

EACO CORP  
Form 10-Q  
January 17, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended November 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. **000-14311**

**EACO CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Florida</b>	<b>59-2597349</b>
(State of Incorporation)	(I.R.S. Employer
	Identification No.)

**1500 NORTH LAKEVIEW AVENUE**

**ANAHEIM, CALIFORNIA 92807**

(Address of Principal Executive Offices)

**(714) 876-2490**

(Registrant's Telephone No.)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically 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 (§232.405 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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 January 11, 2017, 4,861,590 shares of the registrant's common stock were outstanding.



**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****EACO Corporation and Subsidiaries**

## Condensed Consolidated Statements of Income

(in thousands, except for share and per share information)

(Unaudited)

	Three Months Ended November 30,	
	2016	2015
Revenues	\$37,207	34,293
Cost of revenues	26,651	24,324
Gross margin	10,556	9,969
Operating expenses:		
Selling, general and administrative expenses	9,387	9,134
Income from operations	1,169	835
Other (expense) income:		
Net loss on trading securities	(102 )	(9 )
Interest expense, net	(4 )	(6 )
Total other (expense) income	(106 )	(15 )
Income before income taxes	1,063	820
Provision for income taxes	402	320
Net income	661	500
Cumulative preferred stock dividend	(19 )	(19 )
Net income attributable to common shareholders	\$642	\$481
Basic and diluted earnings per share	\$0.13	\$0.10
Basic and diluted weighted average common shares outstanding	4,861,590	4,861,590

See accompanying notes to unaudited condensed consolidated financial statements.



**EACO Corporation and Subsidiaries**

Consolidated Statements of Comprehensive Income

(in thousands)

(Unaudited)

	Three Months Ended November 30, 2016	2015
Net income	\$661	\$500
Other comprehensive (loss) gain, net of tax:		
Foreign translation (loss)	(59)	(1)
Total comprehensive income	\$602	\$499

See accompanying notes to unaudited condensed consolidated financial statements.

**EACO Corporation and Subsidiaries**

## Condensed Consolidated Balance Sheets

(in thousands, except share information)

(Unaudited)

	November 30, 2016	August 31, 2016*
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,088	\$ 4,878
Restricted cash, current	1,864	1,425
Trade accounts receivable, net	18,620	18,797
Inventory, net	23,356	21,532
Marketable securities, trading	204	540
Prepaid expenses and other current assets	1,230	1,135
Total current assets	50,362	48,307
Non-current Assets:		
Equipment and leasehold improvements, net	1,811	1,395
Other assets	885	890
Total assets	\$ 53,058	\$ 50,592
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Trade accounts payable	\$ 13,402	\$ 12,727
Accrued expenses and other current liabilities	2,290	5,600
Liability for short sales of trading securities	1,864	1,425
Total current liabilities	17,556	19,752
Non-current Liabilities:		
Long-term debt	4,079	
Total liabilities	21,635	19,752
Shareholders' Equity:		
Convertible preferred stock, \$0.01 par value per share; 10,000,000 shares authorized; 36,000 shares outstanding (liquidation value \$900)	1	1
Common stock, \$0.01 par value per share; 8,000,000 shares authorized; 4,861,590 shares outstanding	49	49
Additional paid-in capital	12,378	12,378
Accumulated other comprehensive income	671	730
Retained earnings	18,324	17,682
Total shareholders' equity	31,423	30,840
Total liabilities and shareholders' equity	\$ 53,058	\$ 50,592

Edgar Filing: EACO CORP - Form 10-Q

\* Derived from the Company's audited financial statements included in its Form 10-K for the year ended August 31, 2016 as filed with the U. S. Securities and Exchange Commission on November 23, 2016.

See accompanying notes to unaudited condensed consolidated financial statements.

**EACO Corporation and Subsidiaries**

## Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three Months Ended November 30,	
	2016	2015
Operating activities:		
Net income	\$ 661	\$ 500
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	169	144
Bad debt expense	4	8
Change in inventory reserve	135	30
Net loss on investments	102	9
(Increase) decrease in:		
Trade accounts receivable	173	(1,543 )
Inventory	(1,959 )	(248 )
Prepaid expenses and other assets	(90 )	(392 )
Increase (decrease) in:		
Trade accounts payable	190	1,270
Accrued expenses and other current liabilities	(3,310 )	(2,345 )
Net cash used in operating activities	(3,925 )	(2,567 )
Investing activities:		
Purchase of property and equipment	(585 )	(50 )
Sale (purchase) of marketable securities, trading	234	(831 )
Net change in securities sold short	439	370
Change in restricted cash	(439 )	(366 )
Net cash used in investing activities	(351 )	(877 )
Financing activities:		
Borrowings on revolving credit facility	4,079	961
Preferred dividend	(19 )	(19 )
Bank overdraft	485	1,697
Payments on long-term debt		(2 )
Net cash provided by financing activities	4,545	2,637
Effect of foreign currency exchange rate changes on cash and cash equivalents	(59 )	(1 )
Net increase (decrease) in cash and cash equivalents	210	(808 )
Cash and cash equivalents - beginning of period	4,878	5,269
Cash and cash equivalents - end of period	\$ 5,088	\$ 4,461
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$ 2,627	\$ 2,194

See accompanying notes to unaudited condensed consolidated financial statements.

