

# **Welspun USA, Inc.**

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## **Consolidated Financial Report March 31, 2015**

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## Independent Auditor's Report

To the Board of Directors  
Welspun USA, Inc.

We have audited the accompanying consolidated financial statements of Welspun USA, Inc. and its subsidiaries (the "Company" or Welspun USA), which comprise the consolidated balance sheet as of March 31, 2015 and 2014 and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Welspun USA, Inc. and its subsidiaries as of March 31, 2015 and 2014 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Plante & Moran, PLLC*

May 4, 2015

# Welspun USA, Inc.

## Consolidated Balance Sheet

	<u>March 31, 2015</u>	<u>March 31, 2014</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 1,163,685	\$ 2,710,787
Accounts receivable:		
Trade	35,414,144	28,256,516
Affiliates (Note 11)	468,334	390,224
Inventory (Note 2)	33,572,222	28,249,622
Prepaid expenses and other current assets:		
Prepaid expenses and other advances	514,073	658,573
Advances to affiliate (Note 11)	-	6,058,754
Deferred tax assets (Note 6)	812,687	1,227,358
Total current assets	<u>71,945,145</u>	<u>67,551,834</u>
<b>Property and Equipment - Net (Note 3)</b>	321,808	428,129
<b>Other Assets</b>		
Deposits	242,241	238,266
Deferred tax assets (Note 6)	90,065	118,232
Total assets	<u><b>\$ 72,599,259</b></u>	<u><b>\$ 68,336,461</b></u>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Trade accounts payable	\$ 2,453,230	\$ 1,957,457
Trade payables to related parties (Note 11)	18,192,420	20,627,274
Bank line of credit (Note 4)	16,084,741	15,147,743
Current portion of long-term debt (Note 7)	3,000,000	-
Accrued customer incentives	6,588,881	4,497,132
Discontinued operations (Note 12)	20,763	41,055
Accrued and other current liabilities	3,728,014	2,770,100
Total current liabilities	<u>50,068,049</u>	<u>45,040,761</u>
<b>Long-term Debt - Net of current portion (Note 7)</b>	12,000,000	15,000,000
<b>Other Long-term Liabilities - Deferred rent</b>	63,682	66,390
<b>Stockholders' Equity</b>	<u>10,467,528</u>	<u>8,229,310</u>
Total liabilities and stockholders' equity	<u><b>\$ 72,599,259</b></u>	<u><b>\$ 68,336,461</b></u>

# Welspun USA, Inc.

## Consolidated Statement of Operations

	Year Ended	
	March 31, 2015	March 31, 2014
<b>Revenue</b>		
Product	\$ 176,101,419	\$ 154,181,759
Commission income - Related parties	2,973,242	2,592,125
Total revenue	179,074,661	156,773,884
<b>Cost of Sales</b>	156,960,856	137,988,853
<b>Gross Profit</b>	22,113,805	18,785,031
<b>Operating Expenses</b>	17,008,769	14,025,829
<b>Operating Income</b>	5,105,036	4,759,202
<b>Nonoperating Income (Expense)</b>		
Other income	1,160	5,535
Interest expense	(1,524,395)	(1,362,981)
Total nonoperating expense	(1,523,235)	(1,357,446)
<b>Income - Before income taxes</b>	3,581,801	3,401,756
<b>Income Tax Expense</b> (Note 6)	1,343,145	1,364,643
<b>Income Before Discontinued Operations</b>	2,238,656	2,037,113
<b>Discontinued Operations - Net of tax</b> (Note 12)	(438)	144,772
<b>Net Income</b>	<b>\$ 2,238,218</b>	<b>\$ 2,181,885</b>

## Welspun USA, Inc.

### Consolidated Statement of Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Total
<b>Balance - April 1, 2013</b>	\$ 216,871	\$ 8,683,129	\$ (2,852,575)	\$ 6,047,425
Net income	-	-	2,181,885	2,181,885
<b>Balance - March 31, 2014</b>	216,871	8,683,129	(670,690)	8,229,310
Net income	-	-	2,238,218	2,238,218
<b>Balance - March 31, 2015</b>	<b>\$ 216,871</b>	<b>\$ 8,683,129</b>	<b>\$ 1,567,528</b>	<b>\$ 10,467,528</b>

