EDUCATIONAL DEVELOPMENT CORP
Form 10-Q
October 15, 2018

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 August 31, 2018

OR

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

For the transition period from _____ to _____.

Commission file number: 000-04957

EDUCATIONAL DEVELOPMENT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**73-0750007**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5402 South 122nd East Avenue, Tulsa, Oklahoma 74146

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code **(918)622-4522**

Indicate by check mark whether the registrant (1) has filed all reports 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 October 10, 2018, there were 8,195,598 shares of Educational Development Corporation Common Stock, $0.20 par value outstanding.

Table of Contents

TABLE OF CONTENTS

		Page
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	3
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	26
Item 4.	Controls and Procedures	26
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	27
Item 1A.	Risk Factors	27
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 3.	Defaults Upon Senior Securities	27
Item 4.	Mine Safety Disclosures	27
Item 5.	Other Information	27
Item 6.	Exhibits	27
Signatures		28

CAUTIONARY REMARKS REGARDING FORWARD-LOOKING STATEMENTS

The information discussed in this Quarterly Report on Form 10-Q includes “forward-looking statements.” These forward-looking statements are identified by their use of terms and phrases such as “may,” “expect,” “estimate,” “project,” “plan,” “believe,” “intend,” “achievable,” “anticipate,” “continue,” “potential,” “should,” “could,” and similar terms and phrase Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties, and we can give no assurance that such expectations or assumptions will be achieved. Important factors that could cause actual results to differ materially from those in the forward-looking statements are described under “*Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations*” in our Annual Report on Form 10-K for the year ended February 28, 2018 and in this quarterly report. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this Quarterly Report on Form 10-Q and speak only as of the date of this Quarterly Report on Form 10-Q. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED BALANCE SHEETS (UNAUDITED)

ASSETS	**August 31, 2018**	**F 2**
CURRENT ASSETS		
Cash and cash equivalents	$833,000	$
Accounts receivable, less allowance for doubtful accounts $254,800 (August 31) and $297,100 (February 28)	3,161,300	
Inventories - Net	33,515,300	
Prepaid expenses and other assets	1,294,800	
Total current assets	38,804,400	
INVENTORIES - Net	579,300	
PROPERTY, PLANT AND EQUIPMENT - Net	27,835,200	
OTHER ASSETS	26,900	
TOTAL ASSETS	$67,245,800	$
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$14,596,900	$
Line of credit	2,598,700	
Deferred revenues	458,200	
Current maturities of long-term debt	895,500	
Accrued salaries and commissions	1,877,300	
Income taxes payable	1,166,400	
Other current liabilities	2,369,100	
Total current liabilities	23,962,100	
LONG-TERM DEBT - Net of current maturities	19,343,600	
DEFERRED INCOME TAXES - Net	388,000	
OTHER LONG-TERM LIABILITIES	109,000	
Total liabilities	43,802,700	
COMMITMENTS (Note 7)		

SHAREHOLDERS' EQUITY		
Common stock, $0.20 par value; Authorized 16,000,000 shares;		
Issued 12,092,080 (August 31 and February 28) shares;	2,418,400	
Outstanding 8,189,702 (August 31) and 8,179,612 (February 28) shares		
Capital in excess of par value	8,643,300	
Retained earnings	23,612,800	
	34,674,500	
Less treasury stock, at cost	(11,231,400)	
Total shareholders' equity	23,443,100	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$67,245,800	$

See notes to financial statements.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ende	
	2018	**2017**
GROSS SALES	$33,013,600	$30,5
Less discounts and allowances	(10,444,700)	(8,79
Transportation revenue	2,112,100	2,48
NET REVENUES	24,681,000	24,1
COST OF GOODS SOLD	8,462,700	7,65
Gross margin	16,218,300	16,5
OPERATING EXPENSE:		
Operating and selling	3,261,600	3,33
Sales commissions	7,313,000	7,73
General and administrative	3,738,400	3,91
Total operating expenses	14,313,000	14,9
INTEREST EXPENSE	270,000	294,
OTHER INCOME	(400,300)	(427
EARNINGS BEFORE INCOME TAXES	2,035,600	1,68
INCOME TAXES	544,900	645,
NET EARNINGS	$1,490,700	$1,03
BASIC AND DILUTED EARNINGS PER SHARE		
Basic	$0.18	$0.13
Diluted	$0.18	$0.13
WEIGHTED AVERAGE NUMBER OF COMMON AND EQUIVALENT SHARES OUTSTANDING		
Basic	8,185,419	8,17
Diluted	8,192,833	8,18
Dividends per share	$-	$-

See notes to financial statements.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
FOR THE SIX MONTHS ENDED AUGUST 31, 2018

	Common Stock (par value $0.20 per share)				Treasury Stock		
	Number of Shares Issued	Amount	Capital in Excess of Par Value	Retained Earnings	Number of Shares	Amount	Shareholders' Equity
BALANCE - February 28, 2018	12,092,080	$2,418,400	$8,573,300	$20,714,500	3,912,468	$(11,304,100)	$20,402,100
Purchase of treasury stock	-	-	-	-	2,846	(29,600)	(29,600)
Sales of treasury stock	-	-	-	-	(12,936)	102,300	102,300
Dividends paid ($0.05/share)	-	-	-	(409,000)	-	-	(409,000)
Share-based compensation expense (see Note 5)	-	-	70,000	-	-	-	70,000
Net earnings	-	-	-	3,307,300	-	-	3,307,300
BALANCE - August 31, 2018	12,092,080	$2,418,400	$8,643,300	$23,612,800	3,902,378	$(11,231,400)	$23,443,100

See notes to financial statements.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE SIX MONTHS ENDED AUGUST 31,

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$3,307,300	$2,262,200
Adjustments to reconcile net earnings to net cash		
used in operating activities:		
Depreciation	717,600	585,500
Deferred income taxes, net	251,100	206,200
Provision for doubtful accounts	17,200	(114,000)
Provision for inventory valuation allowance	176,300	198,700
Share-based compensation expense	70,000	-
Changes in assets and liabilities:		
Accounts receivable	(264,800)	33,200
Inventories, net	(7,216,400)	4,812,800
Prepaid expenses and other assets	(35,800)	(318,800)
Accounts payable	2,767,400	(8,800,400)
Accrued salaries and commissions, and other liabilities	(1,276,400)	267,200
Deferred revenues	(234,800)	14,000
Income tax payable	(632,400)	(103,500)
Total adjustments	(5,661,000)	(3,219,100)
Net cash used in operating activities	(2,353,700)	(956,900)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(1,331,800)	(1,227,500)
Net cash used in investing activities	(1,331,800)	(1,227,500)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(467,200)	(430,500)
Proceeds from long-term debt	-	1,019,100
Cash received from sale of treasury stock	102,300	18,600
Cash used to purchase treasury stock	(29,600)	(55,600)
Net borrowings under line of credit	2,598,700	1,366,000
Dividends paid	(409,000)	-
Net cash provided by financing activities	1,795,200	1,917,600
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,890,300)	(266,800)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	2,723,300	699,200
CASH AND CASH EQUIVALENTS - END OF PERIOD	$833,000	$432,400
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid for interest	$454,800	$558,900
Cash paid for income taxes	$1,596,100	$1,162,300

See notes to financial statements.

Table of Contents

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying Unaudited Condensed Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim condensed financial information and in accordance with the rules and regulations of the Securities and Exchange Commission. The Unaudited Condensed Financial Statements include all adjustments considered necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Such adjustments consist only of normal recurring items, unless otherwise disclosed herein. Accordingly, the Unaudited Condensed Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. However, we believe that the disclosures made are adequate to make the information not misleading. These interim Unaudited Condensed Financial Statements should be read in conjunction with our audited financial statements as of and for the year ended February 28, 2018 included in our Form 10-K. The results of operations for interim periods are not necessarily indicative of the results to be expected for a full year due to the seasonality of our product sales.