## **EACO CORPORATION AND SUBSIDIARIES**

### **NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

November 30, 2016

#### **Note 1. Organization and Basis of Presentation**

EACO Corporation (“EACO”), incorporated in Florida in September 1985, is a holding company, primarily comprised of its wholly-owned subsidiary, Bisco Industries, Inc. (“Bisco”). Bisco was incorporated in Illinois in 1974 and is a distributor of electronic components and fasteners with 48 sales offices and seven distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

#### **Note 2. Significant Accounting Policies and Significant Recent Accounting Pronouncements**

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. These estimates include allowance for doubtful accounts receivable, slow moving and obsolete inventory reserves, recoverability of the carrying value and estimated useful lives of long-lived assets, workers’ compensation liability and the valuation allowance against deferred tax assets. Actual results could differ from those estimates.

##### **Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in conformity with GAAP for interim financial information and the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) for interim reporting. In the opinion of management, all adjustments considered necessary in order to make the financial statements not misleading have been included.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations for presentation of interim financial information. Therefore, the condensed consolidated interim financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended August 31, 2016 ("fiscal 2016"). The condensed consolidated balance sheet as of August 31, 2016 and related disclosures were derived from the audited consolidated financial statements as of August 31, 2016. Operating results for the three months ended November 30, 2016 are not necessarily indicative of the results that may be expected for future quarterly periods or the entire fiscal year.

### **Principles of Consolidation**

The consolidated financial statements for all periods presented include the accounts of EACO, its wholly-owned subsidiary, Bisco, and Bisco's wholly-owned Canadian subsidiary, Bisco Industries Limited (all of which are collectively referred to herein as the "Company", "we", "us" and "our"). All significant intercompany transactions and balances have been eliminated in consolidation.

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

### **Trade Accounts Receivable, Net**

Trade accounts receivable are carried at original invoice amount, less an estimate for an allowance for doubtful accounts. Management determines the allowance for doubtful accounts by identifying probable credit losses in the Company's accounts receivable and reviewing historical data to estimate the collectability on items not yet specifically identified as problem accounts. Trade accounts receivable are written off when deemed uncollectible. Recoveries of trade accounts receivable previously written off are recorded when received. A trade account receivable is considered past due if any portion of the receivable balance is outstanding for more than 30 days. The Company does not charge interest on past due balances. The allowance for doubtful accounts was \$111,000 at November 30, 2016 and August 31, 2016.

### **Inventories, Net**

Inventory consists primarily of electronic fasteners and components, and is stated at the lower of cost or estimated market value. Cost is determined using the average cost method. Inventories are presented net of a reserve for slow moving or obsolete items of \$1,442,000 and \$1,307,000 at November 30, 2016 and August 31, 2016, respectively. The reserve is based upon management's review of inventories on-hand over their expected future utilization and length of time held by the Company.

### **Securities Sold Short**

Securities sold short represent transactions in which the Company sells a security borrowed from the broker, which it is obligated to purchase and deliver back to the broker. The initial value of the underlying security is recorded as a liability, and is adjusted to market value at each reporting period, with unrealized appreciation or depreciation being recorded for the change in value of the open short position. The Company records a realized gain or loss when the short position is closed. By entering into short sales, the Company bears the market risk of an unfavorable increase in the price of the security sold short in excess of the proceeds received. The market value of open short positions is separately presented as a liability in the consolidated balance sheets.

The Company is required to establish a margin account with the lending broker equal to the market value of open short positions. As the use of such funds is restricted while the short sale is outstanding, the balance of this account is classified as restricted cash, current in the consolidated balance sheets. The restricted cash related to securities sold short was \$1,864,000 and \$1,425,000 for November 30, 2016 and August 31, 2016, respectively.

### **Long-Lived Assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of the impairment review, assets are measured by comparing the carrying amount to future net cash flows. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their estimated fair values.

### **Income Taxes**

Deferred taxes on income result from temporary differences between the reporting of income for financial statement and tax reporting purposes. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some or all of the deferred tax asset will not be realized. In making such determination, the Company considers all available positive and negative evidence, including, but not limited to, scheduled reversals of deferred tax liabilities, projected future taxable income (if any), tax planning strategies and recent financial performance.

We provide tax contingencies, if any, for federal, state, local and international exposures relating to audit results, tax planning initiatives and compliance responsibilities. The development of these reserves requires judgments and estimates regarding tax issues, potential outcomes and timing. Actual results could differ from those estimates.

