

The Stephan Co.
Annual Report
Year Ended December 31, 2018

Part A General Company Information

Item I The exact name of the issuer and its predecessor (if any).

The Stephan Co.

Item II The address of the issuer's principal executive offices.

6708 N. 54th Street
Tampa, Florida 33610
(813) 248-5761
www.thestephanco.com

Item III The jurisdiction(s) and date of the issuer's incorporation or organization.

Florida, May 29, 1952

Part B Share Structure

Item IV The exact title and class of securities outstanding.

Common Stock (SPCO.PK)
CUSIP: 858603103

Item V Par or stated value and description of the security.

A. Par or Stated Value.

Common Stock
\$0.01 per share par value

Preferred Stock
\$0.01 per share par value

B. Common or Preferred Stock.

Common Stock
\$0.01 per share par value
Dividend: at discretion of board of directors.
Voting: one vote per share, non-cumulative, no preemptive rights.

Preferred Stock
\$0.01 per share par value
Dividends, privileges, rights and limitations: at discretion of board of directors.

Item VI The number of shares or total amount of securities outstanding for each class of securities authorized.

Common Stock

- (i) Period end date: December 31, 2018 and 2017
- (ii) Number of shares authorized: 25,000,000
- (iii) Number of shares issued: 4,647,485 in 2018 and 4,599,611 in 2017
- (iv) Number of shares held in treasury: 608,091 in 2018 and 606,591 in 2017
- (v) Number of shares outstanding: 4,039,394 in 2018 and 3,993,020 in 2017
- (vi) Freely tradable shares (public float): 4,039,394 in 2018 and 3,993,020 in 2017
- (vii) Total number of beneficial stockholders: 50
- (viii) Total number of stockholders of record: 127 (approx.)

Preferred Stock

- (i) Period end date: December 31, 2018 and 2017
- (ii) Number of shares authorized: 1,000,000
- (iii) Number of shares issued: 0
- (iv) Number of shares held in treasury: 0
- (v) Number of shares outstanding: 0
- (vi) Freely tradable shares (public float): 0
- (vii) Total number of beneficial stockholders: 0
- (viii) Total number of stockholders of record: 0

Part C Business Information

Item VII The name and address of the transfer agent.

The name and address of the transfer agent is:

American Stock Transfer & Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
(800) 937-5449
(718) 921-8124
info@amstock.com

American Stock Transfer & Trust Company, LLC is regulated by the Securities and Exchange Commission ("SEC") and is audited annually.

Item VIII The nature of the issuer's business.

A. Business Development

- The Stephan Co. (the "Company"), a Florida corporation, was formed in 1952 and was reorganized in 1960 through a merger of the Stephan Cosmetic Corp., a California corporation; Stephan Products, Inc., a Massachusetts corporation; and Stepaco, Inc. a California corporation; into The Stephan Co. The predecessor company of Stephan Products, Inc., one of the merger partners, was organized in Massachusetts in 1897.
- The Company's fiscal and calendar years are the same.
- The Company's Common Stock is quoted on the OTC Pink quotation system maintained by the OTC Markets Group, Inc. There is no established public trading market in the Company's Common Stock.
- In December 2009, the Company voluntarily delisted its Common Stock from the American Stock Exchange and deregistered its Common Stock pursuant to the

Exchange Act of 1934.

- The Company has never been in bankruptcy, receivership, or similar proceeding.
- The Company has never defaulted on any note, lease, or other indebtedness or financing arrangement requiring the issuer to make payments.
- There has been no increase in the number of shares of either class of stock in the past five years.
- In the past five years there have been no stock splits, stock dividends, or recapitalizations.
- Effective December 31, 2015, the Company went through a reorganization to close out all of its dormant entities. Entities remaining after the reorganization in 2016 are The Stephan Company, Bowman Beauty & Barber Supply, Inc. and Morris Flamingo-Stephan, Inc.
- In September 2017, the Company completed the acquisition of MD Barber Supply, LLC, a distributor of barber supplies and specialized products for the barber and consumer beauty industry.
- In November 2018, the Company purchased inventory, assets, patents and trademarks that are used in connection with the business of the BarberMate Brand through an asset purchase agreement.

B. Legal Proceedings

The Company is not involved in any litigation arising in the normal course of business during the year ended December 31, 2018.

C. Business of Issuer

1. The Company's SIC Code is 2844.
2. The Company is currently conducting operations.
3. The issuer is not and has never been a "shell company."

Item IX The nature of products or services offered.

The Stephan Co. ("we," "our," "Stephan," or the "Company"), is headquartered in Tampa, Florida. We currently have distribution centers in Tampa, Florida; Williamsport, Pennsylvania; and Hayden, Idaho focused on distributing barber and beauty products and supplies.

We have one reportable operating segment, which includes a Master Distributor as well as Distributors of barber and beauty supplies for professionals and consumers. Our Master Distributor segment consists of sales to distributors, schools, correctional institutions and supply stores. Our Distributor segment consist of sales to the barber and beauty professionals for use in the barbershops and salons as well as consumers and end users through various marketplaces.

Distributors

Some of our wholly owned subsidiaries are distributors of our products and third-party products. Morris Flamingo-Stephan, Inc., located in Tampa, Florida, is a Master Distributor of beauty and barber supplies, which markets its products utilizing catalogs featuring its brands Campbell's, LatherKing, Stephan Barber, and SuperCuts, along with other national brands. Catalogs are published under the Morris Flamingo and Major-Advance brand names. Williamsport Bowman Barber Supply, Inc., located in Williamsport, Pennsylvania, is a mail order and online barber and beauty supply company. MD Barber Supply, LLC, located in Hayden, Idaho, sells barber supplies and specialized products directly to barbers and consumers through online channels, wholesale accounts, its website and mobile app. Morris Flamingo-Stephan, Inc., Bowman Beauty and Barber Supply, Inc. and MD Barber Supply, LLC comprise the Distributors segment. Our Distributors generally do not manufacture the products they sell.

FINISHED GOODS

Our subsidiaries in our Distributors segment buy and resell finished products, many of which are purchased from international sources. The Company and its subsidiaries seek to maintain a level of finished goods inventory sufficient to cover anticipated sales levels for an upcoming three months.

