EDUCATIONAL DEVELOPMENT CORP
Form 10-Q
January 14, 2019

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 November 30, 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 January 9, 2019, there were 8,197,826 shares of Educational Development Corporation Common Stock, $0.20 par value outstanding.

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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.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED BALANCE SHEETS (UNAUDITED)

ASSETS	**November 30, 2018**	**February 28, 2018**
CURRENT ASSETS:		
Cash and cash equivalents	$7,840,500	$2,723,300
Accounts receivable, less allowance for doubtful accounts of $303,500 (November 30) and $297,100 (February 28)	3,550,200	2,913,700
Inventories - Net	30,646,000	26,618,600
Prepaid expenses and other assets	1,583,400	1,259,000
Total current assets	43,620,100	33,514,600
INVENTORIES - Net	604,000	435,900
PROPERTY, PLANT AND EQUIPMENT - Net	27,496,400	27,860,500
OTHER ASSETS	26,900	26,900
TOTAL ASSETS	$71,747,400	$61,837,900
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$15,156,500	$12,469,000
Deferred revenues	1,057,300	693,000
Current maturities of long-term debt	928,100	881,200
Accrued salaries and commissions	3,791,100	2,007,900
Income taxes payable	545,900	1,798,800
Dividends payable	409,700	-
Other current liabilities	4,116,100	3,517,900
Total current liabilities	26,004,700	21,367,800
LONG-TERM DEBT - Net of current maturities	19,076,000	19,825,100
DEFERRED INCOME TAXES - Net	810,000	136,900
OTHER LONG-TERM LIABILITIES	109,000	106,000
Total liabilities	45,999,700	41,435,800

SHAREHOLDERS' EQUITY		
Common stock, $0.20 par value; Authorized 16,000,000 shares;		
Issued 12,092,080 (November 30 and February 28) shares;	2,418,400	2,418,400
Outstanding 8,203,119 (November 30) and 8,179,612 (February 28) shares		
Capital in excess of par value	8,828,600	8,573,300
Retained earnings	25,609,600	20,714,500
	36,856,600	31,706,200
Less treasury stock, at cost	(11,108,900)	(11,304,100)
Total shareholders' equity	25,747,700	20,402,100
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$71,747,400	$61,837,900

See notes to financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	November 30,		**November 30,**	
	2018	**2017**	**2018**	**2017**
GROSS SALES:	$53,486,000	$44,383,700	$125,574,400	$109,395,400
Less discounts and allowances	(16,572,600)	(9,249,500)	(38,918,700)	(28,317,300)
Transportation revenue	3,569,200	3,775,700	8,530,200	8,959,900
NET REVENUES	40,482,600	38,909,900	95,185,900	90,038,000
COST OF GOODS SOLD	13,141,600	12,211,700	31,274,000	28,460,800
Gross margin	27,341,000	26,698,200	63,911,900	61,577,200
OPERATING EXPENSE:				
Operating and selling	6,540,600	6,121,100	14,554,400	13,684,200
Sales commissions	12,689,200	12,510,400	29,375,300	28,759,300
General and administrative	4,476,000	4,735,200	12,106,900	12,359,600
Total operating expenses	23,705,800	23,366,700	56,036,600	54,803,100
INTEREST EXPENSE	228,600	287,600	712,000	863,800
OTHER INCOME	(397,600)	(388,900)	(1,172,300)	(1,187,400)
EARNINGS BEFORE INCOME TAXES	3,804,200	3,432,800	8,335,600	7,097,700
INCOME TAXES	988,600	1,304,400	2,212,700	2,707,100
NET EARNINGS	$2,815,600	$2,128,400	$6,122,900	$4,390,600
BASIC AND DILUTED EARNINGS PER SHARE				
Basic	$0.34	$0.26	$0.75	$0.54
Diluted	$0.34	$0.26	$0.75	$0.54
WEIGHTED AVERAGE NUMBER OF COMMON AND EQUIVALENT SHARES OUTSTANDING				
Basic	8,194,072	8,174,536	8,185,561	8,175,372
Diluted	8,201,776	8,180,022	8,193,206	8,180,106
Dividends per share	$0.10	$-	$0.15	$-

