



Ediciones SM, Inc.
Statutory Report and
Consolidated Financial Statements
December 31, 2017



Report of Independent Auditors

On Consolidated Balance Sheet Filed with the Department of State

To the Board of Directors and Management of
Ediciones SM, Inc.

We have audited the accompanying consolidated balance sheet of Ediciones SM, Inc. as of December 31, 2017.

Management's Responsibility for the Consolidated Balance Sheet

Management is responsible for the preparation and fair presentation of the consolidated balance sheet 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 a consolidated balance sheet that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated balance sheet based on our audit. We conducted our audit 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 balance sheet is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated balance sheet. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated balance sheet, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated balance sheet 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 Company'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 balance sheet. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying consolidated balance sheet presents fairly, in all material respects, the financial position of Ediciones SM, Inc. as of December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.



Opinion

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

Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position and results of operations of the individual companies.

The Company has extensive transactions and relationships with affiliated companies, as disclosed in the consolidated financial statements and related notes. Our opinion is not modified with respect to this matter.

Restriction of Use

This report is intended solely for the information and use of the Board of Directors and management of the Company and the agencies of the Commonwealth of Puerto Rico responsible for the administration of the income tax, municipal license tax, or property tax and is not intended to be and should not be used by anyone other than these specified parties.



PricewaterhouseCoopers LLP
By *Janier Vizcarra*
License No. 4562

San Juan, Puerto Rico
July 27, 2018

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Ediciones SM, Inc.
December 31, 2017

Supplementary Consolidating Balance Sheet
As of December 31, 2017

	Ediciones SM, Inc.		ISME LLC		Subtotal		Elimination		Ediciones SM, Inc., Consolidated
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	
Assets									
Current assets									
Cash	\$ 5,212,185	\$ 9,835	\$ 5,222,020		\$ 5,222,020			\$ 5,222,020	
Accounts receivable, net	672,887	19,636	692,523		692,523			692,523	
Inventories, net of reserve for slow moving and obsolete items of \$389,888		-	890,727		890,727			890,727	
Due from affiliates	69,771	-	69,771		69,771		69,771	-	
Prepaid expenses	172,428	-	172,428		172,428			172,428	
Loan to affiliate	2,500,000	-	2,500,000		2,500,000			2,500,000	
Total current assets	9,517,998	29,471	9,547,469		9,547,469			9,477,698	
Prepublication costs	646,933	-	646,933		646,933			646,933	
Property, plant and equipment, net	494,396	-	494,396		494,396			494,396	
Other assets	19,316	-	19,316		19,316			19,316	
Deferred tax assets	472,005	-	472,005		472,005			472,005	
Investment in subsidiary at cost *	10,000	-	10,000		10,000		10,000	-	
	\$ 11,160,648	\$ 29,471	\$ 11,190,119		\$ 11,190,119			\$ 11,110,348	
Liabilities and Member's Equity/stockholder's Equity									
Current liabilities									
Accounts payable	\$ 432,606	4,763	437,369		437,369			437,369	
Accrued liabilities	1,182,798	-	1,182,798		1,182,798			1,182,798	
Due to affiliates	564,399	69,771	634,170		634,170	69,771		564,399	
Total current liabilities	2,179,803	74,534	2,254,337		2,254,337			2,184,566	
Member's equity/stockholder's equity									
Member's units/common stocks	10,770	10,000	20,770		20,770	10,000		10,770	
Contributed capital/additional paid-in capital	5,872,497	-	5,872,497		5,872,497			5,872,497	
Accumulated earnings	3,097,578	(55,063)	3,042,515		3,042,515			3,042,515	
Total member's equity/stockholder's equity	8,980,845	(45,063)	8,935,782		8,935,782			8,925,782	
	\$ 11,160,648	\$ 29,471	\$ 11,190,119		\$ 11,190,119			\$ 11,110,348	

Ediciones SM, Inc.
December 31, 2017

Supplementary Consolidating Statement of Income
For the year-ended December 31, 2017