BACKLOG

As of December 31, 2018, the Company did not have a large backlog of orders.

RESEARCH AND DEVELOPMENT

There were no research and development expenditures in 2018 or 2017.

COMPETITION

The hair care and personal grooming business is highly competitive. The Company competes against much larger companies with substantially more resources. Additionally, we believe that several factors are contributing to continuing competitive industry conditions: 1) Increased online competition; 2) Soft overall industry conditions given maturing of the barber and beauty markets; 3) Offset to some extent by consolidation in the industry.

We believe that the principal competitive factors are price and product quality. Products sold by the Company and its subsidiaries compete with numerous varieties of other such products, many of which bear well known, respected, and heavily advertised brand names and are produced and sold by companies having substantially greater financial, technical, personnel, and other resources than the Company. Our products account for a relatively insignificant portion of the total hair care and personal grooming products manufactured and sold annually in the United States.

GOVERNMENT AND INDUSTRY REGULATION, ENVIRONMENTAL MATTERS

Certain of our products are subject to regulation by the Food and Drug Administration, in addition to other federal, state, and local regulatory agencies. The Company believes that its products are in substantial compliance with all applicable regulations. The Company does not believe that compliance with existing or presently proposed environmental standards, practices, or procedures will have a material adverse effect on operations, capital expenditures, or the competitive position of the Company.

EMPLOYEES

As of December 31, 2018, we employed 29 people who were engaged in the warehousing and distribution of products and in the management and administration of the Company's business. Although we do not anticipate the need to hire a significant number of additional employees, the Company believes that any such employees, if needed, would be readily available. The Company believes its employee relationships are satisfactory.

Item X The nature and extent of the issuer's facilities.

Our Distributors operate out of leased facilities. Our Williamsport Bowman business operates out of approximately 7,500 sq. ft. of combined warehouse and administrative space. Our Morris Flamingo business operates out of approximately 10,000 sq. ft. of combined warehouse and administrative space. Our MD Barber Supply business operates out of approximately 2,400 sq.ft. of combined warehouse and administrative space. The Company's headquarters is located in Tampa, Florida.

Item XI The name of the chief executive officer, members of the board of directors, as well as control persons.

EXECUTIVE OFFICERS

Eric Kiekbusch, 55, was hired as President in November 2015. Prior to being named President, Mr. Kiekbusch was the Company's Vice President of Operations beginning in June 2012, where he was responsible for all manufacturing and distribution operations. Mr. Kiekbusch began his employment with The Stephan Co. in October 2009 as the Purchasing / Operations Manager. Prior to the Stephan Co., from 2005 to 2009, Mr. Kiekbusch was the Operations Manager of Detroit Electro-Coatings, a tier one supplier to the automotive industry and from 1988 to 2005 he held several positions at Uni-Bond Brake, Inc., a manufacturer and distributor to the automotive industry, including Plant Manager from 2000 to 2005.

BOARD OF DIRECTORS

The Company's By-Laws provide that directors are to be organized into three classes, with each class to be elected on a staggered basis, every third year. The directors, in each class, when elected have a three-year term or until their successors are elected at the next election of the class. We have not had a Board of Directors election or stockholders meeting since 2005. Our By-Laws provide that the number of directors shall be set from time-to-time by resolution of the Board of Directors and must be a minimum of one.

Set forth below is certain information with respect to the eight members of the Board of Directors who served during 2018, or are currently members of the board.

| Name | Age (as of 07/17/19) | Year first elected as a Company Director | Principal Occupation(s) During Past Five Years; Other Directorships |
|----------------------|----------------------------|---|--|
| Jad Fakhry | 39 | 2014 | Since 2012, Founder and Managing Member of Poplar Point Capital Management LLC. Poplar Point Capital manages a private investment partnership. Appointed as a board member during March 2014. |
| Brian Harper, CFA | 42 | 2016 | Mr. Harper has been Founder and President of Harper Asset Management, LLC, a Registered investment advisory firm, since 2001. Mr. Harper was elected to the Board in March 2016. Elected as Chairman of the Board in March 2017. |
| Benjamin Large | 40 | 2016 | Mr. Large is the Managing Member of Nutmeg Investments, LLC. He has experience working with companies to improve their operating results and corporate governance. He has previous experience in the aerospace field as an electrical engineer responsible for designing satellite programs. Appointed as a Board member during December 2016. |

| Name | Age (as of 07/17/19) | Year first elected as a Company Director | Principal Occupation(s) During Past Five Years; Other Directorships |
|------------|----------------------------|---|---|
| Lee Keddie | 50 | 2015 | Mr. Keddie is President and Chief Executive Officer of CompuMed Inc. (OTC:CMPD) ("CompuMed"), a diagnostic telemedicine solutions company, where he has held that role since 2015 and served on the board since 2014. In addition, he is President and CEO of Value Creation Management Group LLC, a company that invests in and provides consulting to companies that need operational improvement, since he founded it in 2014. Mr. Keddie was a board member of Essex Rental Corp. (NASDAQ:ESSX), a construction lift equipment rental company, from 2015 to 2017 (serving on Audit, Compensation, and Nomination and Governance Committees). Previously, Mr. Keddie was 13 years with HKX, Inc., a developer of control systems for excavators, as a Co-Owner, President and General Manager, from 1999 to 2013. Prior to his business leadership roles, Mr. Keddie spent over eight years in both the commercial and military sectors of the aircraft industry. Mr. Keddie is a professional engineer, and received an Honors Co-op Mechanical Engineering Degree from the University of Waterloo, and spent two additional years at the University of Toronto in Aerospace Studies. |
| Joel Getz | 54 | 2017 | Mr. Getz is Senior Associate Dean for Development and Alumni Relations at the Yale School of Management. Prior to joining Yale in 2008, he was head of development at the William J. Clinton Foundation and served as President of the Mayor's Fund to Advance New York City during the first term of Mayor Michael Bloomberg's administration. Appointed as a Board member during February 2017 and currently serves as Secretary of the Corporation. |

COMMITTEES OF THE BOARD

The Board has established three standing committees including (1) an Audit Committee (2) a Compensation Committee and (3) a Nominating Committee.

