, public or private equity offerings, debt financings, or other means. In addition, as part of our strategic initiatives, our management may seek to retire or purchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise if we believe that it is in our best interests. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

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

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### ***Contractual Obligations***

A summary of the Company's contractual obligations is included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2018. The Company's contractual obligations and other commercial commitments did not change materially between July 31, 2018 and January 31, 2019. The Company's gross liability for unrecognized tax benefits and related accrued interest was approximately \$1.7 million as of January 31, 2019. The Company is unable to reasonably estimate the amount or timing of payments for the liability.

From time to time, the Company agrees to indemnify its clients in the ordinary course of business. Typically, the Company agrees to indemnify its clients for losses caused by the Company. As of January 31, 2019, the Company had no recorded liabilities with respect to these arrangements.

### ***Critical Accounting Policies***

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, inventory, restructuring, share-based compensation expense, long-lived assets, investments, and income taxes. Of the accounting estimates we routinely make relating to our critical accounting policies, those estimates made in the process of: determining the valuation of inventory and related reserves; determining future lease assumptions related to restructured facility lease obligations; measuring share-based compensation expense; preparing investment valuations; and establishing income tax valuation allowances and liabilities are the estimates most likely to have a material impact on our financial position and results of operations. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. However, because these estimates inherently involve judgments and uncertainties, there can be no assurance that actual results will not differ materially from those estimates.

During the six months ended January 31, 2019, other than the adoption of accounting standards updates discussed in the Condensed Consolidated Financial Statements, we believe that there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in the Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018.

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

The Company is exposed to the impact of interest rate changes, foreign currency exchange rate fluctuations and changes in the market values of its investments. The carrying value of cash and cash equivalents, accounts receivable, restricted cash, accounts payable, current liabilities and the revolving line of credit approximate fair value because of the short maturity of these instruments. We believe that the carrying value of our long-term debt approximates fair

value because the stated interest rates of this debt is consistent with current market rates. The carrying value of capital lease obligations approximates fair value, as estimated by using discounted future cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

***Interest Rate Risk***

At January 31, 2019, the Company did not have an outstanding balance under its PNC Bank Credit Facility and the Company did not have any open derivative positions with respect to its borrowing arrangements. As of January 31, 2019, the Company did not have an outstanding balance on the Revolving Facility. As of January 31, 2019, the principal amount outstanding on the Term Loan was \$387.0 million.

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The Company maintains a portfolio of highly liquid cash equivalents typically maturing in three months or less as of the date of purchase. We place our investments in instruments that meet high credit quality standards, as specified in our investment policy and include corporate and state municipal obligations such as commercial paper, certificates of deposit and institutional money market funds.

Our exposure to market risk for changes in interest rates relates primarily to our investment in short-term investments. Our short-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to our investment guidelines and market conditions.

***Foreign Currency Risk***

The Company has operations in various countries and currencies throughout the world and its operating results and financial position are subject to exposure from fluctuations in foreign currency exchange rates. From time to time, the Company has used derivative financial instruments on a limited basis, principally foreign currency exchange rate contracts, to minimize the transaction exposure that results from such fluctuations. As of January 31, 2019 and July 31, 2018, there were no foreign currency forward contracts outstanding.

Revenues from our foreign operating segments accounted for approximately 31.5% and 48.2% of total revenues during the three months ended January 31, 2019 and 2018, respectively. A portion of our international sales made by our foreign business units in their respective countries is denominated in the local currency of each country. These business units also incur a portion of their expenses in the local currency.

The primary foreign currencies in which the Company operates include Chinese Renminbi, Euros, Czech Koruna and Singapore Dollars. The income statements of our international operations that are denominated in foreign currencies are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions results in increased revenues and operating expenses for our international operations. Similarly, our revenues and operating expenses will decrease for our international operations when the U.S. dollar strengthens against foreign currencies. While we attempt to balance local currency revenue to local currency expenses to provide in effect a natural hedge, it is not always possible to completely reduce the foreign currency exchange rate risk due to competitive and other reasons.