	Ediciones SM, Inc.	ISME LLC	Subtotal	Elimination	Ediciones SM, Inc., Consolidated
				Debit	Credit
Net sales	\$ 7,216,315	-	\$ 7,216,315		\$ 7,216,315
Seminars and educational programs	3,167,783	19,636	3,187,419		3,187,419
Other operating income	81,634	-	81,634		81,634
	<u>10,465,732</u>	<u>19,636</u>	<u>10,485,368</u>		<u>10,485,368</u>
Cost and expenses, including depreciation and					
Cost of sales	1,219,253	-	1,219,253		1,219,253
Cost of seminars and educational programs	1,929,389	4,763	1,934,152		1,934,152
Selling, general and administrative, including depreciation expense of \$261,265	6,836,754	69,936	6,706,690		6,706,690
Total cost and expenses	<u>9,785,396</u>	<u>74,699</u>	<u>9,860,095</u>		<u>9,860,095</u>
Income before income taxes	680,336	(55,063)	625,273		625,273
Income tax expense (benefit)					
Current	457,525	-	457,525		457,525
Deferred	(157,677)	-	(157,677)		(157,677)
	<u>299,848</u>	<u>-</u>	<u>299,848</u>		<u>299,848</u>
Net income	380,488	(55,063)	325,425		325,425
Retained Earnings					
Beginning of year	2,717,090	-	2,717,090		2,717,090
End of year	<u>\$ 3,097,578</u>	<u>\$ (55,063)</u>	<u>\$ 3,042,515</u>		<u>\$ 3,042,515</u>

Ediciones SM, Inc.
Consolidated Balance Sheet
December 31, 2017

Assets	
Current assets	
Cash	\$ 5,222,020
Receivables, net of allowance for doubtful accounts of \$69,296	692,523
Inventories, net of allowances for excess and obsolescence of \$389,888	890,727
Prepaid expenses	172,428
Loan to affiliate	2,500,000
Total current assets	<u>9,477,698</u>
Prepublication costs	646,933
Property and equipment, net	494,396
Other assets	19,316
Deferred tax assets	472,005
Total assets	<u>\$ 11,110,348</u>
Liabilities and Stockholders' Equity	
Current liabilities	
Account payable	\$ 437,369
Accrued liabilities	1,182,798
Due to affiliate	564,399
Total current liabilities	<u>2,184,566</u>
Stockholders' equity	
Common stock \$10 par value; 1,100 shares authorized; 1,077 issued and outstanding	10,770
Additional paid-in capital	5,872,497
Retained earnings	3,042,515
Total stockholders' equity	<u>8,925,782</u>
Total liabilities and stockholders' equity	<u>\$ 11,110,348</u>

The accompanying notes are an integral part of these financial statements.

Ediciones SM, Inc.
Consolidated Statement of Operations and Changes in Retained Earnings
Year Ended December 31, 2017

Revenues	
Net sales	\$ 7,216,315
Seminars and educational programs	3,187,419
Other operating income	<u>81,634</u>
	<u>10,485,368</u>
Cost and expenses	
Cost of Sales	1,219,253
Cost of seminars and educational programs	1,934,152
Selling, general and administrative, including depreciation expense of \$261,265	<u>6,706,690</u>
Total cost and expenses	<u>9,860,095</u>
Income before income taxes	<u>625,273</u>
Income tax expense (benefit)	
Current	457,525
Deferred	<u>(157,677)</u>
Total Income tax expense	<u>299,848</u>
Net Income	<u>325,425</u>
Retained earnings	
Beginning of year	<u>2,717,090</u>
End of year	<u>\$ 3,042,515</u>

The accompanying notes are an integral part of these financial statements.

Ediciones SM, Inc.
Consolidated Statement of Cash Flows
Year Ended December 31, 2017

Cash flows from operating activities	
Net income	\$ 325,425
Adjustment to reconcile net income to net cash provided by operating activities	
Depreciation and amortization	261,265
Reversal/Provision for excess and obsolete inventory reserve	(96,057)
Provision for doubtful accounts	1,704
Amortization of prepublication costs	338,709
Loss on sale of property	35
Deferred income tax benefit	(157,677)
Changes in assets and liabilities which increased (decrease) cash	
Receivable	1,891,532
Inventories	322,769
Prepaid expenses and other assets	(100,185)
Accrued liabilities	166,766
Accounts payable	(250,068)
Income tax payable	(5,972)
Due to affiliates	234,539
Net adjustments	<u>2,607,360</u>
Net cash provided by operating activities	<u>2,932,785</u>
Cash flows from investing activities	
Investment in prepublication costs	(336,585)
Loan to affiliate	(2,500,000)
Acquisition of property and equipment	<u>(353,740)</u>
Net cash flows used in investing activities	<u>(3,190,325)</u>
Net decrease in cash	(257,540)
Cash and cash equivalents	
Beginning of year	<u>5,479,560</u>
End of year	<u>\$ 5,222,020</u>
Supplementary information	
Income tax paid	\$ 461,200

The accompanying notes are an integral part of these financial statements.