## **Revenue Recognition**

The Company generally recognizes revenue at the time of product shipment, as the Company's shipping terms are FOB shipping point. Revenue is considered to be realized or realizable and earned when there is persuasive evidence of a sales arrangement in the form of an executed contract or purchase order, the product has been shipped, the sales price is fixed or determinable, and collectability is reasonably assured.

## **Earnings Per Common Share**

Basic earnings per common share for the three months ended November 30, 2016 and 2015 were computed based on the weighted average number of common shares outstanding during each respective period. Diluted earnings per share for those periods have been computed based on the weighted average number of common shares outstanding, giving effect to all potentially dilutive common shares that were outstanding during the respective periods (See Note 4).

## **Foreign Currency Translation and Transactions**

Assets and liabilities recorded in functional currencies other than the U.S. dollar (Canadian dollars for Bisco's Canadian subsidiary) are translated into U.S. dollars at the period-end rate of exchange. Revenue and expenses are translated at the weighted-average exchange rates for the quarters ended November 30, 2016 and 2015. The resulting translation adjustments are charged or credited directly to accumulated other comprehensive income or loss. The average exchange rates for the quarters ended November 30, 2016 and 2015 were \$0.75 and \$0.76, respectively.

## **Concentrations**

Net sales to customers outside the United States were approximately 9% and 8% of total net sales for the three months ended November 30, 2016 and 2015, respectively, and related accounts receivable were approximately 11% and 10% of total accounts receivable at November 30, 2016 and 2015, respectively.

No single customer accounted for more than 10% of revenues for the three months ended November 30, 2016 or 2015.

## Significant Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 “Revenue from Contracts with Customers” to supersede the previous revenue recognition guidance under current GAAP. This guidance presents steps for comprehensive revenue recognition that requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance becomes effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company is currently evaluating this statement and its impact on its results of operations or financial position.

In July 2015, the FASB issued ASU 2015-11 “Simplifying the Measurement of Inventory.” This guidance is part of the “Simplification Initiative” to identify and re-evaluate areas where the generally accepted accounting principles may be complex and cumbersome to apply. This guidance will require that inventory be stated at the lower of cost and net realizable value as opposed to the lower of cost or market. Net realizable value is the estimated selling price for the inventory less completion, disposal and transportation costs. This guidance becomes effective for fiscal years beginning after December 15, 2016. The Company is currently evaluating this statement and its impact on its results of operations or financial position.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes.” The guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as non-current on the balance sheet. This guidance becomes effective for annual reporting periods beginning after December 6, 2016 with early adoption permitted. The Company is currently evaluating this statement and its impact on the Company’s results of operations or financial position.

In February 2016, the FASB issued ASU 2016-02, "Leases," which will require a lessee to recognize assets and liabilities with lease terms of more than 12 months. Both capital and operating leases will need to be recognized on the balance sheet. This guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating this statement and its impact on the Company's results of operations or financial position.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses," which will require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those fiscal years. The Company is currently evaluating this statement and its impact on the Company's results of operations or financial position.

### **Note 3. Debt**

The Company has a \$10,000,000 line of credit agreement with Community Bank, N.A. Borrowings under this agreement bear interest at either the 30, 60 or 90 day London Inter-Bank Offered Rate ("LIBOR") (0.91% and 0.81% for the 90 day LIBOR at November 30, 2016 and August 31, 2016, respectively) plus 1.75% and/or the bank's reference rate (3.50% at November 30, 2016 and August 31, 2016). Borrowings are secured by substantially all of the assets of. The line of credit agreement expires on March 1, 2017, but the Company plans to extend the agreement.

The amounts outstanding under this line of credit as of November 30, 2016 and August 31, 2016 were \$4,079,000 and \$0, respectively. Availability under the line of credit was \$5,921,000 and \$10,000,000 at November 30, 2016 and August 31, 2016, respectively.

The line of credit agreement contains certain covenants, including the maintenance of certain financial ratios. As of November 30, 2016 and August 31, 2016, the Company was in compliance with all financial covenants.

### **Note 4. Earnings per Share**

The following is a reconciliation of the numerators and denominators of the basic and diluted computations for earnings per common share (in thousands, except per share data):

	<b>Three Months Ended November 30,</b>	
	2016	2015
EPS:		
Net income	\$ 661	\$ 500
Less: accrued preferred stock dividends	(19 )	(19 )
Net income available for common shareholders	\$ 642	\$ 481
Earnings per common share – basic and diluted	\$ 0.13	\$ 0.10

For the three months ended November 30, 2016 and 2015, 40,000 potential common shares (issuable upon conversion of 36,000 shares of the Company's Series A Cumulative Convertible Preferred Stock) have been excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive since the conversion price was greater than the average market price of the common stock.

**Note 5. Related Party Transactions**

The Company leases three buildings under operating lease agreements from its majority shareholder, who is also the Company's Chairman and CEO. During the three months ended November 30, 2016 and 2015, the Company incurred approximately \$163,000 and \$165,000, respectively, of expense related to these leases.