# Welspun USA, Inc.

## Consolidated Statement of Cash Flows

	Year Ended	
	March 31, 2015	March 31, 2014
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 2,238,218	\$ 2,181,885
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	202,478	385,545
Bad debt expense	(49,956)	244,082
Deferred income taxes	442,838	959,455
Deferred rent	(66,390)	(132,774)
Changes in operating assets and liabilities which (used) provided cash:		
Accounts receivable	(1,127,028)	5,960,468
Inventory	(5,322,600)	3,046,500
Prepaid expenses and other assets	144,500	(6,279,849)
Deposits	(3,975)	(78,379)
Accounts payable	(1,875,399)	(3,415,613)
Accrued and other liabilities	3,029,371	(881,066)
Net cash (used in) provided by operating activities	(2,387,943)	1,990,254
<b>Cash Flows from Investing Activities</b> - Purchase of property and equipment	(96,157)	(192,329)
<b>Cash Flows from Financing Activities</b>		
Proceeds from debt	-	3,750,000
Net proceeds from (payments on) revolving credit facilities	936,998	(3,525,074)
Net cash provided by financing activities	936,998	224,926
<b>Net (Decrease) Increase in Cash</b>	(1,547,102)	2,022,851
<b>Cash</b> - Beginning of year	2,710,787	687,936
<b>Cash</b> - End of year	<u>\$ 1,163,685</u>	<u>\$ 2,710,787</u>
<b>Supplemental Cash Flow Information</b> - Cash paid for		
Interest	\$ 1,524,395	\$ 1,362,981
Income taxes	803,548	-

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 1 - Nature of Business and Significant Accounting Policies

**Organization and Parent Support** - Welspun USA, Inc. (the "Company" or Welspun USA) was incorporated in the state of Delaware on August 11, 2000. The Company is a subsidiary of Welspun Global Brands Limited (formerly known as Welspun Retail Limited) (the "Parent" or Welspun Global), a foreign corporation incorporated in India, which owns a 69.17 percent interest in Welspun USA. The remaining 30.83 percent is held by Welspun India Limited (Welspun India).

Welspun USA is engaged in the business of importing and distributing terry bath towels, beach towels, bath rugs, bed sheets, and other bedding products. Most of the Company's inventory is sourced through related parties. The Company sells to department stores and hotels throughout the United States and Canada.

**Trade Accounts Receivable** - Accounts receivable are stated at net invoice amounts. An allowance for doubtful accounts is established based on a specific assessment of all invoices that remain unpaid following normal customer payment periods. All amounts deemed to be uncollectible are charged against the allowance for doubtful accounts in the period that determination is made. The allowance for doubtful accounts was \$49,956 as of March 31, 2015. There was no allowance for doubtful accounts as of March 31, 2014.

Trade receivables are periodically evaluated for collectibility based on past credit history with customers and their current financial condition. Changes in the estimated collectibility of trade receivables are recorded in the period in which the estimate is revised. The Company generally does not require collateral for trade receivables.

The Company has an agreement with an insurance company to insure all of its receivables except four customers. Approximately 86 percent and 59 percent of receivables were not covered by insurance for the years ended March 31, 2015 and 2014, respectively. A fixed percentage of sales is payable to the insurance company as a premium. The Company recognizes such premium expenses in the consolidated statement of operations at the same time as revenue for sales of goods is recognized. The Company has incurred insurance premium expenses totaling \$197,114 and \$203,970 for the years ended March 31, 2015 and 2014, respectively, which is included in operating expenses.

**Inventory** - Inventory is stated at the lower of cost or market, with cost determined on a weighted average method.

**Prepaid Expenses and Other Current Assets** - Prepaid expenses include advance payments made by the Company for routine expenses, including inventory purchases, office expenses, insurance premiums, marketing expenses, and lease payments.



**Notes to Consolidated Financial Statements  
March 31, 2015 and 2014**

**Note 1 - Nature of Business and Significant Accounting Policies  
(Continued)**

**Use of Estimates** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, liabilities for customer incentives, the fair value of assets acquired, reserves for impairment, and for determination of deferred tax assets, potential income tax assessments, and loss contingencies.