FAMILY RELATIONSHIPS

No family relationships exist during the years ended December 31, 2018 and 2017.

Item XII Financial Information for the issuer's most recent fiscal period.

See accompanying audited consolidated financial statement.

Item XIII Similar financial information for such part of the two preceding fiscal years as the issuer or the predecessor has been in existence.

Responses to this section are hereby incorporated by reference to filings www.otcmartets.com (symbol: SPCO.PK).

Item XIV Beneficial Ownership.

The following persons or other entities are beneficial owners of more than 5% of the outstanding Common Stock of the Company:

- Harper Asset Management LLC, 6680 Gunpark Drive, Suite 202b, Boulder, CO 80301: 578,787 shares.
- Poplar Point Capital Partners LP, 840 Hinckley Road, Suite 250, Burlingame, CA 94010: 1,427,608 shares.

Total shares held by the above owners of 5% or more of the Company's outstanding common stock totaled 2,006,395 or 49.7%, of total outstanding shares (4,039,394) at December 31, 2018.

The Company deregistered its securities with the Securities and Exchange Commission under Section 12(g) of The Securities Exchange Act of 1934 on December 28, 2009. As a result, significant stockholders (10% owners of equity securities of the Company), officers and directors are no longer required to file Forms 3, 4 and 5 so it is not possible to know with certainty, the definitive beneficial ownership. As of December 31, 2018, there are 3,953,380 shares approximating 97.8% of total outstanding shares, in "street name" in which it is not possible to determine additional beneficial ownership, if any.

Item XV The name, address, telephone number, and email address of each of the following outside providers that advise the issuer on matters relating to operations, business development, and disclosure:

1. Investment Banker: none
2. Promoters: none
3. Accountant or Auditor:
Accountants – REdge Global Services Pvt. Ltd. , 405, Sai paragon Meadows, 4th Street, BEML Layout, Bangalore, KN-560066 - (918) 398-0155
Auditor -- Cherry Bekaert LLP 401 East Jackson St., Suite 1200 Tampa, FL 33602 -- (813) 251-1010
4. Public Relations Consultant: none
5. Investor Relations Consultant: none
6. Any other advisor(s) that assisted, advised, prepared, or provided information with respect to this disclosure statement - the information shall include the telephone number and email address of each advisor: none

Item XVI Management's Discussion and Analysis or Plan of Operation.

A. Management's Discussion and Analysis

Liquidity and Capital Resources

We had cash and cash equivalents of approximately \$428,000 at December 31, 2018. Our cash was maintained in FDIC-insured bank accounts and collateralized short-term investments.

Our continuing operations provided net cash flows of approximately \$550,000 for the year ended December 31, 2018. This additional cash from operations along with some beginning cash balance were used to; distribute dividends to our stockholders totaling to approximately \$602,000 in February and September 2018; Net cash payment for the acquisition of BarberMate assets on November 30, 2018, was \$76,000; and repurchase of 1,500 shares of common stock for approximately \$3,000.

We have adequate liquidity and do not foresee the need for additional capital for day-to-day operations in the next year. At December 31, 2018, we have in excess of \$17.2 million in net operating loss ("NOL") carry forwards available to offset future taxable income, maintain approximately \$1.1 million in working capital and have tangible net worth of \$1.8 million.

We have no off-balance sheet financing arrangements except for operating leases primarily related to our Distributors segment.

Results of Operations 2018 v. 2017

Overall revenues for the year ended December 31, 2018 were approximately \$8,951,000 compared to approximately \$8,314,000 for the year ended December 31, 2017 or a net increase in revenue of approximately \$637,000, or 7.7%, resulted from the inclusion of MD Barber Supply, which was acquired in September 2017, as well as moderate organic growth.

Selling, General, and Administrative expenses increased from 2017 by approximately \$272,000, or 14.7% of this amount \$461,000 is attributable to MD Barber. This was offset by a decrease in expenses at other business units.

B. Off-Balance Sheet Arrangements

The Company's primary off-balance sheet liabilities consist of its operating leases related to its Distributor businesses.

FORWARD-LOOKING STATEMENTS

Certain statements in "Management's Discussion and Analysis or Plan of Operation" and elsewhere in this "Annual Report" constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause our actual results, condition (financial or otherwise), performance, or achievements to be materially different from any future results, performance, condition, or achievements expressed or implied by such forward-looking statements.

Words such as "projects," "believe," "anticipates," "estimate," "plans," "expect," "intends," and similar words and expressions are intended to identify forward-looking statements and are based on our current expectations, assumptions, and estimates about us and our industry. In addition, any statements that refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct.

Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors, risks, and uncertainties. These factors, risks, and uncertainties include, without limitation, our ability to satisfactorily address any material weakness in our financial controls; general economic and business conditions; competition; the relative success of our operating initiatives; our development and operating costs; our advertising and promotional efforts; brand awareness for our product offerings; the existence or absence of adverse publicity; acceptance of any new product offerings; changing trends in customer tastes; the success of any multi-branding efforts; changes in our business strategy or development plans; the quality of our management team; the availability, terms, and deployment of capital; the business abilities and judgment of our personnel; the availability of qualified personnel; our labor and employee benefit costs; the availability and cost of raw materials and supplies; changes in or newly-adopted accounting principles; changes in, or our failure to comply with, applicable laws and regulations; changes in our product mix and associated gross profit margins, as well as management's response to these factors; and other factors that may be more fully described in the Company's literature, press releases, and publicly-filed documents with the Securities and Exchange Commission and the Pink Sheets. See www.otcmarkets.com (symbol: SPCO.PK). You are urged to carefully review and consider these disclosures which describe certain factors that affect our business.

We do not undertake, subject to applicable law, any obligation to publicly release the results of any revisions, which may be made to any forward-looking statements to reflect events or circumstances occurring after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Therefore, we caution each reader of this report to carefully consider the specific factors and qualifications discussed herein with respect to such forward-looking statements, as such factors and qualifications could affect our ability to achieve our objectives and may cause actual results to differ materially from those projected, anticipated, or implied herein.