Ediciones SM, Inc.
Notes to Consolidated Financial Statements
December 31, 2017

1. Organization and Summary of Significant Accounting Policies

Ediciones SM, Inc. (the "Company") was organized under the laws of the Commonwealth of Puerto Rico. The principal activities of the Company are the publishing and distribution of educational books in Puerto Rico. In addition, the Company provides Seminars and Education Programs to the Public School System and Private Schools.

At December 31, 2017, stockholders' ownership is as follows:

Grupo Editorial SM Internacional, S.L.	86.63 %
Marianist Province of the USA	10.12 %
Comercializadora SM, S.A.	3.25 %

The accompanying consolidated financial statements include the accounts of Ediciones SM, Inc. and its wholly-owned subsidiary ISME LLC. All significant intercompany balances and transactions have been eliminated.

ISME LLC is a Puerto Rico limited liability company, wholly-owned by Ediciones SM, Inc., engaged in providing Seminars and Education Programs to the Public School System.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("US GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Company considers highly liquid investments with original maturities at the time of purchase of three months or less to be cash equivalents.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, products are shipped and the customer takes ownership and assumes risk of loss, and collection of the related receivable is probable. Shipping and other transportation costs charged to customers are recorded in both sales and cost of sales. Revenue from government contractual arrangements, such as contracts for seminars and workshops for teachers and professors, is recognized as performance occurs.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and accounts receivable. As of December 31, 2017, the Company maintained its cash in one financial institution. The Federal Deposit Insurance Corporation insures up to \$250,000 per legal entity per financial institution. At December 31, 2017, the Company's uninsured cash balance was approximately \$4,962,185. The Company performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral for accounts receivable arising from the normal course of business. For concentration of credit risk arising from major customers, please refer to note 5.

Ediciones SM, Inc.
Notes to Consolidated Financial Statements
December 31, 2017

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses, current receivables aging, and existing economic data. The Company reviews its allowance for doubtful accounts periodically. Account balances are written-off against the allowance after all means of collection have been exhausted and potential for recovery is considered remote.

Inventories

Inventories are stated at the lower of cost (weighted average method) or net realizable value. The allowance for inventory excess/obsolescence is based upon management's assessment of the marketplace of publications in demand, as compared to the number of units currently on hand.

Prepublication Costs

Costs associated with developing any publication are expensed until the product is determined to be commercially viable. Once commercial viability is determined, prepublication costs, primarily costs incurred to develop a publication such as design, authoring, illustration, typesetting, proofreading and printing, are capitalized. Prepublication costs are amortized from the year of publication based on an accelerated method as books of the first edition (which are generally printed based on the estimated demand for 2 years) are sold. The Company regularly reviews the recoverability of the capitalized costs based on expected future revenues.

Property and Equipment

Property and equipment, including leasehold improvements, are carried at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method based on the estimated useful lives of the respective asset or terms of the lease, whichever is shorter.

Maintenance and repair expenses are charged to operations in the year in which they are incurred. Expenditures which result in the enhancement of the value of the facilities involved are capitalized. Upon retirement or other disposition of property, cost and the related allowances for depreciation are removed from the accounts and any gains or losses are recognized as part of current year operations.

Impairment of Long-Lived Assets

The Company evaluates their long-lived assets considering continued operating losses or significant and long-term changes in industry conditions as the primary indicators of potential impairment. Impairment is recognized when the future undiscounted cash flows of each asset is estimated to be insufficient to recover its related carrying value. If such carrying costs are not recoverable, the asset is written down to estimated fair value. Considerable management judgment is necessary to estimate future cash flows, accordingly, actual results could vary significantly from such estimates, requiring periodic revaluation based on current events or changes in circumstances. Based on these evaluations, there were no adjustments to the carrying values of long-lived assets during 2017.

Advertising and Promotion Costs

Advertising and promotion costs are expensed as incurred. During 2017, these costs amounted to approximately \$380,287 and are included in the selling, general and administrative expenses caption of the accompanying statement of operations.

Ediciones SM, Inc.
Notes to Consolidated Financial Statements
December 31, 2017

Income Tax

The Company provides for income tax at Puerto Rico statutory rates. The Company utilizes the asset and liability method to account for income tax, which requires the recognition of deferred income tax assets and liabilities for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A valuation allowance is recognized for any deferred tax asset for which, based on management's evaluation, it is more likely than not that some portion or the entire deferred tax asset, will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

The benefits of uncertain tax positions are recorded only where the position is more likely than not to be sustained based on its technical merits. The amount recognized is the amount that represents the largest amount of tax benefits that is greater than 50% likely of being ultimately realized. A liability is recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty (if applicable) on such excess. The Company has no uncertain tax positions as of December 31, 2017.