**Property and Equipment** - Property and equipment are recorded at cost. Both straight-line and accelerated methods are used for computing depreciation and amortization. Assets are depreciated over their estimated useful lives. Costs of maintenance and repairs are charged to expense when incurred.

Estimated useful lives are periodically reviewed and, when warranted, changes are made to them.

Leasehold improvements are amortized on the straight-line basis over the shorter of the remaining lease term and estimated useful life of the asset. Amortization is included in depreciation and amortization expense. See Note 3 for further discussion of property and equipment.

**Credit Risk and Major Customers** - Sales are predominately to retail companies in the textile industry located throughout the United States and Canada. The Company extends trade credit to its customers on terms that are generally practiced in the industry. Two major customers accounted for approximately 80 percent and 55 percent of accounts receivable and 78 percent and 75 percent of sales as of and for the years ended March 31, 2015 and 2014, respectively.

**Income Taxes** - A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the year. Deferred tax liabilities or assets are recognized for the estimated future tax effects of temporary differences between financial reporting and tax accounting. The Company recognizes interest and penalties related to income tax matters as part of the provision for income taxes. See Note 6 for further discussion of income taxes.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### **Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

**Revenue Recognition** - Revenue is recognized when it is realized or realizable and has been earned. The Company's policy is to recognize revenue when risk of loss and title to the product transfers to the customer, typically when shipped. Net product sales are comprised of gross sales, less expected returns, trade discounts, and customer allowances, which include costs associated with off-invoice mark-downs and other price reductions, as well as trade promotions. These incentive costs are recognized when the Company recognizes the related revenue. The Company regularly reviews and revises, when deemed necessary, its estimates of sales returns based primarily upon the historical rate of actual product returns.

The Company earns a 1 percent commission on sales by Welspun Global Brands Limited directly to customers located in the United States. The Company recognizes the commission income when earned as sales are made to customers.

**Cost of Sales** - Cost of sales primarily includes the cost of goods including the related expenses such as freight-in and custom duties.

**Shipping and Handling Costs** - The Company records shipping and handling costs for the delivery of finished goods in cost of sales in the consolidated statement of operations. Total shipping and handling costs for the years ended March 31, 2015 and 2014 were \$107,585 and \$100,903, respectively.

**Operating Expenses** - Operating expenses generally include compensation expenses to sales, management, and other personnel, travel costs, royalty, credit insurance expenses, distribution expenses, depreciation on assets, rent, repairs, utilities, general insurance, advertising and marketing, professional fees, and other general expenses not attributable to cost of sales.

**Research and Development** - Research and development expenditures of approximately \$417,600 were charged to operating expense as incurred for the year ended March 31, 2015. There were no such charges for the year ended March 31, 2014.

**Reclassification** - Certain 2014 amounts have been reclassified to conform to the 2015 presentation.

**Subsequent Events** - The consolidated financial statements and related disclosures include evaluation of events up through and including May 4, 2015, which is the date the consolidated financial statements were available to be issued.

# Welspun USA, Inc.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Upcoming Accounting Change** - In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The 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. The new guidance will be effective for the Company's year ending March 31, 2018. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. The Company has not yet determined which application method it will use or the potential effects of the new standard on the financial statements, if any.

### Note 2 - Inventory

Inventory at March 31, 2015 and 2014 consists of the following:

	<u>2015</u>	<u>2014</u>
Trading goods	\$ 33,559,342	\$ 28,203,505
Packaging materials	<u>12,880</u>	<u>46,117</u>
Total inventory	<u>\$ 33,572,222</u>	<u>\$ 28,249,622</u>

As of March 31, 2015 and 2014, the Company recorded reserves for obsolescence and potential close-outs of inventory of \$537,835 and \$691,132, respectively. As of March 31, 2015 and 2014, the Company recorded in-transit inventory of \$8,883,026 and \$9,001,229, respectively.

## Welspun USA, Inc.

### Notes to Consolidated Financial Statements March 31, 2015 and 2014

#### Note 3 - Property and Equipment

Property and equipment are summarized as follows:

	2015	2014	Depreciable Life - Years
Furniture and fixtures	\$ 506,720	\$ 506,220	7
Leasehold improvements	585,163	553,507	10-15
Office equipment	150,136	150,136	7
Machinery and equipment	340,699	313,921	7
Computer hardware	924,293	887,070	5
Computer software	348,479	348,479	3
Total cost	2,855,490	2,759,333	
Accumulated depreciation	2,533,682	2,331,204	
Net property and equipment	\$ 321,808	\$ 428,129	

Depreciation expense was \$202,478 in 2015 and \$385,545 in 2014.