**Note 6. Income Taxes**

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Management evaluates the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered, and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is "more likely than not" that some or all of the deferred tax assets will not be realized. Management has determined that other than deferred tax assets associated with certain state net operating losses and capital losses, net deferred tax assets will more likely than not be utilized. Therefore, a valuation allowance has been established against only those assets related to state net operating losses and capital losses.

During the three months ended November 30, 2016, the Company recorded an income tax provision of \$402,000 resulting in an effective tax rate of 37.8%. The effective tax rate differs from the statutory rate of 34% primarily due to the existence of a valuation allowance against certain deferred tax assets, state income tax expenses and permanent book to tax differences.

Accounting for uncertainty in income taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. For the three months ended November 30, 2016, the Company did not have a liability for unrecognized tax benefit. The Company has elected to classify interest and penalties as a component of its income tax provision. For the three months ended November 30, 2016, the Company did not have a liability for penalties or interest. The Company does not expect any changes to its unrecognized tax benefit for the next twelve months that would materially impact its consolidated financial statements.

## **Note 7. Subsequent Events**

Management has evaluated events subsequent to November 30, 2016, through the date that these consolidated financial statements are being filed with the Securities and Exchange Commission, for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

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

### **Cautionary Statements**

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will" and similar words or expressions. Forward-looking statements include but are not limited to statements regarding our anticipated revenue, expenses, profits and capital needs. These statements are based on our current expectations, estimates, projections, and the impact of certain accounting pronouncements, and are subject to a number of risks and uncertainties that could cause our actual results to differ materially from those projected or estimated, including but not limited to adverse economic conditions, competitive pressures, unexpected costs and losses from operations or investments, increases in costs and overhead, our ability to maintain an effective system of internal controls over financial reporting, potential losses from trading in securities, our ability to retain key personnel and good relationships with suppliers, the willingness of Community Bank or other lenders to extend financing commitments and the availability of capital resources, and the other risks set forth in "Risk Factors" in Part II, Item 1A of this report or identified from time to time in our other filings with the SEC and in public announcements. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. The inclusion of forward looking statements in this Quarterly Report should not be regarded as a representation by management or any other person that the objectives or plans of the Company will be achieved.

## Overview

The condensed consolidated financial statements comprise the accounts of EACO Corporation (“EACO”) and its wholly-owned subsidiary, Bisco Industries, Inc. (“Bisco”) and Bisco’s wholly-owned Canadian subsidiary, Bisco Industries Limited (which are collectively referred to herein as the “Company”, “we”, “us” and “our”).

EACO was incorporated in the State of Florida in September 1985, is a holding company primarily comprised of its wholly-owned subsidiary, Bisco. Bisco was incorporated in Illinois in 1974 and is a distributor of electronic components and fasteners with 48 sales offices and seven distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

Revenues derived from the Bisco subsidiary represents 100% of our total revenues and are expected to continue to represent all of the Company’s total revenues for the foreseeable future.

## Critical Accounting Policies

There have been no changes to the Company’s critical accounting policies for the three months ended November 30, 2016. Please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K for the year ended August 31, 2016 as filed with the SEC on November 23, 2016.

## Results of Operations

### *Comparison of the Three Months Ended November 30, 2016 and 2015*

*Revenues and Gross Profit (\$ in thousands)*

	<b>Three Months Ended</b>		<b>\$</b>	<b>%</b>	
	<b>November 30,</b>	<b>2015</b>			
	<b>2016</b>				
Revenues	\$ 37,207	\$ 34,293	\$ 2,914	8.5	%
Cost of revenues	26,651	24,324	2,327	9.6	%
Gross profit	\$ 10,556	\$ 9,969	\$ 587		

Revenues consist primarily of sales of component parts and fasteners, but also include, to a lesser extent, kitting charges and special order fees, as well as freight charged to customers. The increase in revenues in the three months ended November 30, 2016 (“Q1 2017”) as compared to the three months ended November 30, 2015 (“Q1 2016”) was largely due to increased unit sales, resulting from the Company focusing on improving and expanding its supply chain team, which has enabled the Company to effectively target and purchase inventory with higher turnover rates. Further, in Q1 2017, there were changes in sales management personnel, which lead to increased efficiency and effectiveness of sales teams within certain regions.

The decrease in gross margins in Q1 2017 as compared to Q1 2016 is primarily due to an increase in large individual sales orders with a lower gross margin. This was primarily due to volume discounts and mix of products sold. Increases in large individual orders are due to the Company focusing on relationship building with key customers and vendors.