On July 24, 2018, our Board of Directors authorized a two-for-one stock split in the form of a stock dividend. The stock dividend was distributed on August 22, 2018 to shareholders of record as of August 14, 2018. All share-based data, including the number of shares outstanding and per share amounts, have been retroactively adjusted to reflect the stock split for all periods presented.

Reclassifications

Certain reclassifications have been made to the fiscal 2018 condensed balance sheets, condensed statement of earnings and consolidated statement of cash flows to conform to the classifications used in fiscal 2019. These reclassifications had no effect on net earnings.

Use of Estimates in the Preparation of Financial Statements

The preparation of the Unaudited Condensed Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Actual results could differ from those estimates.

Significant Accounting Policies

Our significant accounting policies are consistent with those disclosed in Note 1 to our audited financial statements as of and for the year ended February 28, 2018 included in our Form 10-K.

New Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") periodically issues new accounting standards in a continuing effort to improve standards of financial accounting and reporting. We have reviewed the recently issued accounting standards updates ("ASU") and concluded that the following recently issued accounting standards apply to us.

In May 2014, FASB issued ASU No. 2014-09, and amended with ASU No. 2015-14 "Revenue from Contracts with Customers," (Topic 606) which provides a single revenue recognition model which is intended to improve comparability over a range of industries, companies and geographical boundaries and will also result in enhanced disclosures. The changes are effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The amendments in this series of updates shall be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company adopted Topic 606, Revenue from Contracts with Customers, with a date of initial application of March 1, 2018, using the full retrospective method applied to all contracts. Results for all reporting periods are presented under Topic 606. As a result of adopting this new accounting guidance, the Company has changed the method of accounting for its hostess awards program from reporting the net cost of these awards in operating and selling expenses to allocating a portion of the transaction price to the material right and reporting these in gross sales and discounts with the associated costs in cost of goods sold. The new reporting of these awards increases gross sales and increases discounts and allowances for a similar amount, having an immaterial effect on net revenues and no effect on net earnings or retained earnings, but lowering the Company's gross margin percentage. The Company has also removed the allowance for sales returns from the net accounts receivable amount reported on the balance sheet. The allowance for sales returns has been adjusted to reflect a refund liability and a return asset. The cumulative impact of adoption of the new revenue recognition standard had no impact on net earnings and retained earnings (See Note 11).

Table of Contents

In February 2016, FASB issued ASU No. 2016-02, “Leases,” which is intended to establish a comprehensive new lease accounting model. The new standard clarifies the definition of a lease, requires a dual approach to lease classification similar to current lease classifications, and causes lessees to recognize leases on the balance sheet as a lease liability with a corresponding right-of-use asset. The new standard is effective for interim and annual periods beginning after December 15, 2018, which means the first quarter of our fiscal year 2020. The new standard requires a modified retrospective transition for capital or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. We are currently reviewing the ASU and evaluating the potential impact on our financial statements.

In June 2016, FASB issued ASU No. 2016-13 “Financial Instruments—Credit Losses”, which requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, which means the first quarter of our fiscal year 2020. We anticipate this ASU to have minimal impact on our financial statements.

In August 2016, FASB issued ASU No. 2016-15 “Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments.” The guidance’s objective is to reduce diversity in practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The new standards required date of adoption is effective for fiscal years beginning after December 15, 2017. This standard was adopted as of March 1, 2018. Adoption of this new standard did not have a material impact on our financial statements.

In May 2017, FASB issued ASU 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting.” This update amends the scope of modification accounting surrounding share-based payment arrangements as issued in ASU 2016-09 by providing guidance on the various types of changes which would trigger modification accounting for share-based payment awards. This ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The new standard is required to be applied prospectively. The guidance was effective March 1, 2018, and the adoption of this ASU did not have a material impact on our financial statements.

Note 2 – INVENTORIES

Inventories consist of the following:

2018

	August 31,	February 28,
Current:		
Book inventory	$33,818,600	$27,078,600
Inventory valuation allowance	(303,300)	(460,000)
Inventories net – current	$33,515,300	$26,618,600
Noncurrent:		
Book inventory	$943,700	$707,700
Inventory valuation allowance	(364,400)	(271,800)
Inventories net – noncurrent	$579,300	$435,900

Book inventory quantities in excess of what we expect will be sold within the normal operating cycle, based on 2.5 years of anticipated sales, are included in non-current inventory.

Significant portions of our inventory purchases are concentrated with an England-based publishing company, Usborne Publishing, Ltd. (“Usborne”). Purchases from this company were approximately $7.9 million and $9.4 million for the three months ended August 31, 2018 and 2017, respectively. Total inventory purchases from all suppliers were $10.6 million and $11.3 million for the three months ended August 31, 2018 and 2017, respectively.

Purchases from Usborne were approximately $15.5 million and $11.3 million for the six months ended August 31, 2018 and 2017, respectively. Total inventory purchases from all suppliers were $21.6 million and $16.6 million for the six months ended August 31, 2018 and 2017, respectively.

Table of Contents

Note 3 – DEBT

Debt consists of the following:

	2018 August 31,	February 28,
Line of credit	$2,598,700	$ -
Long-term debt	$20,239,100	$ 20,706,300
Less current maturities	(895,500)	(881,200)
Long-term debt, net of current maturities	$19,343,600	$ 19,825,100

We have a Loan Agreement dated as of March 10, 2016 (as amended the "Loan Agreement") with MidFirst Bank ("the Bank") which includes multiple loans. Term Loan #1 is comprised of Tranche A totaling $13.4 million and Tranche B totaling $5.0 million, both with the maturity date of December 1, 2025. Tranche A has a fixed interest rate of 4.23% and interest is payable monthly. For Tranche B, interest is payable monthly at the bank adjusted LIBOR Index plus a tiered pricing rate based on the Company's Adjusted Funded Debt to EBITDA Ratio (4.58% at August 31, 2018). Term Loan #1 is secured by the primary office, warehouse and land.

We also have Term Loan #2 with the Bank in the amount of $4.0 million with the maturity date of June 28, 2021, and interest payable monthly at the bank adjusted LIBOR Index plus a tiered pricing rate based on the Company's Adjusted Funded Debt to EBITDA Ratio (4.58% at August 31, 2018). Term Loan #2 is secured by our secondary warehouse and land. The Loan Agreement also provided a $15.0 million revolving loan ("line of credit") through August 15, 2019 with interest payable monthly at the bank adjusted LIBOR Index plus a tiered pricing rate based on the Company's Adjusted Funded Debt to EBITDA Ratio (4.58% at August 31, 2018).

The Tranche B, the line of credit and the Term Loan #2 accrue interest at a tiered rate based on our Adjusted Funded Debt to EBITDA Ratio, which is payable monthly. The variable interest pricing tier is as follows:

Pricing Tier	Adjusted Funded Debt to EBITDA Ratio	LIBOR Margin (bps)
I	>2.00	325.00
II	>1.50 but ≤2.00	300.00
III	>1.00 but ≤1.50	275.00
IV	≤1.00	250.00

EBITDA is defined in the Loan Agreement as earnings before interest expense, income tax expense (benefit) and depreciation and amortization expenses.

We had $2,598,700 and no borrowings outstanding on our revolving credit agreement at August 31, 2018 and February 28, 2018, respectively. Available credit under the revolving credit agreement was $8,867,700 and $9,424,000 at August 31, 2018 and at February 28, 2018, respectively.

On June 15, 2018 the Company executed the Eighth Amendment Loan Agreement with the Bank related to our Loan Agreement dated as of March 10, 2016. This Amendment established a new $3,000,000 advancing term loan to be used for capital expansions to increase daily shipping capacity. We had no borrowings outstanding on the advancing term loan at August 31, 2018.

The Loan Agreement also contains a provision for our use of the Bank’s letters of credit. The Bank agrees to issue or obtain issuance of commercial or stand-by letters of credit provided that no letters of credit will have an expiry date later than August 15, 2019, and that the sum of the line of credit plus the letters of credit would not exceed the borrowing base in effect at the time. For the quarter ended August 31, 2018, we had no letters of credit outstanding.