#### Note 4 - Line of Credit

Under a line of credit agreement with the Bank of Baroda, the Company has available borrowings of \$20,000,000, including a letter of credit of \$5,000,000, which expires on August 20, 2015. Interest is payable monthly at a rate of 3.50 percent above the six-month LIBOR (an effective rate of 3.90 percent and 3.83 percent at March 31, 2015 and 2014, respectively). Outstanding borrowings are \$16,084,741 and \$15,147,743 as of March 31, 2015 and 2014, respectively. The line of credit is collateralized by inventory, receivables, and other current assets of the Company and is guaranteed by Welspun India Limited.

# Welspun USA, Inc.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 5 - Capital Stock

Common stock consists of 3,000,000 authorized shares of stock with a par value of \$0.10. As of March 31, 2015 and 2014, there were 2,168,706 shares issued and outstanding.

### Note 6 - Income Taxes

The components of the income tax provision included in the consolidated statement of operations are detailed as follows:

	2015	2014
Current tax - Federal	\$ 778,782	\$ -
Current tax - State and foreign	116,682	136,944
Deferred tax - Federal	423,207	668,464
Deferred tax - State and foreign	24,474	290,991
Total income tax expense	<u>\$ 1,343,145</u>	<u>\$ 1,096,399</u>

Income tax expense attributable to continuing operations for the years ended March 31, 2015 and 2014 is approximately \$1,343,000 and \$1,365,000, respectively. Income tax recovery attributable to discontinued operations is approximately \$0 and (\$268,000) for the years ended March 31, 2015 and 2014, respectively.

A reconciliation of the provision for income taxes from continuing operations to income taxes computed by applying the statutory United States federal rate to income before taxes is as follows:

	2015	2014
Income tax expense, computed at 34 percent of pretax income	\$ 1,217,663	\$ 1,156,597
Effect of nondeductible expenses	21,776	17,510
Effect of state and foreign taxes	93,163	122,904
Effect of tax credits	(70,464)	(75,531)
Adjustments of prior year estimates and other	81,007	143,163
Total income tax expense on continuing operations	<u>\$ 1,343,145</u>	<u>\$ 1,364,643</u>

# Welspun USA, Inc.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 6 - Income Taxes (Continued)

The details of the temporary differences that give rise to deferred tax assets (liabilities) are as follows:

	2015	2014
Deferred rent	\$ 25,262	\$ 75,784
Inventory	768,417	732,618
Other federal credit	-	252,617
Net operating losses	-	180,180
Depreciation and amortization	27,260	14,975
Deferred finance charges	62,805	89,416
Allowance for bad debts	19,008	-
	<u>902,752</u>	<u>1,345,590</u>
Net deferred tax asset	\$	\$

Deferred tax assets result from recognition of expenses for financial reporting purposes that are not deductible for tax purposes until paid and net operating loss carryforwards. As of March 31, 2015, the Company has no operating loss carryforwards.

No valuation allowance has been recognized for the deferred tax assets as management believes all assets are recoverable.

As of March 31, 2015 and 2014, the Company's unrecognized tax benefits were not significant. There were no penalties or interest recognized as of or during the years ended March 31, 2015 and 2014.

Unrecognized tax benefits are subsequently adjusted when there are changes in facts and circumstances. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a settlement that is materially different from the current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense and the effective tax rate in the period in which the new information becomes available.

The Company files income tax returns in U.S. federal and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before March 2012.