Part E Issuance History

Item XVII List of securities offerings and shares issued for services in the past two years.

Neither Common nor Preferred Shares were issued for services in the last two years.

Part F Exhibits

Item XVIII Material Contracts

The Company entered into an employment agreement with its President effective January 1, 2019 for a term of two years. The agreement requires annual base compensation and provides for incentive above a threshold EBITDA amount set. The agreement provides for severance if employment is terminated without cause during the term of the agreement. During the financial year 2018, the EBITDA thresholds, as per the 2016 employment agreement, were met and the incentives accrued.

Item XIX Articles of Incorporation and Bylaws

The Stephan Co. is a Florida corporation in good standing.

Item XX Purchases of Equity Securities by the Issuer and Affiliated Purchasers

In April 2016, the Company was authorized by its Board of Directors to repurchase shares of its outstanding common stock pursuant to open market transactions for up to 500,000 shares. Through December 31, 2018, the company had repurchased 267,555 shares of common stock for approximately \$335,000.

Information for the issuer's most recent fiscal period
Pursuant to Item XII Above

**Consolidated Financial Statements and
Report of Independent Auditor**

The Stephan Co.

December 31, 2018 and 2017

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Report of Independent Auditor

To Board of Directors and Shareholders
The Stephan Co. and Subsidiaries
Tampa, Florida

We have audited the accompanying consolidated financial statements of Stephan Co. and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the 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 the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



Tampa, Florida
July 23, 2019

The Stephan Co.
CONSOLIDATED BALANCE SHEETS
At December 31, 2018 and December 31, 2017
(In thousands, except share and per share amounts)

| | <u>2018</u> | <u>2017</u> |
|---|-----------------|-----------------|
| <u>ASSETS</u> | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 428 | \$ 561 |
| Accounts receivable, net | 138 | 284 |
| Inventories, net | 1,266 | 1,092 |
| Prepaid expenses and other current assets | 74 | 42 |
| Total Current Assets | 1,906 | 1,979 |
| Other assets, net | 9 | 8 |
| Property and equipment, net | 156 | 198 |
| Deferred tax assets, net | 495 | 318 |
| Intangibles, net | 225 | 168 |
| Goodwill | 1,890 | 1,890 |
| TOTAL ASSETS | \$ 4,681 | \$ 4,561 |
| <u>LIABILITIES & STOCKHOLDERS' EQUITY</u> | | |
| Current Liabilities | | |
| Accounts payable and accrued expenses | \$ 765 | \$ 666 |
| Total Current Liabilities | 765 | 666 |
| TOTAL LIABILITIES | 765 | 666 |
| COMMITMENTS AND CONTINGENCIES (Notes 10) | | |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, \$.01 par value; 1,000,000 shares authorized; none issued or outstanding | - | - |
| Common stock, \$.01 par value; 25,000,000 shares authorized; 4,647,485 and 4,599,611 shares in 2018 and 2017, respectively issued (4,039,394 and 3,993,020 shares outstanding in 2018 and 2017, respectively) | 46 | 46 |
| Additional paid-in capital | 18,632 | 18,583 |
| Accumulated deficit | (13,565) | (13,540) |
| Treasury stock, at cost (608,091 and 606,591 shares in 2018 and 2017, respectively) | (1,197) | (1,194) |
| Total Stockholders' Equity | 3,916 | 3,895 |
| TOTAL LIABILITIES & STOCKHOLDERS' EQUITY | \$ 4,681 | \$ 4,561 |

See Notes to Consolidated Financial Statements.

The Stephan Co
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2018 and December 31, 2017
(in thousands, except share and per share data)

| | <u>2018</u> | <u>2017</u> |
|---|---------------|---------------|
| Revenue, net | \$ 8,951 | \$ 8,314 |
| Cost of revenue | 6,289 | 5,783 |
| Gross profit | 2,662 | 2,531 |
| Selling, general, and administrative expenses | 2,115 | 1,843 |
| Stock based compensation | 40 | |
| Depreciation and amortization | 71 | 95 |
| Operating income | 436 | 593 |
| Other Income, net | 53 | 42 |
| Income before income taxes | 489 | 635 |
| Income tax benefit | 88 | 224 |
| NET INCOME | \$ 577 | \$ 859 |
| Per common share: | | |
| Basic and diluted net income | \$ 0.14 | \$ 0.22 |
| Net income | \$ 0.14 | \$ 0.22 |
| Weighted average common shares outstanding: | | |
| Basic | 4,017,629 | 3,863,648 |
| Diluted | 4,022,629 | 3,967,106 |

See Notes to Consolidated Financial Statements.

The Stephan Co
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2018 and December 31, 2017
(in thousands, except share information)

| | <u>Shares Issued</u> | <u>Par Value</u> | <u>Additional Paid-in Capital</u> | <u>Accumulated Deficit</u> | <u>Treasury Stock</u> | <u>Stockholders' Equity</u> |
|---------------------------------------|--------------------------|---------------------|---------------------------------------|--------------------------------|---------------------------|---------------------------------|
| Balance at January 1, 2017 | 4,389,611 | \$ 44 | \$ 18,178 | \$ (13,814) | \$ (1,150) | \$ 3,258 |
| Stocks issued in business acquisition | 200,000 | 2 | 392 | - | - | 394 |
| Options Exercised | 10,000 | - | 13 | - | - | 13 |
| Stock buyback – 24,007 shares | - | - | - | - | (44) | (44) |
| Dividends Paid | - | - | - | (585) | - | (585) |
| Net Income | - | - | - | 859 | - | 859 |
| Balance at December 31, 2017 | <u>4,599,611</u> | <u>46</u> | <u>18,583</u> | <u>(13,540)</u> | <u>(1,194)</u> | <u>3,895</u> |
| Options Exercised** | 31,874 | - | 9 | - | - | 9 |
| Shares issued to Board of Directors | 16,000 | - | 40 | - | - | 40 |
| Stock buyback - 1,500 shares | - | - | - | - | (3) | (3) |
| Dividends Paid | - | - | - | (602) | - | (602) |
| Net income | - | - | - | 577 | - | 577 |
| Balance at December 31, 2018 | <u><u>4,647,485</u></u> | <u><u>\$ 46</u></u> | <u><u>\$ 18,632</u></u> | <u><u>\$ (13,565)</u></u> | <u><u>\$ (1,197)</u></u> | <u><u>\$ 3,916</u></u> |

** In August 2018, the Company issued 26,812 shares in a cashless exercise of 50,000 options.

See Notes to Consolidated Financial Statements.