Fair Value of Financial Instruments

US GAAP defines fair value as the price that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also establishes a fair value hierarchy, to prioritize the inputs used in valuation techniques.

At December 31, 2017, the Company does not have assets and liabilities that are measured at fair value.

2. Property and Equipment

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

	Useful Life <i>(in years)</i>	
Leasehold improvements	-	\$ 650,706
Office furniture and equipments		535,004
Computer equipment and software		1,170,851
Autos		139,512
		<u>2,496,073</u>
Less: Accumulated depreciation and amortization		<u>(2,001,677)</u>
		<u>\$ 494,396</u>

Ediciones SM, Inc.
Notes to Consolidated Financial Statements
December 31, 2017

3. Income Tax

The Puerto Rico income tax regime for corporate taxpayers is based on the maximum of the regular tax or the alternative minimum tax. Regular tax is based on marginal rates with a maximum effective tax rate of 39% whereas the alternative minimum tax is a 30% flat rate applicable over alternative minimum taxable income. Based on the current year's results of operations, the Company is a regular corporate taxpayer subject to maximum tax rate of 39%. The deferred tax asset as of December 31, 2017 consists of the following:

Bad debt reserve	\$ 27,025
Management Fees	192,777
Inventory reserve	152,056
Depreciation	<u>100,147</u>
Total deferred tax assets	<u>\$ 472,005</u>

The deferred tax asset was calculated at the statutory income tax rate of 39% which as of year-end is the enacted tax rate in Puerto Rico at the time this deferred tax asset is expected to be realizable. Management believes that a valuation allowance with respect to the realization of the gross deferred tax asset is not necessary. In assessing realizability, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

The effective income tax rate differs from the amount computed by applying the Puerto Rico statutory income tax rate of 39% to the income before income taxes as a result of permanent differences including the disallowance of management fees, meals and entertainment, and other miscellaneous permanent differences.

In Puerto Rico, the tax authority permits examination of tax returns for up to four years after the initial return is filed. The tax years open for examination for the Company is 2013 to 2017.

4. Related Party Transactions

During 2017, the Company purchased inventory from its majority stockholder and affiliates, amounting to approximately \$90,180. In addition, the Company sold inventory to affiliates amounting to approximately \$2,996.

During the year ended December 31, 2017, the entity was charged by one affiliate entity for approximately \$158,341 for management fees and \$551,566 by another affiliate for image services. Other miscellaneous transactions related to services made during the year between affiliates amounted to \$54,547.

In June 9, 2017, Ediciones SM, Inc. invested the amount of \$10,000 as only member of ISME LLC.

On July 19, 2017, the Company entered into a loan agreement with an affiliate under which the Company committed to lend \$2,500,000 to such affiliate. The loan bears an interest of 3.62% and principal and payment are due on April 4, 2018. The loan was collected on March 26, 2018.

Ediciones SM, Inc.
Notes to Consolidated Financial Statements
December 31, 2017

5. Sales to Major Customers

During the year ended December 31, 2017, 62.6% of the Company's net sales were concentrated in three customers. The Company's major customers, who accounted for 10% or more of the net sales during year, were as follows:

Customer A	25.95 %
Customer B	19.82 %
Customer C	16.83 %

One of these customers accounted for 33% of accounts receivable trade as of December 31, 2017.

6. Lease Commitments

The Company leases equipment under various operating leases over periods ranging from one to six years. Additionally, the Company leases warehouse and office space under a lease agreement, which original term ended in 2014, and has subsequently continue with the lease agreement on a month-to-month basis.

The following table sets forth the aggregate minimum future annual rental commitments at December 31, 2017 under all operating leases for the fiscal years:

2018	\$	10,476
2019		4,824
	\$	<u>15,300</u>

The rent expense for the year ended December 31, 2017 was to \$215,208.

7. Contingencies

The Company is involved in one legal and administrative matter, generally related to its operations. Management believes that the outcome of such matter will not have a material effect on the financial position, cash flows or results of operations of the Company.

8. Subsequent Events

The Company has performed a review of subsequent events from January 1, 2017 through July 27, 2018, the date the financial statements were available to be issued, and concluded there were no events or transactions that occurred during this period that required recognition or disclosure on these financial statements.

TAB 20

Joint Venture Documentation (If Applicable)

TAB 20: Joint Venture Documentation

Not Applicable