The Loan Agreement contains provisions that require us to maintain specified financial ratios, restrict transactions with related parties, prohibits mergers or consolidation, disallow additional debt, and limit the amount of compensation, salaries, investments, capital expenditures, leasing transactions we can make on a quarterly basis. Additionally, the Loan Agreement places limitations on the amount of dividends that may be distributed and certain stock buyback transactions.

Table of Contents

The following table reflects aggregate future maturities of long-term debt during the next five fiscal years and thereafter as follows:

	Year ending February 28 (29),
2019	$ 434,200
2020	925,900
2021	967,700
2022	1,016,300
2023	1,064,900
Thereafter	15,830,100
Total	$ 20,239,100

Note 4 – EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS is based on the combined weighted average number of common shares outstanding and dilutive potential common shares issuable which include, where appropriate, the assumed exercise of options. In computing diluted EPS, we have utilized the treasury stock method. See Note 1 for additional information regarding the stock split that occurred in fiscal 2019.

The computation of weighted average common and common equivalent shares used in the calculation of basic and diluted EPS is shown below.

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Earnings per share:				
Net earnings applicable to common shareholders	$ 1,490,700	$ 1,036,900	$ 3,307,300	$ 2,262,200
Shares:				
Weighted average shares outstanding-basic	8,185,419	8,171,296	8,181,305	8,175,791
Assumed exercise of options	7,414	9,962	7,615	8,716
Weighted average shares outstanding-diluted	8,192,833	8,181,258	8,188,920	8,184,507
Diluted earnings per share:				
Basic	$ 0.18	$ 0.13	$ 0.40	$ 0.28
Diluted	$ 0.18	$ 0.13	$ 0.40	$ 0.28

Note 5 – STOCK-BASED COMPENSATION

We account for stock-based compensation whereby share-based payment transactions with employees, such as stock options and restricted stock, are measured at estimated fair value at the date of grant. For awards subject to service conditions compensation expense is recognized over the vesting period on a straight-line basis. Awards subject to performance conditions are attributed separately for each vesting tranche of the award and are recognized ratably from the service inception date to the vesting date for each tranche. Forfeitures are recognized when they occur.

The Company has outstanding stock options under the 2002 Employee Incentive Stock Option Plan totaling 10,000 shares. No options have been exercised in the three and six months ended August 31, 2018. All options outstanding at August 31, 2018 expire in December 2019.

In July 2018, our shareholders approved the Company's 2019 Long-Term Incentive Plan ("2019 LTI Plan"). The 2019 LTI Plan establishes up to 600,000 shares of restricted stock which can be granted to certain members of management based on exceeding specified net revenues and pre-tax performance metrics during fiscal years 2019, 2020 and 2021. Restricted shares granted under the 2019 LTI Plan "cliff vest" after five years.

Table of Contents

The restricted share awards granted under the 2019 LTI Plan contain both service and performance conditions. The Company recognizes share compensation expense only for the portion of the restricted share awards that are considered probable of vesting. Shares are considered granted, and the service inception date begins, when a mutual understanding of the key terms and conditions between the Company and the employees have been established. The fair value of these awards is determined based on the closing price of the shares on the grant date. The probability of restricted share awards granted with future performance conditions is evaluated at each reporting period and compensation expense is adjusted based on the probability assessment.

For certain awards that provide discretion to adjust the allocation of the restricted shares, the service-inception date for such awards could precede the grant date as a mutual understanding of the key terms and conditions between the Company and the employees has not yet been established. For awards in which the service-inception date precedes the grant date, compensation cost is accrued beginning on the service-inception date. The Company estimates the award's fair value on each subsequent reporting date, until the grant date, based on the closing market price of the Company’s common stock. On the grant date, the award's fair value is fixed, subject to the remaining performance conditions, and the cumulative amount of previously recognized compensation expense is adjusted to the fair value at the grant date.

On July 24, 2018, the Company granted approximately 239,000 restricted shares under the 2019 LTI Plan with a grant-date fair value of $9.57 per share. In addition, the Company authorized approximately 80,000 restricted shares under the 2019 LTI Plan in which the service-inception date was established resulting in the fair value of these awards being measured at $12.00 per share, the closing price of the Company's stock at August 31, 2018. The grant date for these awards will be established when a mutual understanding of the key terms and conditions is reached between the Company and the employees. The remaining compensation expense of the above awards will be recognized ratably from the service inception date to the vesting date for this tranche which is approximately 54 months. The number of restricted shares to be distributed depends on attaining the performance metrics defined by the 2019 LTI Plan and may result in the distribution of a number of shares that is greater or less than the number of restricted shares granted, as outlined in the terms of the 2019 LTI Plan.

A summary of compensation expense recognized in connection with restricted share awards follows:

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Compensation Expense	$ 70,000	$ -	$ 70,000	$ -

Note 6 – SHIPPING AND HANDLING COSTS

We classify shipping and handling costs as operating and selling expenses in the statements of earnings. Shipping and handling costs include postage, freight, handling costs, as well as, shipping materials and supplies. These costs were $3,259,900 and $3,121,500 for the three months ended August 31, 2018 and 2017, respectively. These costs were $7,658,900 and $6,871,200 for the six months ended August 31, 2018 and 2017, respectively.

Note 7 – COMMITMENTS

In connection with the 2015 purchase of our 400,000 square-foot facility on 40-acres, we entered in to a 15-year lease with the seller, a non-related third party, who leases 181,300 square feet, or 45.3% of the facility. The lease is being accounted for as an operating lease.

The cost of the leased space upon acquisition was estimated at $10,159,000, which was also the carrying cost as of August 31, 2018.

The lessee pays $110,100 per month, through the lease anniversary date of December 2018, with a 2.0% annual increase adjustment on each anniversary date thereafter. The lease terms allow for one five-year extension, which is not a bargain renewal option, at the expiration of the 15-year term. Revenue associated with the lease is being recorded on a straight-line basis and is reported in other income on the statements of earnings.

At August 31, 2018, we had outstanding purchase commitments for inventory totaling approximately $13,627,000 which will be due during fiscal year 2019. Of these commitments, $8,344,000 were with Usborne, $4,861,200 with various Kane Miller publishers and the remaining $421,800 with other suppliers.

Table of Contents

Note 8 – BUSINESS SEGMENTS

We have two reportable segments: Usborne Books & More (“UBAM”) and Publishing. These reportable segments are business units that offer different methods of distribution to different types of customers. They are managed separately based on the fundamental differences in their operations. Our Publishing segment markets its products to retail accounts, which include book, school supply, toy and gift stores and museums, through commissioned sales representatives, trade and specialty wholesalers and an internal tele-sales group. Our UBAM segment markets its products through a network of independent sales consultants using a combination of direct sales, home shows, book fairs and internet sales.

The accounting policies of the segments are the same as those of the rest of the Company. We evaluate segment performance based on earnings before income taxes of the segments, which is defined as segment net sales reduced by cost of sales and direct expenses. Corporate expenses, depreciation, interest expense and income taxes are not allocated to the segments but are listed in the “Other” row below. Corporate expenses include the executive department, accounting department, information services department, general office management and building facilities management. Our assets and liabilities are not allocated on a segment basis.

Information by reporting segment for the three and six-month periods ended August 31, 2018 and 2017, follows:

NET REVENUES

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Publishing	$ 2,605,500	$ 1,977,000	$ 4,911,700	$ 4,099,100
UBAM	22,075,500	22,209,900	49,791,600	47,029,000
Total	$ 24,681,000	$ 24,186,900	$ 54,703,300	$ 51,128,100

EARNINGS (LOSS) BEFORE INCOME TAXES

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Publishing	$ 636,700	$ 388,300	$ 1,143,000	$ 957,400
UBAM	4,277,100	4,570,300	9,376,100	8,949,800
Other	(2,878,200)	(3,275,900)	(5,987,700)	(6,242,300)
Total	$ 2,035,600	$ 1,682,700	$ 4,531,400	$ 3,664,900

Note 9 – FAIR VALUE MEASUREMENTS

The valuation hierarchy included in U.S. GAAP considers the transparency of inputs used to value assets and liabilities as of the measurement date. A financial instrument's classification within the valuation hierarchy is based on the lowest level of input that is significant to its fair value measurement. The three levels of the valuation hierarchy and the classification of our financial assets and liabilities within the hierarchy are as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly. If an asset or liability has a specified term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Unobservable inputs for the asset or liability.