# Welspun USA, Inc.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 7 - Long-term Debt

Long-term debt at March 31 is as follows:

	<u>2015</u>	<u>2014</u>
Note payable to Exim Bank in quarterly installments beginning April 15, 2015 of \$750,000 including interest at 5.50 percent above the one-month Eurodollar Deposit Rate (an effective rate of 5.69 percent at both March 31, 2015 and 2014). The note is collateralized by mortgages, asset security and pledge documents, and all property and equipment of Welspun India Limited and is due on March 28, 2020	<u>\$ 15,000,000</u>	<u>\$ 15,000,000</u>
Less current portion	<u>3,000,000</u>	<u>-</u>
Long-term portion	<u><u>\$ 12,000,000</u></u>	<u><u>\$ 15,000,000</u></u>

The balance of the above debt matures as follows:

2016	\$ 3,000,000
2017	3,000,000
2018	3,000,000
2019	3,000,000
2020	<u>3,000,000</u>
Total	<u><u>\$ 15,000,000</u></u>

Under the agreements with the bank, the Company is subject to various financial covenants, including maintaining certain financial ratios.

### Note 8 - Operating Leases

The Company is obligated under operating leases primarily for vehicles, equipment, office, and warehouse space, expiring at various dates through 2022. The leases require the Company to pay taxes, insurance, utilities, and maintenance costs. The Company expenses the net minimum lease costs on the straight-line method over the life of the lease. The difference between lease expense and amounts payable under the lease agreement is recorded as deferred rent of \$220,625 and \$199,168 as of March 31, 2015 and 2014, respectively. The current portion of deferred rent is included in accounts payable. Total rent expense under these leases was \$2,279,036 and \$2,201,817 for the years ended March 31, 2015 and 2014, respectively.

# Welspun USA, Inc.

## Notes to Consolidated Financial Statements March 31, 2015 and 2014

### Note 8 - Operating Leases (Continued)

Future minimum annual commitments under these operating leases are as follows:

Years Ending March 31	Amount
2016	\$ 1,010,064
2017	990,531
2018	1,255,346
2019	778,684
2020	794,162
Thereafter	<u>1,211,760</u>
Total	<u>\$ 6,040,547</u>

### Note 9 - License Commitments

The Company has trademark licensing agreements under which it can utilize certain trade names in marketing its products. The Company has future commitments to pay of \$4,489,000 as of March 31, 2015. Minimum royalties, image fund fees, and merchandise coordinator fees were paid under these agreements.

Royalty expenses were \$506,395 and \$469,786 for the years ended March 31, 2015 and 2014, respectively.

### Note 10 - Retirement Plans

The Company provides a defined contribution savings plan for substantially all employees. The plan provides for the Company to make a discretionary profit-sharing contribution and a required matching contribution. Expenses under the plan amounted to \$136,481 and \$169,776 for the years ended March 31, 2015 and 2014, respectively.

### Note 11 - Related Party Transactions

Sales are made and services and inventory are purchased from entities affiliated through common ownership and the Parent. Amounts due from related parties include sales of product, chargebacks, commissions, and other receivables. Following is a summary of transactions and balances with related parties for 2015 and 2014:

	2015	2014
Sales and services to related parties	\$ 3,387,953	\$ 3,145,968
Due from related parties	468,334	390,224
Advances to related parties	-	6,058,754
Purchases from related parties	141,900,475	115,996,123
Due to related parties	18,192,420	20,627,274
Claims and rebates granted	1,673,880	392,336



# **Welspun USA, Inc.**

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## **Notes to Consolidated Financial Statements March 31, 2015 and 2014**

### **Note 11 - Related Party Transactions (Continued)**

The Company also earns a commission on sales to Welspun Global Brands Limited's customers in the United States. Amounts earned under the commission agreement were \$2,973,242 and \$2,592,125 for the years ended March 31, 2015 and 2014, respectively. These amounts are included in the sales to related parties in the above table.

### **Note 12 - Discontinued Operations**

On May 31, 2012, the Company ceased operations within its Welspun Decorative Hospitality, LLC (WDH), KOJO Canada, Inc., and Koni Corporation, Inc. divisions. The results of operations of the divisions for the years ended March 31, 2015 and 2014 are disclosed separately on the consolidated statement of operations. During the year ended March 31, 2015, WDH was the only discontinued operation with any activity. Total net loss from operations before tax was \$438 and \$123,474 in 2015 and 2014, respectively. The balance of total assets and total liabilities held for sale at March 31, 2015 is \$0 and \$20,763, respectively. The balance of total assets and total liabilities held for sale at March 31, 2014 is \$0 and \$41,055, respectively.