See notes to financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
FOR THE NINE MONTHS ENDED NOVEMBER 30, 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
Purchases of treasury stock	-	-	-	-	3,079	(31,900)	(31,900)
Sales of treasury stock	-	-	-	-	(26,586)	227,100	227,100
Dividends paid ($0.10/share)	-	-	-	(818,100)	-	-	(818,100)
Dividends declared ($0.05/share)	-	-	-	(409,700)	-	-	(409,700)
Share-based compensation expense (see Note 5)	-	-	255,300	-	-	-	255,300
Net earnings	-	-	-	6,122,900	-	-	6,122,900
BALANCE - November 30, 2018	12,092,080	$2,418,400	$8,828,600	$25,609,600	3,888,961	$(11,108,900)	$25,747,700

See notes to financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE NINE MONTHS ENDED NOVEMBER 30,

	2018	**2017**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$6,122,900	$4,390,600
Adjustments to reconcile net earnings to net cash		
provided by operating activities:		
Depreciation	1,085,100	911,700
Deferred income taxes, net	673,100	179,400
Provision for doubtful accounts	68,500	(210,700)
Provision for inventory valuation allowance	246,200	78,400
Share-based compensation expense	255,300	-
Changes in assets and liabilities:		
Accounts receivable	(705,000)	(709,500)
Inventories, net	(4,441,700)	9,807,100
Prepaid expenses and other assets	(324,400)	(198,700)
Accounts payable	3,327,000	(7,301,700)
Accrued salaries and commissions, and other liabilities	2,384,300	3,889,200
Deferred revenues	364,300	28,600
Income taxes payable	(1,252,900)	469,600
Total adjustments	1,679,800	6,943,400
Net cash provided by operating activities	7,802,700	11,334,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(1,360,500)	(1,330,500)
Net cash used in investing activities	(1,360,500)	(1,330,500)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(702,100)	(657,800)
Proceeds from long-term debt	-	1,019,000
Cash received from sale of treasury stock	227,100	32,000
Cash received from issuance of shares	-	26,300
Cash used to purchase treasury stock	(31,900)	(98,000)
Net borrowings under line of credit	-	(4,882,900)
Dividends paid	(818,100)	-
Net cash used in financing activities	(1,325,000)	(4,561,400)
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,117,200	5,442,100
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	2,723,300	699,200
CASH AND CASH EQUIVALENTS - END OF PERIOD	$7,840,500	$6,141,300
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid for interest	$704,300	$868,900
Cash paid for income taxes	$2,859,100	$2,058,100

See notes to financial statements.

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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 sheet, condensed statement of earnings and condensed 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 10).

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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	
	November 30,	**February 28,**

Current:		
Book inventory	$30,905,100	$27,078,600
Inventory valuation allowance	(259,100)	(460,000)
Inventories net - current	$30,646,000	$26,618,600
Noncurrent:		
Book inventory	$1,021,400	$707,700
Inventory valuation allowance	(417,400)	(271,800)
Inventories net - noncurrent	$604,000	$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 $8.0 million and $6.9 million for the three months ended November 30, 2018 and 2017, respectively. Total inventory purchases from all suppliers were $10.1 million and $10.9 million for the three months ended November 30, 2018 and 2017, respectively.

Purchases from Usborne were approximately $23.5 million and $18.2 million for the nine months ended November 30, 2018 and 2017, respectively. Total inventory purchases from all suppliers were $31.7 million and $27.5 million for the nine months ended November 30, 2018 and 2017, respectively.

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Note 3 – DEBT

Debt consists of the following:

	2018 November 30,	February 28,
Line of credit	$-	$-
Long-term debt	$20,004,100	$20,706,300
Less current maturities	(928,100)	(881,200)
Long-term debt, net of current maturities	$19,076,000	$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 (4.84% at November 30, 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 (4.84% at November 30, 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 (4.84% at November 30, 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 no borrowings outstanding on our revolving credit agreement at November 30 and February 28, 2018. Available credit under the revolving credit agreement was $10,600,400 and $9,424,000 at November 30, 2018 and 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 November 30, 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 November 30, 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.

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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	$222,500
2020	943,700
2021	985,400
2022	1,033,900
2023	1,082,300
Thereafter	15,736,300
Total	$20,004,100

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 November 30,		Nine Months Ended November 30,	
	2018	**2017**	**2018**	**2017**
Earnings per share:				
Net earnings applicable to common shareholders	$2,815,600	$2,128,400	$6,122,900	$4,390,600
Shares:				
Weighted average shares outstanding-basic	8,194,072	8,174,536	8,185,561	8,175,372
Assumed exercise of options	7,704	5,486	7,645	4,734
Weighted average shares outstanding-diluted	8,201,776	8,180,022	8,193,206	8,180,106
Diluted earnings per share:				
Basic	$0.34	$0.26	$0.75	$0.54
Diluted	$0.34	$0.26	$0.75	$0.54

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 nine months ended November 30, 2018. All options outstanding at November 30, 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.