We do not report any assets or liabilities at fair value in the financial statements. However, the estimated fair value of our line of credit is estimated by management to approximate the carrying value of $2,598,700 and $0 at August 31, 2018 and February 28, 2018, respectively. The estimated fair value of our term notes payable is estimated by management to approximate $19,492,300 and $19,454,500 at August 31, 2018 and February 28, 2018, respectively. Management's estimates are based on the obligations' characteristics, including floating interest rate, maturity, and collateral. Such valuation inputs are considered a Level 2 measurement in the fair value valuation hierarchy.

Table of Contents

Note 10 – DEFERRED REVENUES

As of the end of our second quarter, we had received approximately $458,200 in payments for sales orders which were shipped out subsequent to the quarter end. As of August 31, 2018, these prepaid sales orders are included in deferred revenues on the condensed balance sheet.

Note 11 – REVENUE RECOGNITION

Revenue is derived from the sales of children’s books and related products which are generally capable of being distinct and accounted for as single performance obligation to deliver tangible goods. Substantially all of our books are sold to end consumers and publishing retail outlets. Accordingly, revenues are recognized at shipping point, which is the point in time the customer obtains control of the products. Shipping and handling fees are recorded as operating and selling expenses when the product is shipped and revenue is recognized. The Company estimates product returns based on historical return rates. The majority of the Company's contracts have a single performance obligation and are short term in nature. Sales taxes, that are collected from customers and remitted to governmental authorities, are accounted for on a net basis and therefore are excluded from net sales.

Adoption of ASC Topic 606, “Revenue from Contracts with Customers”

On March 1, 2018, the Company adopted Topic 606, as prescribed by the FASB, using the full retrospective method. Results for all reporting periods are presented under Topic 606.

There was no change to net earnings or retained earnings due to the adoption of Topic 606, with the impact primarily related to the recording of our hostess award program in gross sales and discounts and allowances, as opposed to recording the net costs in operating and selling expenses.

Disaggregation of Revenue

Please refer to Note 8 – Business Segments for revenue by segment.

Arrangements with Multiple Performance Obligations

Certain contracts associated with the hostess awards program include sales incentives, such as discounted or free products. These incentives provide a separate performance obligation in the contract and material right to the customer. The transaction price is allocated to the material right based on its relative standalone selling price and is recognized in revenue as the performance obligations are satisfied, which occurs at shipping point or at the expiration of the material right. As our sales incentives are delivered with the associated products ordered, there is no deferral required. Revenue allocated to the material right are recognized in gross sales, discounts and allowances and cost of goods sold in our condensed statement of earnings.

Practical Expedients and Exemptions

The Company generally expenses sales commissions when incurred. These costs are recorded within operating expenses. The Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

Impact on Financial Statements

As a result of applying Topic 606, the impact to the Company's condensed consolidated balance sheet as of February 28, 2018 was as follows:

	As Reported	Adjustments	Without Adoption
ASSETS			
Accounts receivable-Net	$2,913,700	$ (99,900)	$2,813,800
Inventories-Net	26,618,600	(100)	26,618,500
Prepaid expenses and other assets	1,259,000	(117,000)	1,142,000
Total current assets	33,514,600	(217,000)	33,297,600
TOTAL ASSETS	61,837,900	(217,000)	61,620,900
LIABILITIES			
Other current liabilities	3,517,900	(217,000)	3,300,900
Total liabilities	41,435,800	(217,000)	41,218,800

Table of Contents

As a result of applying Topic 606, the impact to the Company's condensed statement of earnings for the three months ended August 31, 2017 was as follows:

	As Reported	Adjustments	Without Adoption
GROSS SALES	$ 30,500,600	$ (2,579,600)	$ 27,921,000
Less discounts and allowances	(8,797,300)	2,574,000	(6,223,300)
Transportation revenue	2,483,600	-	2,483,600
NET REVENUES	24,186,900	(5,600)	24,181,300
COST OF GOODS SOLD	7,650,300	(990,700)	6,659,600
Gross margin	16,536,600	985,100	17,521,700
OPERATING EXPENSE:			
Operating and selling	3,336,300	983,900	4,320,200
Sales commissions	7,739,700	-	7,739,700
General and administrative	3,910,500	-	3,910,500
Total operating expenses	14,986,500	983,900	15,970,400
INTEREST EXPENSE	294,700	-	294,700
OTHER INCOME	(427,300)	1,200	(426,100)
EARNINGS BEFORE INCOME TAXES	1,682,700	-	1,682,700
INCOME TAXES	645,800	-	645,800
NET EARNINGS	$ 1,036,900	$ -	$ 1,036,900

Table of Contents

As a result of applying Topic 606, the impact to the Company's operating results by reporting segment for the three months ended August 31, 2017 was as follows:

UBAM

	As Reported	Adjustments	Without Adoption
GROSS SALES	$ 26,312,700	$ (2,579,600)	$ 23,733,100
Less discounts and allowances	(6,577,100)	2,574,000	(4,003,100)
Transportation revenue	2,474,300	-	2,474,300
NET REVENUES	22,209,900	(5,600)	22,204,300
COST OF GOODS SOLD	6,516,300	(990,700)	5,525,600
Gross margin	15,693,600	985,100	16,678,700
OPERATING EXPENSE:			
Operating and selling	2,578,000	983,800	3,561,800
Sales commissions	7,664,100	-	7,664,100
General and administrative	881,200	-	881,200
Total operating expenses	11,123,300	983,800	12,107,100
OPERATING INCOME	$ 4,570,300	$ 1,300	$ 4,571,600

Publishing

	As Reported	Adjustments	Without Adoption
GROSS SALES	$ 4,187,900	$ -	$ 4,187,900
Less discounts and allowances	(2,220,200)	-	(2,220,200)
Transportation revenue	9,300	-	9,300
NET REVENUES	1,977,000	-	1,977,000
COST OF GOODS SOLD	1,134,000	-	1,134,000
Gross margin	843,000	-	843,000
OPERATING EXPENSE:			
Operating and selling	294,100	-	294,100
Sales commissions	75,600	-	75,600
General and administrative	85,000	-	85,000
Total operating expenses	454,700	-	454,700
OPERATING INCOME	$ 388,300	$ -	$ 388,300

15

Table of Contents

As a result of applying Topic 606, the impact to the Company's condensed statement of earnings for the six months ended August 31, 2017 was as follows:

	As Reported	Adjustments	Without Adoption
GROSS SALES	$65,011,700	$ (5,916,800)	$59,094,900
Less discounts and allowances	(19,067,800)	5,900,800	(13,167,000)
Transportation revenue	5,184,200	-	5,184,200
NET REVENUES	51,128,100	(16,000)	51,112,100
COST OF GOODS SOLD	16,249,100	(2,164,700)	14,084,400
Gross margin	34,879,000	2,148,700	37,027,700
OPERATING EXPENSE:			
Operating and selling	7,563,100	2,149,500	9,712,600
Sales commissions	16,248,900	-	16,248,900
General and administrative	7,624,400	-	7,624,400
Total operating expenses	31,436,400	2,149,500	33,585,900
INTEREST EXPENSE	576,200	-	576,200
OTHER INCOME	(798,500)	(800)	(799,300)
EARNINGS BEFORE INCOME TAXES	3,664,900	-	3,664,900
INCOME TAXES	1,402,700	-	1,402,700
NET EARNINGS	$2,262,200	$ -	$2,262,200