The Stephan Co
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and December 31, 2017
(in thousands)

| | <u>2018</u> | <u>2017</u> |
|--|---------------|---------------|
| <u>CASH FLOWS FROM OPERATING ACTIVITIES</u> | | |
| NET INCOME | \$ 577 | \$ 859 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Deferred income taxes | (177) | (203) |
| Stock based compensation | 40 | |
| Depreciation and amortization | 71 | 95 |
| Changes in operating assets & liabilities: | | |
| Accounts receivable, net | 146 | (88) |
| Inventories, net | (174) | 14 |
| Prepaid expenses and other assets | (33) | 38 |
| Accounts payable and accrued expenses | 100 | 38 |
| NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES | 550 | 753 |
| <u>CASH FLOWS FROM INVESTING ACTIVITIES</u> | | |
| Cash paid for acquisition, net | (76) | (207) |
| Purchases of property and equipment | (11) | (27) |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (87) | (234) |
| <u>CASH FLOWS FROM FINANCING ACTIVITIES</u> | | |
| Loan repayments | - | (126) |
| Stock options exercised | 9 | 13 |
| Stock repurchased | (3) | (44) |
| Dividends paid | (602) | (585) |
| NET CASH FLOWS USED IN FINANCING ACTIVITIES | (596) | (742) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (133) | (223) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 561 | 784 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | \$ 428 | \$ 561 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid for taxes | \$ - | \$ - |
| Supplemental Disclosure of non-cash financing activity: | | |
| Common stock issued in connection with acquisition of MD Barber | \$ - | \$ 394 |

See Notes to Consolidated Financial Statements.

The Stephan Co.

**NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS**

DECEMBER 31, 2018 AND 2017

NOTE 1: DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS: The Stephan Co. and its wholly owned subsidiaries (the "Company") is engaged in the distribution of grooming products to the barber industry ("Distributor segment") principally throughout the United States.

USE OF ESTIMATES: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates include assessing the collectability of accounts receivable, realization of deferred income tax assets, the useful lives of long-lived assets, goodwill impairment, the valuation and useful lives of intangible assets and inventory reserves. Although these estimates are based on management's knowledge of current events, and those it may undertake in the future, they may ultimately differ from actual results.

BUSINESS COMBINATIONS: The Company accounts for business combinations under the acquisition method of accounting in accordance with Accounting Standards Codification ("ASC") 805, "*Business Combinations*," where the total purchase price is allocated to the tangible and identified intangible assets acquired and liabilities assumed based on their estimated fair values. Significant estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from acquired customer lists and trade names. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill.

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of The Stephan Co. and its wholly owned subsidiaries: Williamsport Bowman Barber Supply, Inc. ("Bowman"), Morris Flamingo-Stephan, Inc. ("Morris Flamingo") and MD Barber Supply, LLC ("MD"). MD was acquired during 2017. All significant intercompany balances have been eliminated in consolidation.

GOODWILL: The Company followed accounting guidance under ASC Topic 350, *Intangibles – Goodwill and Other*, that allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived asset is impaired before determining whether it is necessary to perform the more detailed quantitative impairment test. The evaluation considers relevant factors and circumstances such as general macroeconomic conditions, industry and market conditions, changes in cost factors, overall financial performance, and entity and reporting unit specific events. For the years ended December 31, 2018 and 2017, the qualitative factors assessment did not suggest impairment.

IMPAIRMENT OF LONG-LIVED ASSETS OTHER THAN GOODWILL: The Company periodically evaluates whether events or circumstances have occurred that would indicate that long-lived assets may not be recoverable or that their remaining useful lives may be impaired. When such events or circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected undiscounted future cash flows resulting from the use of the asset. If the results of this testing indicate an impairment of the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the projection of their associated cash flows and then the discounting of these projected cash flows to their present value. For years ended December 31, 2018 and 2017, there was no impairment of long-lived assets.

CONCENTRATION OF CREDIT RISK: The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral. The Company does not believe that its customers' credit risks represent a material risk of loss to the Company. When goods are ordered from other countries, some foreign manufacturers require a deposit at the time of order.

SHARE-BASED PAYMENTS: Share-based payments, comprised of stock option grants, are measured at their fair value on the awards' grant date, based on estimated number of awards that are ultimately expected to vest. Share-based compensation awards issued to non-employees for services rendered are recorded at either the fair value of the services rendered or the fair value of the share-based payment, whichever is more readily determinable. The Company recognizes compensation expense based on management's determination of the equity instrument's fair value at the grant date and allocates the expense ratably over the applicable vesting period.

Fair value assumptions are based on a number of factors, including: (i) the expected volatility which was determined using the historical volatility of the Company's stock price; (ii) the expected term of the options which was based on the period of time that the options granted are expected to be outstanding, (iii) the expected dividends, (iv) expected forfeitures, and (v) the risk-free rate which was the U.S. Treasury rate effective at the time of grant for the duration of the options granted.

REVENUE RECOGNITION: Revenue is recognized when there is persuasive evidence of an arrangement, the price is fixed and determinable and all significant contractual obligations have been satisfied, which involve the risk of loss of transfer and reasonable assurance that any account receivable will be collected. Revenue is shown after deductions for payment and volume discounts and returns. The Company estimates that these discounts and returns approximate between 1% and 2% of gross revenue. The Company participates in various promotional activities in conjunction with its retailers and distributors, primarily through the use of discounts, new warehouse allowances, slotting allowances, co-op advertising and periodic price reduction programs. These allowances totaled \$11,000 and \$11,000 at December 31, 2018 and 2017, respectively.

ADVERTISING EXPENSES: The Company expenses all advertising costs as incurred. Total advertising costs for the years ended December 31, 2018 and 2017 were approximately \$311,000 and \$294,000, respectively, and are included in selling, general, and administrative expenses in the accompanying Consolidated Statements of Operation.