The conversion of the foreign subsidiaries' financial statements into U.S. dollars will lead to a translation gain or loss which is recorded as a component of other comprehensive income (loss). For the three months ended January 31, 2019 and 2018, we recorded a foreign currency translation gain of approximately \$1.9 million and \$3.7 million, respectively, which is recorded within accumulated other comprehensive income in stockholders' equity in our condensed consolidated balance sheet. In addition, certain of our subsidiaries have assets and liabilities that are denominated in currencies other than the relevant entity's functional currency. Changes in the relative exchange rates between the currencies result in remeasurement gains or losses at each balance sheet date and transaction gains or losses upon settlement. For the three months ended January 31, 2019 and 2018, we recorded net realized and unrealized foreign currency transaction and remeasurement losses of approximately \$1.5 million and \$1.4 million, respectively, which are recorded in Other gains (losses), net in our condensed consolidated statements of operations.

Our international business is subject to risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign currency exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. As exchange rates vary, our international financial results may vary from



expectations and adversely impact our overall operating results.

Our international business is subject to risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign currency exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. As exchange rates vary, our international financial results may vary from expectations and adversely impact our overall operating results.

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**Table of Contents****Item 4. Controls and Procedures.***Evaluation of Disclosure Controls and Procedures*

An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Disclosure controls and procedures means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based upon that evaluation, management, including the Chief Executive Officer and Chief Financial Officer, concluded that, due to the material weakness described below as well as previously disclosed in internal controls over financial reporting as reported in the Company's 10-K for the period ended July 31, 2018, as filed with the SEC on December 4, 2018, our disclosure controls and procedures were not effective as of July 31, 2018 and January 31, 2019.

A material weakness is a control deficiency, or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement to the annual or interim financial statements will not be prevented or detected on a timely basis. In its evaluation of the effectiveness of its internal control over financial reporting as of July 31, 2018, management determined that the Company did not maintain effective internal controls over the assessment, timely review and evaluation of a material complex non-routine transaction, specifically relating to the Company's accrued pricing liability.

Notwithstanding the material weakness, management has concluded that the consolidated financial statements included in this Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented.

*Remediation of the Material Weakness in Internal Control Over Financial Reporting*

The Company has created creating a formal process related to the design and implementation of controls over the accounting policies for complex, non-routine transactions. This process includes the early evaluation of complex, non-routine transactions and documentation by the Company's accounting staff. Regular meetings with accounting staff and executive level officers involved and familiar with accounting issues related to complex, non-routine transactions will be held. As necessary, outside legal and/or accounting advice will be obtained. The Company will also revise our current risk assessment process to identify potential non-routine transactions that need to be monitored and incorporated under the planned new formal process.

Management believes the measures described above and others that will be implemented will remediate the control deficiencies the Company has identified and strengthen its internal control over financial reporting. Management is committed to continuous improvement of the Company's internal control processes and will continue to diligently review the Company's financial reporting controls and procedures. The material weakness in our internal control over financial reporting will not be considered remediated until the remediated controls operate for a sufficient period of

time and management has concluded, through testing, that these controls are operating effectively. The Company and its outside legal counsel are working to have the material weakness remediated as soon as possible. The Company is committed to continuing to improve our internal control processes and will continue to diligently and vigorously review our financial reporting controls and procedures. As management continues to evaluate and work to improve internal control over financial reporting, the Company may decide to take additional measures to address control deficiencies or decide to modify, or in appropriate circumstances not to complete, certain of the remediation measures described above.

*Changes in Internal Control over Financial Reporting*

Beginning August 1, 2018, the Company implemented ASC Topic 606, Revenue from Contracts with Customers. Although the new revenue standard did not have a material impact on consolidated financial statements, the Company did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, new training, ongoing contract review requirements, and the gathering of information necessary provided for expanded disclosures.

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Except as described in the preceding paragraph, there have been no changes in our internal controls over financial reporting (as defined in Rule 13(a)-15(f) or Rule 15d-15(f) of the Exchange Act) during the three months ended January 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings.**