As a result of applying Topic 606, the impact to the Company's operating results by reporting segment for the six months ended August 31, 2017 was as follows:

UBAM

	As Reported	Adjustments	Without Adoption
GROSS SALES	$56,299,000	$ (5,917,500)	$50,381,500
Less discounts and allowances	(14,437,800)	5,901,500	(8,536,300)
Transportation revenue	5,167,800	-	5,167,800
NET REVENUES	47,029,000	(16,000)	47,013,000
COST OF GOODS SOLD	13,990,000	(2,164,700)	11,825,300
Gross margin	33,039,000	2,148,700	35,187,700

OPERATING EXPENSE:			
Operating and selling	5,743,200	2,148,700	7,891,900
Sales commissions	16,087,800	-	16,087,800
General and administrative	2,258,200	-	2,258,200
Total operating expenses	24,089,200	2,148,700	26,237,900
OPERATING INCOME	$8,949,800	$ -	$8,949,800

Table of Contents

Publishing

	As Reported	Adjustments	Without Adoption
GROSS SALES	$ 8,712,700	$ 700	$ 8,713,400
Less discounts and allowances	(4,630,000)	(700)	(4,630,700)
Transportation revenue	16,400	-	16,400
NET REVENUES	4,099,100	-	4,099,100
COST OF GOODS SOLD	2,259,100	-	2,259,100
Gross margin	1,840,000	-	1,840,000
OPERATING EXPENSE:			
Operating and selling	539,000	-	539,000
Sales commissions	161,100	-	161,100
General and administrative	182,500	-	182,500
Total operating expenses	882,600	-	882,600
OPERATING INCOME	$ 957,400	$ -	$ 957,400

Note 12 – SUBSEQUENT EVENTS

In September 2018, our board of directors declared a distribution of $0.05 per share of common stock. This cash distribution was paid on September 26, 2018 to shareholders of record on September 17, 2018. The total cash distributions paid under this declaration was approximately $409,100.

Table of Contents

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Factors Affecting Forward-Looking Statements

The following discussion contains forward-looking statements that reflect our future plans, estimates, beliefs and expected performance. The forward-looking statements are dependent upon events, risks and uncertainties that may be outside our control. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, number of our success in recruiting and retaining new consultants, our ability to locate and procure desired books, our ability to ship the volume of orders that are received without creating backlogs, our ability to obtain adequate financing for working capital and capital expenditures, economic and competitive conditions, regulatory changes and other uncertainties, as well as those factors discussed below and elsewhere in our Annual Report on Form 10-K for the year ended February 28, 2018 and this Quarterly Report on Form 10-Q, all of which are difficult to predict. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may or may not occur. See "Cautionary Remarks Regarding Forward-Looking Statements" in the front of this Quarterly Report on Form 10-Q.

Overview

We are the exclusive United States trade co-publisher of Usborne children's books and the owner of Kane Miller. We operate two separate segments: UBAM and Publishing, to sell our Usborne and Kane Miller children's books. These two segments each have their own customer base. The Publishing segment markets its products on a wholesale basis to various retail accounts. The UBAM segment markets its products through a network of independent sales consultants using a combination of home shows, internet party plan events and book fairs. All other supporting administrative activities are recognized as other expenses outside of our two segments. Other expenses are primarily compensation of our office, warehouse and sales support staff as well as the cost of operating and maintaining our corporate office and distribution facility.

The following table shows our condensed statements of earnings data:

	Three Months Ended August 31,		Six Months Ended August 31,	
	2018	**2017**	**2018**	**2017**
Net revenues	$ 24,681,000	$ 24,186,900	$ 54,703,300	$ 51,128,100
Cost of goods sold	8,462,700	7,650,300	18,132,400	16,249,100

Gross margin	16,218,300	16,536,600	36,570,900	34,879,000
Operating expense:				
Operating and selling	3,261,600	3,336,300	8,013,800	7,563,100
Sales commissions	7,313,000	7,739,700	16,686,100	16,248,900
General and administrative	3,738,400	3,910,500	7,630,900	7,624,400
Total operating expenses	14,313,000	14,986,500	32,330,800	31,436,400
Other (income) expense				
Interest expense	270,000	294,700	483,400	576,200
Other income	(400,300)	(427,300)	(774,700)	(798,500)
Earnings before income taxes	2,035,600	1,682,700	4,531,400	3,664,900
Income taxes	544,900	645,800	1,224,100	1,402,700
Net earnings	$ 1,490,700	$ 1,036,900	$ 3,307,300	$ 2,262,200

See the detailed discussion of revenues, costs of services, gross margin, general and administrative expenses by reportable segment below. The following is a discussion of significant changes in the non-segment related general and administrative expenses, other income and expenses and income taxes during the respective periods.

Table of Contents

Non-Segment Operating Results for the Three Months Ended August 31, 2018

Total operating expenses not associated with a reporting segment decreased $0.4 million, or 11.8%, to $3.0 million for the three-month period ending August 31, 2018, compared to $3.4 million for the same quarterly period a year ago. Our operating expenses decreased from reduced payroll in our warehouse of approximately $0.2 million due to efficiencies from automation introduced during the last year offset by approximately $0.1 million of compensation associated with the new 2019 LTI Plan. Other operating expenses declined $0.3 million primarily due to $0.1 million of reduced property tax expense due to a state exemption received on our new facility, among other lesser changes.

Interest expense remained consistent at $0.3 million for the three months ended August 31, 2018, when compared to the same quarterly period a year ago. Interest expense decreased $0.1 million due to reduced borrowings on the line of credit of $2.6 million in the second quarter of fiscal 2019 as compared to $6.2 million in the second quarter of fiscal 2018. These reduced expenses were offset by increased interest expenses of $0.1 million on the Company's other borrowings due to increases in the LIBOR based floating interest rates during the past year.

Income taxes decreased $0.1 million to $0.5 million for the three months ended August 31, 2018, from $0.6 million for the same quarterly period a year ago. Our effective tax rate was 26.8% for the quarter ended August 31, 2018, and 38.4% for the quarter ended August 31, 2017. The decrease in the tax rate resulted from our reduced federal tax rate included with the passage of the Tax Cuts and Jobs Act of 2017 ("Tax Act"). Our tax rates are higher than the federal statutory rate of 21% due to the inclusion of state income and franchise taxes.

Non-Segment Operating Results for the Six Months Ended August 31, 2018

Total operating expenses not associated with a reporting segment decreased $0.2 million, or 3.1%, to $6.3 million for the six-month period ending August 31, 2018, compared to $6.5 million for the same period a year ago. Payroll increased $0.1 million associated with the Company's 2019 LTI Plan offset by reduced payroll in our warehouse of $0.2 million due to increase automation and $0.1 million in reduced property taxes due to a state exemption received on our new facility.

Interest expense decreased $0.1 million to $0.5 million for the six months ended August 31, 2018, from $0.6 million for the same period a year ago. Interest expense decreased primarily as a result of reduced borrowings against the line of credit in the first six months of fiscal 2019 as compared to the same period a year ago.

Income taxes decreased $0.2 million to $1.2 million for the six months ended August 31, 2018, from $1.4 million for the same period a year ago. Our effective tax rate was 27.0% for the six months ended August 31, 2018, and 38.3% for the six months ended August 31, 2017. The decrease in the tax rate resulted from our reduced federal tax rate included with the passage of the Tax Act. Our tax rates are higher than the federal statutory rate of 21% due to the inclusion of state income and franchise taxes.