COST OF GOODS SOLD: This item includes the cost of raw materials, packaging, direct labor and applicable direct and indirect overhead costs.

SHIPPING AND HANDLING COSTS: Expenses for shipping products sold to customers were approximately \$871,000 in 2018 and \$732,000 in 2017 and were included in cost of revenues in the Consolidated Statements of Operations. Charges to customers for freight and handling are included in net revenues in the Consolidated Statements of Operations.

CASH AND CASH EQUIVALENTS / CONCENTRATION OF RISK: Cash and cash equivalents include cash and money market placements. The Company had most of its cash deposited with various financial institutions and was subject to Federal Deposit Insurance Corporation ("FDIC") insurance. Cash deposits are within FDIC insurable limits at December 31, 2018.

ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS: Trade credit is generally extended to distributors and large retailers based upon credit worthiness. The allowance for doubtful accounts is based upon specific identification of customer balances that are unlikely to be collected plus an estimated amount for potentially uncollectible amounts. Receivables are written-off when considered uncollectible.

INVENTORIES: Inventories are stated at the lower of cost (determined on the first-in, first-out basis) or net realizable value.

PROPERTY AND EQUIPMENT: Property and equipment are recorded at cost. Routine repairs and maintenance are expensed as incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

| | <u>Years</u> |
|--------------------------------|--------------|
| Machinery and equipment | 5-10 |
| Furniture and office equipment | 3-5 |

INCOME TAXES: The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting basis and tax basis of assets and liabilities. Valuation allowances, if any, are provided when a portion or all of a deferred tax asset may not be realized. Deferred tax assets and liabilities are included in the consolidated financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net income or loss by the weighted average number of shares of common stock outstanding.

At December 31, 2018, the Company had 5,000 options outstanding and all of them were "in-the-money." The effect of options for the year ended December 31, 2018 is reflected in the diluted net income per share in the consolidated statement of operations.

RECLASSIFICATIONS: Long-term deferred tax liabilities were netted against long-term deferred tax assets in the December 31, 2017 consolidated balance sheet to conform with current year presentation.

NOTE 2: NEW ACCOUNTING STANDARDS

Revenue Recognition:

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASC Topic 606, *Revenue from Contracts with Customers* ("*Topic 606*"). This accounting standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers to reflect the consideration to which the entity expects to be entitled in exchange for goods and services.

The standard will replace most existing revenue recognition guidance accounting principles generally accepted in the United States of America. Topic 606 is effective for the Company as of January 1, 2019 and permits the use of either a modified retrospective or cumulative effect transition method. The Company has not selected a transition method and will evaluate in financial year 2019 the effect Topic 606 will have on its consolidated financial statements and related disclosures.

Leases:

In February 2016, the FASB issued ASU 2016-02, *Leases*. This standard requires all entities that lease assets with terms of more than 12 months to capitalize the assets and related liabilities on the consolidated balance sheet.

The standard is effective for the Company as of January 1, 2020 and requires the use of a modified retrospective transition approach for its adoption. The Company is currently evaluating the effect ASU 2016-02 will have on its consolidated financial statements and related disclosures. Management expects the assets leased under operating leases similar to the leases disclosed in Note 10 will be capitalized together with the related lease obligations on the balance sheet upon the adoption of ASU 2016-02.

NOTE 3: BUSINESS AQUISITIONS

In November 2018, the Company purchased inventory, assets, patents, and trademarks that are used in connection with the business of the BarberMate Brand through an asset purchase agreement and in consideration the Company paid \$76,000 in cash. In accordance with the acquisition method of accounting for business combinations under the provisions of ASC 805, the entire consideration paid was capitalized as an intangible asset as the inventory and other assets were considered to have nominal value.

Intangible assets consist of customer lists and tradename and the fair values were determined based on the income approach (estimated discounted cash flows related to the intangibles). The Company utilized a relief of royalty method to value the trade name with a royalty rate of 1.5% and a discount rate of 17.5%. The customer relationships were valued using a cash flow forecast with a customer retention rate of 80%.

In September 2017, the Company completed the acquisition of MD Barber Supply, LLC. In accordance with the acquisition method of accounting for business combinations under the provisions of ASC 805, the assets acquired and the liabilities assumed are recorded at their respective fair values and added to those of the Company. The assets acquired, and liabilities assumed, and consideration paid in the acquisition of MD Barber are as follows:

Assets acquired (Liabilities Assumed):

| | |
|--|------------|
| Cash | \$ 24 |
| Accounts receivable | 15 |
| Inventory | 132 |
| Intangible Assets ** | 184 |
| Accounts Payable and Accrued liabilities | (49) |
| Loans Payable | (126) |
| | <u>180</u> |
| Residual Goodwill | <u>495</u> |
| | \$ 675 |

Purchase price Consideration:

| | |
|--|---------------|
| Cash paid | \$ 246 |
| Stocks issued (200,000 shares at \$1.97 per share) *** | 394 |
| Purchase credit **** | 35 |
| Total considerations paid | <u>\$ 675</u> |

** Intangible assets consist of customer lists and tradename and the fair values were determined based on the income approach (estimated discounted cash flows related to the intangibles). The Company utilized a relief of royalty method to value the trade name with a royalty rate of 1.5% and a discount rate of 17.5%. The Customer relationships were valued using a cash flow forecast with a customer retention rate and attrition rate of 85% and 15%, respectively.

The Company recorded all acquired assets and liabilities assumed at fair value. This acquisition will also allow the Company to distribute its existing products via the online channel resulting from the acquisition of MD Barber.

*** Pursuant to the purchase agreement, 100,000 shares of consideration paid is contingent on MD Barber reaching sales of \$840,000 and contingent on gross profit reaching at least \$250,000 for the period October 01, 2017 to September 30, 2018. During the period, the set targets were achieved and the company recorded the entire value of the stock as consideration.

**** The purchase credit for \$35,000 is available to one of the former shareholders of MD Barber as part of the purchase agreement. The purchase credit allows the former shareholder to purchase inventory, at discounted price, up to the available credit, for certain period of time for resale to others. The former

shareholder agreed not to compete with the Company or Stephan after the relationship ends for a certain period of time.