*Selling, General and Administrative Expenses (\$ in thousands)*

	<b>Three Months Ended</b>				
	<b>November 30,</b>		<b>\$</b>	<b>%</b>	
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>Change</b>	
Selling, general and administrative expenses	\$ 9,387	\$ 9,134	\$ 253	2.8	%
Percent of revenues	25.2	26.6		(1.4)	%

Selling, general and administrative expense (“SG&A”) consists primarily of payroll and related expenses for the Company’s sales and administrative staff, professional fees including accounting, legal and technology costs and expenses, and sales and marketing costs. SG&A in Q1 2017 increased from Q1 2016 largely due to an increase in annual raises, and to a lesser extent, due to rent escalation in leased properties and annual bonuses, which are typically payable in the first fiscal quarter. SG&A as a percent of revenue in Q1 2017 decreased from Q1 2016 primarily due to the Company being able to increase sales with current and new customers without having to incur additional significant SG&A expenses.

*Other Income (Expense), Net (\$ in thousands)*

	<b>Three Months Ended</b>				
	<b>November 30,</b>		<b>\$</b>	<b>%</b>	
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>Change</b>	
Other income (expense):					
Net (loss) on trading securities	\$ (102 )	\$ (9 )	\$ (93 )	(1033.3)	%
Other expense	(4 )	(6 )	2	33.3	%
Other (expense) income, net	\$ (106 )	\$ (15 )	\$ (91 )		
Other (expense) income, net as a percent of revenues	0.0	0.0		0	%

Other income (expense), net primarily consists of income or losses on investments in short-term marketable equity securities of publicly-held corporations, interest related to the Company's line of credit and other long-term debt and gains and losses associated with sales of capital assets. The Company's investment strategy consists of both long and short positions, as well as utilizing options designed to improve returns. During Q1 2017, the Company recognized a net loss of \$102,000 as compared to a net loss of \$9,000 in Q1 2016 in net realized and unrealized gains. Losses in Q1 2017 and Q1 2016 were due primarily to a decrease in the value of short positions the Company held.

Other expense decreased \$2,000 or 33.3% for the three months ended November 30, 2016 as compared to the same period in fiscal 2015. The decrease was primarily attributable to less dividend fees related to short positions the Company held.

*Income Tax Provision (\$ in thousands)*

	<b>Three Months Ended</b>		<b>\$</b>	<b>%</b>
	<b>November 30, 2016</b>	<b>2015</b>		
Income tax provision	\$ 402	\$ 320	\$ 82	25.6 %
Percent of pre-tax income	37.8 %	39.0 %		

The provision for income taxes increased by \$82,000 in the three month period ended November 30, 2016 over the prior year period. This increase was primarily a result of higher taxable income in the current quarter as compared to the prior year period. The percent of pre-tax income decreased from 39% at Q1 2016 to 37.8% for Q1 2017. The decrease in the rate is due to an increase in deferred tax assets and permanent items in Q1 2017.

### **Liquidity and Capital Resources**

The Company has a \$10,000,000 line of credit agreement with Community Bank. Borrowings under this agreement bear interest at either the 30, 60 or 90 day LIBOR (0.91% and 0.81% for the 90 day LIBOR at November 30, 2016 and August 31, 2016, respectively) plus 1.75% and/or the bank's reference rate (3.50% at November 30, 2016 and August 31, 2016). Borrowings are secured by substantially all of the assets of. The line of credit agreement expires in March 2017. The amounts outstanding under this line of credit as of November 30, 2016 and August 31, 2016 were \$4,079,000 and zero, respectively. The line of credit agreement contains certain nonfinancial and financial covenants, including the maintenance of certain financial ratios. As of November 30, 2016 and August 31, 2016, the Company was in compliance with all such covenants.

### ***Cash Flows from Operating Activities***

Cash used in operating activities was \$3,925,000 for the three months ended November 30, 2016 as compared with cash used in operations of \$2,567,000 for the three months ended November 30, 2015. The current period cash used by operating activities was primarily due to the decrease in accrued expenses and an increase in inventory. Increases in inventory is primarily due to acquiring favorable inventory at volume discounts. This was partially offset by an increase in trade accounts payable (largely related to the higher revenues) and an increase in net income. The prior year cash used in operating activities was primarily due to the decrease in accrued expenses and an increase in accounts receivable.

### ***Cash Flows from Investing Activities***

Cash used in investing activities was \$351,000 for the three months ended November 30, 2016 as compared with cash used in such activities of \$877,000 for the three months ended November 30, 2015. The decrease in investing activities comparing Q1 2017 to Q1 2016 is primarily due to the Company's purchase of marketable securities during Q1 2015.

***Cash Flows from Financing Activities***

Cash provided by financing activities for the three months ended November 30, 2016 was \$4,545,000 as compared with cash provided of \$2,637,000 for the three months ended November 30, 2015. The increase in cash provided by financing activities comparing Q1 2017 to Q1 2016 is primarily due to borrowing of \$4,079,000 on the Company's line of credit and an increase in the bank overdraft in the quarters in Q1 2017. The increase in borrowing on the line of credit in Q1 2017 is primarily due to an increase in purchasing of inventory, the payment of the annual bonuses to our personnel and payment of corporate income taxes related to fiscal year 2016.