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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 employee 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 employee 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 240,000 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 on July 24, 2018, resulting in the Company beginning the expense recognition of the fair value of these awards. On October 25, 2018, the Company granted the 80,000 previously authorized restricted shares by communicating the key terms and conditions of the awards to the recipients with a grant-date fair value of $11.24 per share. The remaining compensation expense of the above awards, totaling approximately $2,950,000, will be recognized ratably from the service inception date to the vesting date for this tranche which is approximately 51 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		**Nine Months Ended**	
	November 30,		**November 30,**	
	2018	**2017**	**2018**	**2017**
Share-based compensation expense	$185,300	$ -	$255,300	$ -

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 $5,897,500 and $5,328,900 for the three months ended November 30, 2018 and 2017, respectively. These costs were $13,556,400 and $12,200,100 for the nine months ended November 30, 2018 and 2017, respectively.

Note 7 – 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 our internal tele-sales group. Our UBAM segment markets its products through a network of independent sales consultants using a combination of internet sales, direct sales, home shows and book fairs.

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 revenues 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, warehouse operations and building facilities management. Our assets and liabilities are not allocated on a segment basis.

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Information by reporting segment for the three and nine-month periods ended November 30, 2018 and 2017, follows:

NET REVENUES

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2018	**2017**	**2018**	**2017**
Publishing	$3,161,300	$2,439,600	$8,073,000	$6,538,700
UBAM	37,321,300	36,470,300	87,112,900	83,499,300
Total	$40,482,600	$38,909,900	$95,185,900	$90,038,000

EARNINGS (LOSS) BEFORE INCOME TAXES

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2018	**2017**	**2018**	**2017**
Publishing	$998,800	$556,800	$2,141,800	$1,514,200
UBAM	6,459,800	6,916,600	15,835,800	15,866,400
Other	(3,654,400)	(4,040,600)	(9,642,000)	(10,282,900)
Total	$3,804,200	$3,432,800	$8,335,600	$7,097,700

Note 8 – 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 $0 at November 30 and February 28, 2018. The estimated fair value of our term notes payable is estimated by management to approximate $19,164,000 and $19,454,500 at November 30 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.

Note 9 – DEFERRED REVENUES

As of the end of our third quarter, we had received approximately $1,057,300 in payments for sales orders which were, or will be, shipped out subsequent to the quarter end. As of November 30, 2018, these prepaid sales orders are included in deferred revenues on the condensed balance sheet.

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Note 10 – 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 a 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 7 – 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

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As a result of applying Topic 606, the impact to the Company's condensed statement of earnings for the three months ended November 30, 2017 was as follows:

	As Reported	Adjustments	Without Adoption
GROSS SALES:	$44,383,700	$(2,489,100)	$41,894,600
Less discounts and allowances	(9,249,500)	2,487,200	(6,762,300)
Transportation revenue	3,775,700	-	3,775,700
NET REVENUES	38,909,900	(1,900)	38,908,000
COST OF GOODS SOLD	12,211,700	(1,716,900)	10,494,800
Gross margin	26,698,200	1,715,000	28,413,200
OPERATING EXPENSE:			
Operating and selling	6,121,100	1,716,200	7,837,300
Sales commissions	12,510,400	-	12,510,400
General and administrative	4,735,200	-	4,735,200
Total operating expenses	23,366,700	1,716,200	25,082,900
INTEREST EXPENSE	287,600	-	287,600
OTHER INCOME	(388,900)	(1,200)	(390,100)
EARNINGS BEFORE INCOME TAXES	3,432,800	-	3,432,800
INCOME TAXES	1,304,400	-	1,304,400
NET EARNINGS	$2,128,400	$-	$2,128,400

As a result of applying Topic 606, the impact to the Company's operating results by reporting segment for the three months ended November 30, 2017 was as follows:

UBAM

	As Reported	Adjustments	Without Adoption
GROSS SALES:	$39,250,800	$(2,489,100)	$36,761,700
Less discounts and allowances	(6,546,200)	2,487,200	(4,059,000)
Transportation revenue	3,765,700	-	3,765,700
NET REVENUES	36,470,300	(1,900)	36,468,400
COST OF GOODS SOLD	10,831,100	(1,716,900)	9,114,200
Gross margin	25,639,200	1,715,000	27,354,200

OPERATING EXPENSE:			
Operating and selling	5,144,000	1,716,200	6,860,200
Sales commissions	12,420,000	-	12,420,000
General and administrative	1,158,600		