Total one-time expenses incurred in the acquisition of MD Barber amounted to approximately \$13,800 included under other expenses in the accompanying consolidated statement of operations.

NOTE 4: ACCOUNTS RECEIVABLE

At December 31, 2018 and 2017, the gross carrying amount of trade accounts receivable in continuing operations was approximately \$165,000 and \$311,000, respectively. The reserve for uncollectible accounts was approximately \$27,000 both at December 31, 2018 and 2017.

NOTE 5: INVENTORIES

Inventories at December 31, 2018 and 2017 consisted of the following:

| <i>(in thousands)</i> | <u>2018</u> | <u>2017</u> |
|-----------------------|-----------------|-----------------|
| Raw materials | \$ 47 | \$ 56 |
| Finished goods | <u>1,219</u> | <u>1,036</u> |
| Total inventories | <u>\$ 1,266</u> | <u>\$ 1,092</u> |

Raw materials include surfactants, chemicals and fragrances sourced by the Company and provided to its contracted manufacturer. This also includes packaging materials such as outer boxes and cartons used for shipping, as well as components consisting of bottles or containers (plastic or glass), jars, caps, pumps, and similar materials that will become part of the finished product. Finished goods also include hairdryers, electric clippers, lather machines, scissors, and salon furniture. The aforementioned inventory values are net of inventory obsolescence reserves of \$29,000 and \$34,500 at December 31, 2018 and 2017, respectively.

NOTE 6: PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2018 and 2017 consisted of the following:

| <i>(in thousands)</i> | <u>2018</u> | <u>2017</u> |
|--------------------------------|---------------|---------------|
| Machinery and equipment | \$ 447 | \$ 431 |
| Furniture and office equipment | <u>191</u> | <u>196</u> |
| Total cost | 638 | 627 |
| Accumulated depreciation | <u>(482)</u> | <u>(429)</u> |
| Property and equipment, net | <u>\$ 156</u> | <u>\$ 198</u> |

Depreciation expense was approximately \$53,000 and \$79,000 for the years ended December 31, 2018 and 2017, respectively.

NOTE 7: INTANGIBLE ASSETS

Intangible assets consists of the following at December 31:

| <i>(In thousands)</i> | <u>Estimated Useful Lives</u> | <u>2018</u> | <u>2017</u> |
|-------------------------------|-------------------------------|-----------------|-----------------|
| Customer list | 10 Years | \$ 209 | \$ 136 |
| Tradename | 10 Years | 51 | 48 |
| | | <u>260</u> | <u>184</u> |
| Less Accumulated Amortization | | <u>(35)</u> | <u>(16)</u> |
| | | <u>\$ 225</u> | <u>168</u> |
| | | | |
| Non amortizing goodwill | | \$ 1,890 | \$ 1,890 |
| Less Amortization | | - | - |
| | | <u>\$ 1,890</u> | <u>\$ 1,890</u> |

Amortization expenses totaled approximately \$18,000 and \$16,000 during the years ended December 31, 2018 and 2017, respectively. Future amortization of intangible assets as of December 31, 2018 is expected to be as follows:

| <u>Years Ending December 31,</u> | <i>(In thousands)</i> |
|----------------------------------|-----------------------|
| 2019 | \$ 26 |
| 2020 | 26 |
| 2021 | 26 |
| 2022 | 26 |
| 2023 | 26 |
| Thereafter | 95 |
| | <u>\$ 225</u> |

NOTE 8: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2018 and 2017 consisted primarily of trade accounts payable, accrued payroll, and accrued expenses are as follows:

| <i>(in thousands)</i> | <u>2018</u> | <u>2017</u> |
|---|---------------|---------------|
| Accounts payable | \$ 543 | \$ 486 |
| Accrued expenses | 120 | 120 |
| Taxes payable | 55 | 15 |
| Accrued payroll | 33 | 28 |
| Accrued returns | 11 | 11 |
| Accrued vacation | 3 | 6 |
| Total accounts payable and accrued expenses | <u>\$ 765</u> | <u>\$ 666</u> |

NOTE 9: INCOME TAXES

The provision for income taxes in 2018 and 2017 is comprised of current federal and state income taxes due to those states prohibiting the filing of consolidated tax returns and a change in valuation allowance. Income tax components for the years ended December 31, 2018 and 2017 are as follows:

| <i>(in thousands)</i> | <u>2018</u> | <u>2017</u> |
|-------------------------------|----------------|-----------------|
| Deferred tax expense | \$ (31) | \$ 2,499 |
| Change in valuation allowance | (146) | (2,702) |
| Current federal tax expense | 101 | 212 |
| Current state tax expense | 110 | 13 |
| Utilization of NOL | (122) | (225) |
| Income tax refund | <u>-</u> | <u>(21)</u> |
| Total income tax benefit | <u>\$ (88)</u> | <u>\$ (224)</u> |

Deferred income taxes reflect the net tax effects of temporary differences (items recognized for tax returns and financial statements in different years). The Consolidated Financial Statements include deferred income tax assets and (liabilities) attributable to the following items:

| <i>(in thousands)</i> | <u>2018</u> | <u>2017</u> |
|--|-----------------|-----------------|
| Net operating loss carryover | \$ 4,021 | \$ 3,965 |
| Inventory reserve & capitalization | 16 | 16 |
| Stock option compensation | 5 | 5 |
| Amortization of Intangibles for tax purposes | 27 | 79 |
| Fixed asset depreciation | - | - |
| Other, net | 30 | 23 |
| Deferred tax assets | <u>\$ 4,099</u> | <u>\$ 4,088</u> |
| Valuation Allowance | <u>(3,505)</u> | <u>(3,651)</u> |
| Deferred tax asset | <u>\$ 594</u> | <u>\$ 437</u> |
| Goodwill | \$ 70 | \$ 86 |
| Fixed asset depreciation | <u>29</u> | <u>33</u> |
| Deferred tax liability | <u>\$ (99)</u> | <u>\$ (119)</u> |
| Deferred tax asset, net | <u>\$ 495</u> | <u>\$ 318</u> |

In assessing the realizability of the deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which the temporary differences representing net future deductible amounts become deductible. Based on all available positive and negative evidence management has established a partial valuation allowance at December 31, 2018 and 2017. A Valuation allowance equal to the potentially unrealizable deferred tax asset of \$3,505,000 was recorded at December 31, 2018.