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements that are reasonably likely to have a material current or future effect on the financial position, revenues, results of operations, liquidity or capital expenditures.

## **Contractual Financial Obligations**

In addition to using cash flow from operations, the Company finances its operations through borrowings under its line of credit. These financial obligations are recorded in accordance with accounting rules applicable to the underlying transactions, with the result that amounts owed under debt agreements and capital leases are recorded as liabilities on the balance sheet while lease obligations recorded as operating leases are disclosed in the Notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended August 31, 2016 as filed with the SEC on November 23, 2016.

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

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this item.

## **Item 4. Controls and Procedures**

**Evaluation of disclosure controls and procedures.** As required by Rule 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's Chief Executive Officer, who also serves as the Company's principal financial officer. Based upon that evaluation, the Company's Chief Executive Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered in this report.

**Changes in internal control over financial reporting.** There have been no changes in internal control over financial reporting during the fiscal quarter covered by this report that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

From time to time, we may be subject to legal proceedings and claims which arise in the normal course of our business. Any such matters and disputes could be costly and time consuming, subject us to damages or equitable remedies, and divert our management and key personnel from our business operations. We currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

#### **Item 1A. Risk Factors**

*Our business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this report and in our other filings with the SEC, including our Annual Report on Form 10-K and subsequent reports on Forms 10-Q and 8-K. If any of the risks actually occur, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price for shares of our common stock may decline, and you could lose all or part of your investment.*

#### **Changes and uncertainties in the economy have harmed and could continue to harm our operating results.**

As a result of the continuing economic uncertainties, our operating results, and the economic strength of our customers and suppliers, are increasingly difficult to predict. Sales of our products are affected by many factors, including, among others, general economic conditions, interest rates, inflation, liquidity in the credit markets, unemployment trends, geopolitical events, and other factors. Although we sell our products to customers in a broad range of industries, the significant weakening of economic conditions on a global scale has caused some of our customers to experience a slowdown that has had adverse effects on our sales and operating results. Changes and uncertainties in the economy also increase the risk of uncollectible accounts receivable. The pricing we receive from suppliers may also be impacted by general economic conditions. Continued and future changes and uncertainties in the economic climate in the United States and elsewhere could have a similar negative impact on the rate and amounts of purchases by our current and potential customers, create price inflation for our products, or otherwise have a negative impact on our expenses, gross margins and revenues, and could hinder our growth.

**If we fail to maintain an effective system of internal controls over financial reporting or experience additional material weaknesses in our system of internal controls, we may not be able to report our financial results accurately or timely or detect fraud, which could have a material adverse effect on the market price of our common stock and our business.**

We have from time to time had material weaknesses in our internal controls over financial reporting due to deficiencies in the process related to the preparation of our financial statements, segregation of duties, sufficient control in the area of financial reporting oversight and review, and appropriate personnel to ensure the complete and proper application of GAAP as it relates to certain routine accounting transactions. Although we believe we have addressed these material weaknesses, we may experience material weaknesses or significant deficiencies in the future and may fail to maintain a system of internal control over financial reporting that complies with the reporting requirements applicable to public companies in the United States. Our failure to address any deficiencies or weaknesses in our internal control over financial reporting or to properly maintain an effective system of internal control over financial reporting could impact our ability to prevent fraud or to issue our financial statements in a timely manner that presents fairly, in accordance with GAAP, our financial condition and results of operations. The existence of any such deficiencies and/or weaknesses, even if cured, may also lead to the loss of investor confidence in the reliability of our financial statements, could harm our business and negatively impact the trading price of our common stock. Such deficiencies or material weaknesses may also subject us to lawsuits, investigations and other penalties.

**We have incurred significant losses in the past from trading in securities, and we may incur such losses in the future, which may also cause us to be in violation of covenants under our loan agreement.**

Bisco has historically funded its operations in part from cash generated by trading in marketable domestic equity securities. Bisco's investment strategy includes taking both long and short positions, as well as utilizing options to maximize return. This strategy can lead, and has led, to significant losses based on market conditions and trends. We may incur losses in future periods from such trading activities, which could materially and adversely affect our liquidity and financial condition.

In addition, unanticipated losses from our trading activities may cause Bisco to be in violation of certain covenants under its line of credit agreement with Community Bank. The agreement is secured by substantially all of Bisco's assets. The loan agreement contains covenants which require that, on a quarterly basis, Bisco's losses from trading in securities not exceed its pre-tax operating income. We cannot assure you that unanticipated losses from our trading activities will not cause us to violate our covenants in the future or that the bank will grant a waiver for any such default or that it will not exercise its remedies, which could include the refusal to allow additional borrowings on the line of credit or the acceleration of the obligation's maturity date and foreclosure on Bisco's assets, with respect to any such noncompliance, which could have a material adverse effect on our business and operations.