UBAM Operating Results for the Three and Six Months Ended August 31, 2018

The following table summarizes the operating results of the UBAM segment:

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Gross sales	$ 27,484,400	$ 26,312,700	$ 61,643,000	$ 56,299,000
Less discounts and allowances	(7,511,300)	(6,577,100)	(16,795,100)	(14,437,800)
Transportation revenue	2,102,400	2,474,300	4,943,700	5,167,800
Net revenue	22,075,500	22,209,900	49,791,600	47,029,000
Cost of goods sold	7,031,400	6,516,300	15,455,900	13,990,000
Gross margin	15,044,100	15,693,600	34,335,700	33,039,000
Operating expense:				
Operating and selling	2,517,000	2,578,000	6,466,300	5,743,200
Sales commissions	7,220,600	7,664,100	16,507,400	16,087,800
General and administrative	1,029,400	881,200	1,985,900	2,258,200
Total operating expenses	10,767,000	11,123,300	24,959,600	24,089,200
Operating income	$ 4,277,100	$ 4,570,300	$ 9,376,100	$ 8,949,800
Average number of active consultants	32,800	29,700	34,000	28,600

Table of Contents

UBAM Operating Results for the Three Months Ended August 31, 2018

UBAM gross sales increased $1.2 million, or 4.6%, to $27.5 million during the three months ended August 31, 2018, as compared to $26.3 million during the same period a year ago. The increase in gross sales resulted from an increase in orders due primarily to an increase in the number of our active consultants. The average number of active sales consultants increased 3,100, or 10.4%, to 32,800 in the second quarter of fiscal 2019 from 29,700 in the second quarter of fiscal year 2018. Our consultant growth is driven by our existing active consultants recruiting new consultants and retaining existing consultants.

The increase in gross sales was offset by an increase in discounts and allowances of $0.9 million, or 13.6%, to $7.5 million in the three months ended August 31, 2018, as compared to $6.6 million during the same period a year ago. Discounts and allowances increased as a result of increased gross sales and a change in the mix of order types between the periods. Discounts and allowances vary depending on the type of order, or order mix. Order types with higher discounts, such as book fairs, typically result in lower sales commissions for the consultant. As such, the order mix for the three-month period ending August 31, 2018 had higher discounts and allowances but lower sales commissions than the same period a year ago.

Transportation revenue decreased $0.4 million, or 16.0%, to $2.1 million during the three months ended August 31, 2018, as compared to $2.5 million for the same period last year. The decrease in transportation revenue is also directly related to the change in mix of order types. Orders with higher discounts, such as book fairs, offer free shipping which resulted in a decrease in shipping revenue between the periods.

Gross margin decreased $0.7 million, or 4.5%, during the three-month period ending August 31, 2018, when compared to the same quarter a year ago, due primarily to an increase in discounts and allowances and decrease in transportation revenue. Gross margin, as a percentage of net revenues, decreased 2.6% to 68.1% for the three-month period ending August 31, 2018 when compared to 70.7% the same period a year ago. The decrease in gross margin as a percentage of net revenues was due to the change in mix of order types received during the quarter. This change in mix also resulted in less sales commissions during the quarter.

UBAM operating expenses consists of operating and selling expenses, sales commissions and general and administrative expenses. Operating and selling expenses primarily consists of freight expenses and materials and supplies. Sales commissions include amounts paid to consultants for new sales and promotions. These operating expenses are directly tied to the sales volumes of the UBAM segment. General and administrative expenses include payroll, outside services, inventory reserves and other expenses directly associated with the UBAM segment. Operating expenses decreased $0.3 million, or 2.7%, to $10.8 million during the three-month period ending August 31, 2018, when compared to $11.1 million reported in the same quarter a year ago. The decrease in operating expenses

was primarily due to a decrease in sales commissions partially offset by an increase in general and administrative expenses. The sales commissions decreased due to a change in the mix of order types between the periods. Our order types have different discounts and allowances, freight charges and sales commission percentages associated with them. General and administrative expenses increased $0.1 million, or 11.1%, to $1.0 million reported during the three months ended August 31, 2018, from $0.9 million reported in the same period last year. General and operating expenses increased as a result of an increase in monthly sales awards earned by consultants.

Operating income of the UBAM segment decreased $0.3 million, or 6.5%, to $4.3 million during the three-month period ending August 31, 2018 as compared to $4.6 million from the same period a year ago. The decrease in operating income was primarily due to a decrease in margins due to a change in mix of order types and an increase in general and administrative expenses.

UBAM Operating Results for the Six Months Ended August 31, 2018

UBAM gross sales increased $5.3 million, or 9.4%, to $61.6 million during the six-month period ending August 31, 2018, as compared to $56.3 million from the same period a year ago. The gross sales increase resulted from an increase in the number of active consultants. The average number of active sales consultants increased 5,400, or 18.9% to 34,000 in the fiscal year 2019 from 28,600 in the fiscal year 2018. Our consultant growth is driven by existing active consultants recruiting and retaining new consultants.

The increase in gross sales was partially offset by an increase in discounts and allowances of $2.4 million, or 16.7%, to $16.8 million in the six months ended August 31, 2018, as compared to $14.4 million during the same period a year ago. Discounts and allowances increased as a result of increased gross sales and a change in the mix of order types between the periods.

Transportation revenue decreased $0.3 million, or 5.8%, to $4.9 million during the six months ended August 31, 2018, as compared to $5.2 million for the same period last year. The decrease in transportation revenue is also directly related to the change in mix of order types. Orders with higher discounts, such as book fairs, offer free shipping which resulted in a decrease in shipping revenue between the periods.

Table of Contents

Gross margin increased $1.3 million, or 3.9%, to $34.3 million during the six-month period ending August 31, 2018, when compared to $33.0 million during the same period a year ago, due primarily to an increase in sales. Gross margin, as a percentage of net revenues, decreased to 69.0% for the six-month period ending August 31, 2018 when compared to 70.3% the same period a year ago. The decrease in gross margin as a percentage of net revenues was due to a change in the mix of order types between the periods.

UBAM operating expenses consists of operating and selling expenses, sales commissions and general and administrative expenses. Operating expenses increased $0.9 million, or 3.7%, to $25.0 million during the six-month period ending August 31, 2018, when compared to $24.1 million reported the same period a year ago. The increase in operating expenses was due to an increase in operating and selling expenses of $0.8 million primarily related to an increase in postage and freight related to higher sales. Sales commissions increased $0.4, or 2.5%, to $16.5 million reported during the six months ended August 31, 2018, from $16.1 million reported in the same period last year. Sales commissions increased primarily due to an increase to gross sales. Offsetting these increases was a decrease in general and administrative expenses of $0.3 million, or 13.0%, to $2.0 million reported during the six months ended August 31, 2018, from $2.3 million reported in the same period last year. General and operating expenses decreased primarily as a result of a reduction in merchant services fees associated with our online payment processing among other changes.

Operating income of the UBAM segment increased $0.5 million, or 5.6%, to $9.4 million during the six-month period ending August 31, 2018, when compared with $8.9 million from the same period a year ago. The increase in operating income was primarily due to increased gross sales.

Publishing Operating Results for the Three and Six Months Ended August 31, 2018

The following table summarizes the operating results of the Publishing segment:

	Three Months Ended August 31,		**Six Months Ended August 31,**	
	2018	**2017**	**2018**	**2017**
Gross sales	$ 5,529,200	$ 4,187,900	$ 10,445,400	$ 8,712,700
Less discounts and allowances	(2,933,400)	(2,220,200)	(5,551,000)	(4,630,000)
Transportation revenue	9,700	9,300	17,300	16,400
Net revenue	2,605,500	1,977,000	4,911,700	4,099,100
Cost of goods sold	1,431,300	1,134,000	2,676,500	2,259,100
Gross margin	1,174,200	843,000	2,235,200	1,840,000

Total operating expenses	537,500	454,700	1,092,200	882,600
Operating income	$ 636,700	$ 388,300	$ 1,143,000	$ 957,400

Publishing Operating Results for the Three Months Ended August 31, 2018

Our Publishing division's net revenues increased $0.6 million, or 30.0%, to $2.6 million during the three-month period ending August 31, 2018, from $2.0 million reported in the same period a year ago. This increase is primarily related to an increase in orders from our largest customers which had reduced sales in the same period last year.