On April 13, 2018, a purported shareholder, Donald Reith, filed a verified complaint, *Reith v. Lichtenstein, et al.*, 2018-0277 (Del. Ch.) in the Delaware Court of Chancery. The complaint alleges class and derivative claims for breach of fiduciary duty and/or aiding and abetting breach of fiduciary duty and unjust enrichment against the Company's Board of Directors (the Board), Warren Lichtenstein, Glen Kassan, William T. Fejes, Jack L. Howard, Jeffrey J. Fenton, Philip E. Lengyel and Jeffrey S. Wald; and stockholders Steel Holdings, Steel Partners, L.P., SPHG Holdings, Handy & Harman Ltd. and WHX CS Corp. (collectively, Steel Parties) in connection with the acquisition of \$35 million of the Series C Preferred Stock by SPHG Holdings and equity grants made to Lichtenstein, Howard and Fejes on December 15, 2017 (collectively, Challenged Transactions). The Company is named as a nominal defendant. The complaint alleges that although the Challenged Transactions were approved by a Special Committee consisting of the independent members of the Board (Messrs. Fenton, Lengyel and Wald), the Steel Parties dominated and controlled the Special Committee, who approved the Challenged Transactions in breach of their fiduciary duty. Plaintiff alleges that the Challenged Transactions unfairly diluted shareholders and therefore unjustly enriched Steel Holdings, SPHG Holdings and Messrs. Lichtenstein, Howard and Fejes. The complaint also alleges that the Board made misleading disclosures in the Company's proxy statement for the 2017 meeting in connection with seeking approval to amend the 2010 Incentive Award Plan to authorize the issuance of additional shares to accommodate certain shares underlying the equity grants. Remedies requested include rescission of the Series C Convertible Preferred Stock and equity grants, disgorgement of any unjustly obtained property or compensation and monetary damages.

On June 18, 2018, defendants moved to dismiss the complaint for failure to plead demand futility and failure to state a claim. The motions are fully briefed, and argument was held March 5, 2019. On March 5, 2019, the Court of Chancery heard oral argument on (i) the motion to dismiss the Reith complaint and (ii) Ladjvardian's (see below) motion to intervene and stay. The Court took the motion to dismiss under advisement. Discovery is stayed pending a decision on the motions to dismiss. Because the litigation is at an early stage and motions to dismiss are pending, we are unable at this time to provide a calculation of potential damages or litigation loss that is probable or estimable. Although there can be no assurance as to the ultimate outcome, the Company believes it has meritorious defenses, has denied liability, and intends to defend this litigation vigorously.

On January 18, 2019, Mohammad Ladjvardian, a purported shareholder, filed a verified complaint pursuant to 8 Del. C. § 220. The complaint seeks previously demanded books and records concerning the matters in Ladjvardian's letters dated January 29, 2018, and August 21, 2018. The complaint does not seek money damages, but does request an award of reasonable attorneys' fees and costs incurred in pursuing the action. Steel Connect filed an Answer on February 7, 2019. On February 20, 2019, the Court entered a scheduling order. Trial in this matter is scheduled for June 26, 2019. Ladjvardian moved to intervene in the Reith matter. On March 5, 2019, the Court took the motion under advisement and denied Ladjvardian's motion to intervene.

**Item 1A. Risk Factors.**

There have not been any material changes from the risk factors previously disclosed in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended July 31, 2018. In addition to the other information set forth in this report, you should carefully consider the risks and uncertainties discussed in Part I, Item 1A. Risk Factors discussed in our Annual Report, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be not material also may materially and adversely affect our business, financial condition and/or operating results.

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

None.

**Table of Contents****Item 3. Default Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Note applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.****Exhibit****Number****Description**

4.1	<u>Form of 7.50% Convertible Senior Note due 2024 issued by Steel Connect, Inc. to SPH Group Holdings LLC., is incorporated herein by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on February 28, 2019.</u>
10.1	<u>7.50% Convertible Senior Note Due 2024 Purchase Agreement, dated as of February 28, 2019, by and between Steel Connect, Inc. and SPH Group Holdings LLC., is incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 28, 2019.</u>
31.1*	<u>Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2*	<u>Certification of the Principal Financial Officer and Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1±	<u>Certification of the Principal Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2±	<u>Certification of the Principal Financial Officer and Principal Accounting Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101*	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Unaudited Condensed Consolidated Balance Sheets as of January 31, 2019 and July 31, 2018, (ii) Unaudited Condensed Consolidated Statements of Operations for the three and six months ended January 31, 2019 and 2018, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended January 31, 2019 and 2018 (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended January 31, 2019 and 2018 and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

\* Filed herewith.

± Furnished herewith.



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**SIGNATURE**

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.

STEEL CONNECT, INC.

Date: March 11, 2019

By: /S/ LOUIS J. BELARDI  
**Louis J. Belardi**  
**Chief Financial Officer**  
**(Duly Authorized Officer, Principal Financial**  
**and Accounting Officer)**