**We rely heavily on our internal information systems, which, if not properly functioning, could materially and adversely affect our business.**

Our information systems have been in place for many years, and are subject to system failures as well as problems caused by human error, which could have a material adverse effect on our business. Many of our systems consist of a number of legacy or internally developed applications, which can be more difficult to upgrade to commercially available software. It may be time consuming and costly for us to retrieve data that is necessary for management to evaluate our systems of control and information flow. In the future, management may decide to convert our information systems to a single enterprise solution. Such a conversion, while it would enhance the accessibility and reliability of our data, could be expensive and would not be without risk of data loss, delay or business interruption. Maintaining and operating these systems requires continuous investments. Failure of any of these internal information systems or material difficulties in upgrading these information systems could have material adverse effects on our business and our timely compliance with our reporting obligations.

**We may not be able to attract and retain key personnel.**

Our future performance will depend to a significant extent upon the efforts and abilities of certain key management and other personnel, including Glen Ceiley, our Chairman and CEO, as well as other executive officers and senior management. The loss of service of one or more of our key management members could have a material adverse effect on our business.

**We do not have long-term supply agreements or guaranteed price or delivery arrangements with the majority of our suppliers.**

In most cases, we have no guaranteed price or delivery arrangements with our suppliers. Consequently we may experience inventory shortages on certain products. Furthermore, our industry occasionally experiences significant product supply shortages and customer order backlogs due to the inability of certain manufacturers to supply products as needed. We cannot assure you that suppliers will maintain an adequate supply of products to fulfill our orders on a timely basis, at a recoverable cost, or at all, or that we will be able to obtain particular products on favorable terms or at all. Additionally, we cannot assure you that product lines currently offered by suppliers will continue to be available to us. A decline in the supply or continued availability of the products of our suppliers, or a significant increase in the price of those products, could reduce our sales and negatively affect our operating results.

**Our supply agreements are generally terminable at the suppliers' discretion.**

Substantially all of the agreements we have with our suppliers, including our authorized distributor agreements, are terminable with little or no notice and without any penalty. Suppliers that currently sell their products through us could decide to sell, or increase their sales of, their products directly or through other distributors or channels. Any termination, interruption or adverse modification of our relationship with a key supplier or a significant number of other suppliers would likely adversely affect our operating income, cash flow and future prospects.

**The competitive pressures we face could have a material adverse effect on our business.**

The market for our products and services is very competitive. We compete for customers with other distributors, as well as with many of our suppliers. A failure to maintain and enhance our competitive position could adversely affect our business and prospects. Furthermore, our efforts to compete in the marketplace could cause deterioration of gross profit margins and, thus, overall profitability. Some of our competitors may have greater financial, personnel, capacity and other resources or a more extensive customer base than we do.

**Our strategy of expanding into new geographic areas could be costly.**

One of our primary growth strategies is to grow our business through the opening of sales offices in new geographic markets. Based on our analysis of demographics in the United States, Canada and Mexico, we currently estimate there is potential market opportunity in North America to support additional sales offices. We cannot guarantee that our estimates are accurate or that we will open enough offices to capitalize on the full market opportunity or that any new offices will be successful. In addition, a particular local market's ability to support a sales office may change because of a change due to competition, or local economic conditions.

**We may be unable to meet our goals regarding new office openings.**

Our growth, in part, is primarily dependent on our ability to attract new customers. Historically, the most effective way to attract new customers has been opening new sales offices in additional geographic regions or new markets. Our current business strategy focuses on opening a specified number of new sales offices each year, and quickly growing each new sales office. Given the recent economic slowdown, we may not be able to open or grow new offices at our projected or desired rates or hire the qualified sales personnel necessary to make such new offices successful. Failure to do so could negatively impact our long-term growth and market share.

**Opening sales offices in new markets presents increased risks that may prevent us from being profitable in these new locations, and/or may adversely affect our operating results.**

Our new sales offices do not typically achieve operating results comparable to our existing offices until after several years of operation. The added expenses relating to payroll, occupancy, and transportation costs can impact our ability to leverage earnings. In addition, offices in new geographic areas face additional challenges to achieving profitability. In new markets, we have less familiarity with local customer preferences and customers in these markets are less

familiar with our name and capabilities. Entry into new markets may also bring us into competition with new, unfamiliar competitors. These challenges associated with opening new offices in new markets may have an adverse effect on our business and operating results.

**We rely on third party suppliers for most of our products, and may not be able to identify and procure relevant new products and products lines that satisfy our customers' needs on favorable terms and prices, or at all.**

We currently rely on a large number of third party suppliers for most of our products. Since we do not manufacture our products, we rely on these suppliers to provide quality products that are in demand by our customers. Our success depends in part on our ability to develop product expertise and continue to identify and provide future high quality products and product lines that complement our existing products and product lines and that respond to our customers' needs. We may not be able to compete effectively unless we can continue to offer a broad range of high quality, reliable products that address the trends in the markets in which we compete.