Gross margin increased $0.4 million, or 50.0%, to $1.2 million during the three-month period ending August 31, 2018, from $0.8 million reported in the same quarter a year ago. This increase is primarily related to the growth in gross sales. Gross margin as a percentage of net revenues, increased 2.5%, to 45.1% during the three-month period ending August 31, 2018, from 42.6% reported in the same quarter a year ago, due to a change in customer mix between the two quarters.

Total operating expenses of the Publishing segment remained consistent at $0.5 million during the three-month period ending August 31, 2018 and 2017, respectively.

Operating income of the Publishing segment increased $0.2 million, or 50.0%, to $0.6 million during the three-month period ending August 31, 2018 when compared to $0.4 million reported in the same period a year ago. The increase in operating income was primarily due to increased gross sales.

Table of Contents

Publishing Operating Results for the Six Months Ended August 31, 2018

Our Publishing division's net revenues increased $0.8 million, or 19.5%, to $4.9 million during the six-month period ending August 31, 2018, from $4.1 million reported in the same period a year ago. This increase is primarily related to an increase in orders from our largest customers which had reduced sales in the same period last year.

Gross margin increased $0.4 million, or 22.2%, to $2.2 million during the six-month period ending August 31, 2018, from $1.8 million reported in the same period a year ago. This increase is primarily related to the growth in gross sales. Gross margin as a percentage of net revenues, increased 0.6%, to 45.5% during the six-month period ending August 31, 2018, from 44.9% reported in the same period a year ago, due to a change in customer mix between the periods.

Total operating expenses increased $0.2 million, or 22.2%, to $1.1 million during the six-month period ending August 31, 2018, from $0.9 million reported in the same period a year ago. This increase is primarily related to an increase in freight costs and sales commissions associated with the growth in sales.

Total operating income increased $0.1 million, or 10.0%, to $1.1 million during the six-month period ending August 31, 2018, from $1.0 million reported in the same period a year ago. The increase in operating income was primarily due to increased gross sales.

Liquidity and Capital Resources

EDC has a history of profitability and positive cash flow. We typically fund our operations from the cash we generate. We also use available cash primarily to pay down outstanding bank loan balances, for capital expenditures, to pay dividends, and to acquire treasury stock. We have utilized a bank credit facility and other term loan borrowings to meet our short-term cash needs, as well as fund capital expenditures, when necessary. Our revolving bank credit facility loan balance was $2,598,700 with $8,867,700 in available capacity at August 31, 2018.

During the first six months of fiscal 2019, we experienced cash outflow from our operations of $2,353,700. Cash flows resulted from the following items:

- net earnings of $3,307,300,
- depreciation expense of $717,600,
- share-based compensation expense of $70,000,
- an increase in deferred income tax liability, net of $251,100,
- an increase in provision for inventory valuation allowance of $176,300,
- an increase in the provision for doubtful accounts of $17,200, and
- an increase in accounts payable of $2,767,400,

Offset by:

- an increase in accounts receivable of $264,800,
- an increase in inventories, net of $7,216,400,
- an increase in prepaid expenses and other assets of $35,800,
- a decrease in accrued salaries and commissions, and other liabilities of $1,276,400,
- a decrease in deferred revenue of $234,800, and
- a decrease in income tax payable of $632,400,

Table of Contents

Cash used in investing activities was $1,331,800 for capital expenditures, which was primarily comprised of improvements to our warehouse picking and inventory management systems and various other improvements to the warehouse and facility.

Cash provided by financing activities was $1,795,200, which was primarily comprised of cash received from net borrowings under our line of credit of $2,598,700, $72,700 net cash received from treasury stock transactions, offset by payments on long-term debt of $467,200 and dividends paid of $409,000.

During fiscal year 2019, we continue to expect our cash from operations, along with our expanded line of credit with our Bank, will provide us the ability to meet our liquidity requirements. Cash generated from operations will be used to increase inventory in anticipation of continued sales growth, to liquidate existing debt, and any excess cash is expected to be distributed to our shareholders.

We have a Loan Agreement with the Bank including Term Loan #1 comprised of Tranche A of $13.4 million and Tranche B of $5.0 million both with the maturity date of December 1, 2025. Tranche A has a fixed interest rate of 4.23% and interest is payable monthly. The Loan Agreement also includes Term Loan #2 in the amount of $4.0 million, which is secured by a warehouse and land with the maturity date of June 28, 2021, and a $15.0 million revolving loan (“line of credit”) through August 15, 2019.

Effective March 10, 2016, we signed a First Amendment Loan Agreement with the Bank which provided an increase to $6.0 million from our original $4.0 million line of credit through June 15, 2016. Effective June 15, 2016, we signed a Second Amendment Loan Agreement with the Bank which provided a further increase to $7.0 million from our previous $6.0 million line of credit and extended it through June 15, 2017. Effective June 28, 2016, we signed a Third Amendment Loan Agreement with the Bank which included Term Loan #2 in the amount of $4.0 million. Effective February 7, 2017, we signed a Fourth Amendment Loan Agreement with the Bank which modified certain debt covenant calculations and waived an existing default that occurred in the fourth quarter of fiscal year 2017.

Effective, June 15, 2017, the Company executed the Fifth Amendment Loan Agreement with the Bank which modified the Loan Agreement to increase the maximum revolving principal amount from $7.0 million to $10.0 million and extended the termination date of the Loan Agreement to June 15, 2018. The Fifth Amendment also modified the Loan Agreement to include an Advancing Term Loan of $3.0 million which the Company used to cover the cost of the fiscal 2018 capital improvements to increase our daily shipping capacity. The Advancing Term loan accrued interest between June 15, 2017 and December 1, 2017, at which time the balance was converted to a term loan and set to amortize over a thirty-six-month period. The Advancing Term Loan was repaid early, without penalty, in February 2018.

Effective September 1, 2017, we signed a Sixth Amendment Loan Agreement with the Bank which further increased the maximum revolving principal amount from $10.0 million to $15.0 million, subject to certain collateral restrictions.

Effective February 15, 2018, we signed a Seventh Amendment Loan Agreement with the Bank which modified the limitation on dividends as well as modified and removed other financial covenant calculations.

Effective June 15, 2018, we signed an Eighth Amendment Loan Agreement with the Bank which extended the termination date until August 15, 2019, reduced the interest rate pricing grid for all floating rate borrowings, established a new $3.0 million advancing term loan to be used for capital expansions to increase daily shipping capacity, released the personal Guaranty of Randall W. White and Carol White, along with other covenant restrictions being lessened. The amendment also included an adjustment to the Adjusted Funded Debt to EBITDA Ratio for covenant compliance.

We had $2.6 million in borrowings on our revolving credit agreement at August 31, 2018 and no borrowings at February 28, 2018. Available credit under the revolving credit agreement was $8,867,700 at August 31, 2018.

Tranche B of Term Loan #1, Term Loan #2 and the line of credit accrue interest monthly, at the bank adjusted LIBOR Index plus a tiered pricing rate based on the Company’s Adjusted Funded Debt to EBITDA Ratio (4.58% at August 31, 2018).

The Loan Agreement also contains a provision for our use of the Bank’s letters of credit. The Bank agrees to issue or obtain issuance of commercial or stand-by letters of credit provided that the sum of the line of credit plus the letters of credit issued would not exceed the borrowing base in effect at the time. For the three months ended August 31, 2018, we had no outstanding letters of credit. The agreement contains provisions that require us to maintain specified financial ratios, restrict transactions with related parties, prohibit mergers or consolidation, disallow additional debt, and limit the amounts of dividends declared, compensation, salaries, investments, capital expenditures, and leasing transactions.

Table of Contents

The following table reflects aggregate future maturities of long-term debt during the next five fiscal years and thereafter as follows:

	Year ending February 28 (29),	
2019	$	434,200
2020		925,900
2021		967,700
2022		1,016,300
2023		1,064,900
Thereafter		15,830,100
Total	$	20,239,100

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to our valuation of inventory, allowance for uncollectible accounts receivable, allowance for sales returns, long-lived assets and deferred income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Actual results may materially differ from these estimates under different assumptions or conditions. Historically, however, actual results have not differed materially from those determined using required estimates. Our significant accounting policies are described in the notes accompanying the financial statements included elsewhere in this report. However, we consider the following accounting policies to be more significantly dependent on the use of estimates and assumptions.