The effective income tax rate (the sum of the federal and state tax provisions divided by income before income taxes) differed from the federal statutory rate of 21% as follows:

| (as a percentage of income before income taxes) | <u>2018</u> | <u>2017</u> |
|---|---------------|---------------|
| Statutory rate | 21.0% | 34.0% |
| State taxes | 1.3% | 1.2% |
| Change in tax rate | 6.6% | 358.4% |
| Other | 0.1% | 0.1% |
| True-up of deferred taxes | -13.4% | 0% |
| Valuation allowance | - 54.8% | -425.9% |
| Tax rates to current deferreds | 0% | 0% |
| Effective income tax rate | <u>-17.9%</u> | <u>-32.0%</u> |

The Company has net operating loss carryforwards of approximately \$17.2 million for federal and approximately \$9.8 Million for state income tax purposes available to offset future taxable income. The utilization of these net operating losses to reduce future taxable income will depend on the ability of the Company to generate sufficient taxable income. All of the Company's NOLs were generated prior to the tax cut jobs act, which was effective for 2018. As such, these NOLs are subject to expiration beginning in 2025.

The Company is subject to U.S. federal and/or state examinations by tax authorities for up to five years. During the periods open to examination, the Company has NOLs for U.S. federal and state tax purposes that have attributes from closed periods. Since these NOLs and tax credit carry-forwards may be utilized in future periods, they remain subject to examination. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company did not have significant amounts of interest or penalties in the years presented.

NOTE 10: LEASES

Rent expense in 2018 and 2017 was approximately \$107,000 and \$98,000, respectively.

Existing leases for Morris Flamingo, Williamsport Bowman, and MD Barber were extended to expire in November 2020, September 2020, and July 2019, respectively. The future minimum lease payment for operating leases is as follows:

| <u>Year</u> | <u>Rent</u> (in thousands) |
|-------------|-------------------------------|
| 2019 | \$ 99 |
| 2020 | <u>77</u> |
| | <u>\$ 176</u> |

NOTE 11: CAPITAL STOCK AND STOCK OPTIONS

a) Preferred stock

1,000,000 shares of preferred stock, \$0.01 par value, are authorized; however, none have been issued. Rights, designations, preferences, and limitations of the preferred stock are subject to the Board of Directors upon issuance.

b) Stock Options

In 1990, the stockholders of the Company approved the 1990 Key Employee Stock Incentive Plan, as amended, and the 1990 Non-Employee (Outside Directors) Plan, as amended, and in 2000, the stockholders approved a ten-year extension of both plans. Both plans were extended to June 21, 2015. The number of shares and terms of each grant are determined by the Compensation

Committee of the Board of Directors, in accordance with the 1990 Key Employee stock incentive Plan, as amended. Both of these plans have not been extended as of December 31, 2018.

The Outside Directors Plan provides for annual common stock option grants to non-employee directors. Such options are granted on the earlier of June 30 or the date of the Company's Annual Meeting of Stockholders, at the fair market value at the date of grant. No options were granted to non-employee directors in 2018 and 2017.

The option grants to certain key members of the management team generally become exercisable one year from the grant date and exercisable within a maximum of 5-10 years from the date of grant. Common stock issued under the plans have the same rights and privileges as the Company's currently outstanding Common Stock. There was no stock compensation expense related to these grants for the years ended December 31, 2018 and 2017.

Stock option activity and the average exercise prices for 2018 and 2017 are set forth below:

| | Key Employees | Weighted Exercise Average Price | Outside Directors | Weighted Exercise Average Price | Aggregate Intrinsic Value | |
|----------------------------------|-----------------|---------------------------------|---------------------|---------------------------------|---------------------------|-------------------|
| | | | | | Key Employees | Outside Directors |
| Outstanding at January 1, 2017 | 83,334 | \$ 1.12 | 35,186 | \$ 2.00 | \$ 18,558 | \$ 20 |
| Exercised/Expired/Canceled | <u>-</u> | \$ - | <u>(20,062)</u> | \$ 2.33 | | |
| Outstanding at December 31, 2017 | 83,334 | \$ 1.12 | 15,124 | \$ 1.56 | \$ 119,074 | \$ 13,883 |
| Exercised/Expired/Canceled | <u>(83,334)</u> | \$ 1.12 | <u>(10,124)</u> | \$ 1.67 | | |
| Outstanding at December 31, 2018 | <u><u>-</u></u> | \$ - | <u><u>5,000</u></u> | \$ 1.35 | \$ 0 | \$ 2,000 |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price and the exercise price, multiplied by the related in-the-money options).

The exercise price range of options outstanding and exercisable as of December 31, 2018, for both the Key Employees and Outside Directors, the weighted average contractual lives remaining, and the weighted average exercise price were as follows:

| Price Range | Key Employees | | | Outside Directors | | |
|-------------------|---------------------|---------------------------------|---------------------------------|---------------------|---------------------------------|---------------------------------|
| | Options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Life | Options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Life |
| \$ 1.35 - \$ 3.15 | <u>-</u> | | | <u>5,000</u> | \$1.35 | 0.5 |
| Total | <u><u>-</u></u> | | | <u><u>5,000</u></u> | | |

NOTE 12: SUBSEQUENT EVENTS

Subsequent events were evaluated through July 23, 2019 in connection with the preparation of these consolidated financial statements, which is the date the consolidated financial statements were available to be issued.

In March 2019, the Company made a \$0.075 per share dividend payment. This dividend payment totaled approximately \$303,000.

In April 2019, The Company amended the earlier Trademark Acquisition and License Agreement dated December 22, 2017, with the trademark buyer. As per the original agreement, the Company sold the trademarks and agreed to receive six yearly equal installments of \$50,000 with the final installment due no later than November 30, 2022. As per the amended agreement, the Company received \$165,000 in April 2019 in lieu of the remaining multi-year payments scheduled for the next three years.