**Our ability to successfully attract and retain qualified sales personnel is uncertain.**

Our success depends in large part on our ability to attract, motivate, and retain a sufficient number of qualified sales employees, who understand and appreciate our strategy and culture and are able to adequately represent us to our customers. Qualified individuals of the requisite caliber and number needed to fill these positions may be in short supply in some areas, and the turnover rate in the industry is high. If we are unable to hire and retain personnel capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and product knowledge, our sales could be materially adversely affected. Additionally, competition for qualified employees could require us to pay higher wages to attract a sufficient number of employees. An inability to recruit and retain a sufficient number of qualified individuals in the future may also delay the planned openings of new offices. Any such delays, material increases in existing employee turnover rates, or increases in labor costs, could have a material adverse effect on our business, financial condition or operating results.

**We generally do not have long-term sales contracts with our customers.**

Most of our sales are made on a purchase order basis, rather than through long-term sales contracts. A variety of conditions, both specific to each customer and generally affecting each customer's industry, may cause customers to reduce, cancel or delay orders that were either previously made or anticipated, go bankrupt or fail, or default on their payments. Significant or numerous cancellations, reductions, delays in orders by customers, losses of customers, and/or customer defaults on payment could materially adversely affect our business.

**Increases in the costs of energy, shipping and raw materials used in our products could impact our cost of goods and distribution and occupancy expenses, which would result in lower operating margins.**

Costs of raw materials used in our products and energy costs have been rising during the last several years, which has resulted in increased production costs for our suppliers. These suppliers typically look to pass their increased costs along to us through price increases. The shipping costs for our products have risen as well and may continue to rise. While we typically try to pass increased supplier prices and shipping costs through to our customers or to modify our activities to mitigate the impact, we may not be successful. Failure to fully pass these increased prices and costs through to our customers or to modify our activities to mitigate the impact would have an adverse effect on our operating margins.

**We may not have adequate or cost-effective liquidity or capital resources.**

Our ability to satisfy our cash needs depends on our ability to generate cash from operations and to access our line of credit and the capital markets, which are subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our net cash used in operations for the three months ended November 30, 2016 was approximately \$3.9 million. The total outstanding on our line of credit as of November 30, 2016 was approximately \$4.1 million, which line of credit is secured by substantially all of Bisco's assets. Our ability to continue to draw on our line of credit is subject to our satisfaction of certain covenants contained in such agreement. As such, we may need to pursue additional debt or equity financing, which, which funding may not be available on acceptable terms, on a timely basis or at all. Our failure to obtain such funding could adversely impact our ability to execute our business plan and our financial condition and results of operations.

**The Company's Chairman and CEO holds almost all of our voting stock and can control the election of directors and significant corporate actions.**

Glen Ceiley, our Chairman and CEO, owns or controls approximately 98% of our outstanding voting stock. Mr. Ceiley is able to exert significant influence over the outcome of almost all corporate matters, including significant corporate transactions requiring a stockholder vote, such as a merger or a sale of the Company or our assets. This concentration of ownership and influence in management and board decision-making could also harm the price of our common stock by, among other things, discouraging a potential acquirer from seeking to acquire shares of our common stock (whether by making a tender offer or otherwise) or otherwise attempting to obtain control of the Company.

**Sales of our common stock by Glen Ceiley could cause the price of our common stock to decline.**

There is currently no established trading market for our common stock, and the volume of any sales is generally low. As of November 30, 2016, the number of shares held by non-affiliates of Mr. Ceiley is less than 90,000 shares. If Mr. Ceiley sells or seeks to sell a substantial number of his shares of our common stock in the future, the market price of our common stock could decline. The perception among investors that these sales may occur could produce the same effect.

**Inclement weather and other disruptions to the transportation network could impact our distribution system.**

Our ability to provide efficient shipment of products to our customers is an integral component of our overall business strategy. Disruptions at distribution centers or shipping ports may affect our ability to both maintain core products in inventory and deliver products to our customers on a timely basis, which may in turn adversely affect our results of operations. In addition, severe weather conditions could adversely impact demand for our products in particularly hard hit regions.

**Our advertising and marketing efforts may be costly and may not achieve desired results.**

We incur substantial expense in connection with our advertising and marketing efforts. Postage represents a significant advertising expense for us because we generally mail fliers to current and potential customers through the U.S. Postal Service. Any future increases in postal rates will increase our mailing expenses and could have a material adverse effect on our business, financial condition and results of operations.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The following exhibits are filed as part of this report on Form 10-Q.

<b>No.</b>	<b>Exhibit</b>
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

**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.

**EACO CORPORATION**  
(Registrant)

Date: January 17, 2017 /s/ **Glen Ceiley**  
Glen Ceiley  
Chief Executive Officer  
(Principal Executive Officer & Principal Financial Officer)

/s/ **Michael Narikawa**  
Michael Narikawa  
Controller  
(Principal Accounting Officer)

**EXHIBIT INDEX**

<b>No.</b>	<b>Exhibit</b>
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document