Revenue Recognition

Sales are generally recognized and recorded when products are shipped. Products are shipped FOB shipping point. The UBAM segment’s sales are typically paid at the time the product is ordered. UBAM sales accounted for 91.0% of

net revenues for the six-month period ended August 31, 2018, and 92.0% for the six-month period ended August 31, 2017. Sales that have been paid for but not shipped are classified as deferred revenue on the balance sheet. Sales associated with consignment inventory are recognized when reported and payment associated with the sale has been remitted. Transportation revenue represents the amount billed to the customer for shipping the product and is recognized when the product is shipped.

Estimated allowances for sales returns, which reduce net sales and costs of goods sold, are recorded as sales are recognized and recorded. Management uses a moving average calculation to estimate the allowance for sales returns. We are not responsible for product damaged in transit. Damaged returns are primarily from retail stores. These returns primarily result from damage that occurs in the stores, not in shipping to the stores. It is industry practice to accept non-damaged returns from retail customers. Management has estimated sales returns of approximately $217,000 as of August 31, 2018, and February 28, 2018, which is included in other current liabilities on the Company’s balance sheet. In addition, Management has recorded an asset for the expected value of non-damaged inventories to be returned. The estimated value of returned products of $117,000 is included in other current assets on the Company’s balance sheet as of August 31, 2018 and February 28, 2018.

Allowance for Doubtful Accounts

We maintain an allowance for estimated losses resulting from the inability of our customers to make required payments. An estimate of uncollectable amounts is made by management based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer's financial condition and current economic trends. Management has estimated and included an allowance for doubtful accounts of $254,800 at August 31, 2018, and $297,100 at February 28, 2018.

Inventory

Our inventory contains over 2,000 titles, each with different rates of sale, depending upon the nature and popularity of the title. Almost all of our product line is saleable as the books are not topical in nature and remain current in content today as well as in the future. Most of our products are printed in Europe, China, Singapore, India, Malaysia and Dubai resulting in a three to six-month lead-time to have a title printed and delivered to us.

Table of Contents

Certain inventory is maintained in a noncurrent classification. Management continually estimates and calculates the amount of noncurrent inventory. Noncurrent inventory arises due to occasional purchases of titles in quantities in excess of what will be sold within the normal operating cycle, due to minimum order requirements of our suppliers. Noncurrent inventory was estimated by management using the current year turnover ratio by title. All inventory in excess of 2 ½ years of anticipated sales is classified as noncurrent inventory. Noncurrent inventory balances prior to valuation allowances were $943,700 and $707,700 at August 31, 2018 and February 28, 2018, respectively.

Consultants that meet certain eligibility requirements are allowed to receive inventory on consignment. We believe allowing our consultants to have consignment inventory greatly increases their ability to be successful in making effective presentations at home shows, book fairs and other events; and having consignment inventory leads to additional sales opportunities. Approximately 11% of our active consultants maintained consignment inventory at August 31, 2018 and February 28, 2018. Consignment inventory is stated at cost, less an estimated reserve for consignment inventory that is not expected to be sold or returned to the Company. The total value of inventory on consignment with active consultants was $1,319,600 and $1,270,700 at August 31, 2018 and February 28, 2018, respectively. Inventory related to inactive consultants amounted to $182,000 and $278,500 as of August 31, 2018 and February 28, 2018, respectively.

Inventories are presented net of a valuation allowance, which includes reserves for inventory obsolescence and active and inactive consultant consignment inventory that is not expected to be sold or returned. Management estimates the allowance for both current and noncurrent inventory. Management has estimated a valuation allowance for both current and noncurrent inventory as well as consignment inventory held by active and inactive consultants of $667,700 and $731,800 as of August 31, 2018 and February 28, 2018, respectively.

Our principal supplier, Usborne, generally requires a minimum reorder of 6,500 or more of a title in order to get a solo print run. Smaller orders require a shared print run with the supplier’s other customers, which can result in lengthy delays to receive the ordered title. Anticipating customer preferences and purchasing habits requires historical analysis of similar titles in the same series. We place our initial order or re-orders based upon this analysis.

These factors and historical analysis have led our management to determine that 2 ½ years represents a reasonable estimate of the normal operating cycle for our products.

Stock-Based Compensation

We account for stock-based compensation whereby share-based payment transactions with employees, such as stock options and restricted stock, are measured at estimated fair value at the date of grant. For awards subject to service conditions compensation expense is recognized over the vesting period on a straight-line basis. Awards subject to performance conditions are attributed separately for each vesting tranche of the award and are recognized ratably from the service inception date to the vesting date for each tranche. Forfeitures are recognized when they occur.

The restricted share awards granted under the 2019 LTI Plan contain both service and performance conditions. The Company recognizes share compensation expense only for the portion of the restricted share awards that are considered probable of vesting. Shares are considered granted, and the service inception date begins, when a mutual understanding of the key terms and conditions between the Company and the employees have been established. The fair value of these awards is determined based on the closing price of the shares on the grant date. The probability of restricted share awards granted with future performance conditions is evaluated at each reporting period and compensation expense is adjusted based on the probability assessment.

For certain awards that provide discretion to adjust the allocation of the restricted shares, the service-inception date for such awards could precede the grant date as a mutual understanding of the key terms and conditions between the Company and the employees has not yet been established. For awards in which the service-inception date precedes the grant date, compensation cost is accrued beginning on the service-inception date. The Company estimates the award's fair value on each subsequent reporting date, until the grant date, based on the closing market price of the Company’s common stock. On the grant date, the award's fair value is fixed, subject to the remaining performance conditions, and the cumulative amount of previously recognized compensation expense is adjusted to the fair value at the grant date.

Table of Contents

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

Item 4. CONTROLS AND PROCEDURES

An evaluation was performed of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) and 15d-15(e) as of August 31, 2018. This evaluation was conducted under the supervision and with the participation of our management, including our Chief Executive Officer (Principal Executive Officer) and our Chief Financial Officer and Corporate Secretary (Principal Financial and Accounting Officer).

Based on that evaluation, these officers concluded that our disclosure controls and procedures were effective pursuant to Exchange Act Rule 13a-15(e).

In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during the quarter ended August 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Not applicable.

Item 1A. RISK FACTORS

Not required by smaller reporting company.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Period	Total # of Shares Purchased	Average Price Paid per Share	Total # of Shares Purchased as Part of Publicly Announced Plan (1)	Maximum # of Shares that May be Repurchased under the Plan (2)
June 1 - 30, 2018	0	N/A	0	590,362
July 1 - 31, 2018	0	N/A	0	590,362
August 1 - 31, 2018	0	N/A	0	590,362
Total	0	N/A	0	

(1) In April 2008, the Board of Directors authorized us to purchase up to 1,000,000 additional shares of our common stock under a plan initiated in 1998. This plan has no expiration date.

(2) On August 22, 2018 the Company issued a two-for-one stock split in the form of a stock dividend. The maximum number of shares that may be repurchased under the plan have been updated to reflect the stock split.

We announced no sales or repurchases of our common stock during the three months ended August 31, 2018.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

31.1	Certification of the Chief Executive Officer of Educational Development Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 furnished herewith.
31.2	Certification of Chief Financial Officer and Corporate Secretary (Principal Financial and Accounting Officer) of Educational Development Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 furnished herewith.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

EDUCATIONAL DEVELOPMENT CORPORATION

(Registrant)

Date: October 15, 2018 By /s/ Randall W. White

Chairman of the Board, President

and Chief Executive Officer

(Principal Executive Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer of Educational Development Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 furnished herewith.
31.2	Certification of Chief Financial Officer and Corporate Secretary (Principal Financial and Accounting Officer) of Educational Development Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 furnished herewith.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.