

ModusLink Global Solutions Inc  
Form 10-Q  
December 07, 2017  
Table of Contents

**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 October 31, 2017**

**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 Number 001-35319**

**ModusLink Global Solutions, Inc.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**04-2921333**  
**(I.R.S. Employer**  
**Identification No.)**

**1601 Trapelo Road, Suite 170**

**Waltham, Massachusetts**  
**(Address of principal executive offices)**  
**(781) 663-5000**

**02451**  
**(Zip Code)**

**(Registrant's telephone number, including area code)**

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, a smaller reporting company or an emerging growth company. See the 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 (Do not check if a smaller reporting company)

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 November 30, 2017, there were 55,557,326 shares issued and outstanding of the registrant's Common Stock, \$0.01 par value per share.



**Table of Contents**

**MODUSLINK GLOBAL SOLUTIONS, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

	<b>Page Number</b>
<b><u>Part I.</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	
<u>Condensed Consolidated Financial Statements</u>	3
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
<u>Item 4.</u>	
<u>Controls and Procedures</u>	32
<b><u>Part II.</u></b>	
<b><u>OTHER INFORMATION</u></b>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	33
<u>Item 1A.</u>	
<u>Risk Factors</u>	33
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 3.</u>	
<u>Default Upon Senior Securities</u>	34
<u>Item 4.</u>	
<u>Mine Safety Disclosures</u>	34
<u>Item 5.</u>	
<u>Other Information</u>	34
<u>Item 6.</u>	
<u>Exhibits</u>	34

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements**

3

**Table of Contents****MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)****(unaudited)**

	<b>October 31, 2017</b>	<b>July 31, 2017</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 119,768	\$ 110,670
Trading securities		11,898
Accounts receivable, trade, net of allowance for doubtful accounts of \$585 and \$616 at October 31, 2017 and July 31, 2017, respectively	85,091	81,450
Inventories	31,535	34,369
Funds held for clients	12,333	13,454
Prepaid expenses and other current assets	7,483	6,005
Total current assets	256,210	257,846
Property and equipment, net	15,446	18,555
Other assets	4,604	4,897
Total assets	\$ 276,260	\$ 281,298
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 74,507	\$ 71,476
Accrued restructuring	165	186
Accrued expenses	34,588	37,898
Funds held for clients	12,333	13,454
Other current liabilities	25,406	26,141
Total current liabilities	146,999	149,155
Notes payable	60,891	59,758
Other long-term liabilities	10,056	9,414
Long-term liabilities	70,947	69,172
Total liabilities	217,946	218,327
Commitments and contingencies (Note 9)		
Stockholders' equity:		

Edgar Filing: ModusLink Global Solutions Inc - Form 10-Q

Preferred stock, \$0.01 par value per share. Authorized 5,000,000 shares; zero issued or outstanding shares at October 31, 2017 and July 31, 2017		
Common stock, \$0.01 par value per share. Authorized 1,400,000,000 shares; 55,557,326 issued and outstanding shares at October 31, 2017; 55,555,973 issued and outstanding shares at July 31, 2017	556	556
Additional paid-in capital	7,457,346	7,457,051
Accumulated deficit	(7,404,186)	(7,398,949)
Accumulated other comprehensive income	4,598	4,313
Total stockholders' equity	58,314	62,971
Total liabilities and stockholders' equity	\$ 276,260	\$ 281,298

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

**MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
Net revenue	\$ 102,522	\$ 121,327
Cost of revenue	93,448	111,994
Gross profit	9,074	9,333
Operating expenses		
Selling, general and administrative	12,867	13,601
Restructuring, net	37	1,374
Total operating expenses	12,904	14,975
Operating loss	(3,830)	(5,642)
Other income (expense):		
Interest income	164	165
Interest expense	(2,107)	(2,029)
Other gains (losses), net	1,422	(488)
Total other income (expense)	(521)	(2,352)
Loss before income taxes	(4,351)	(7,994)
Income tax expense	1,087	1,049
Gains on investments in affiliates, net of tax	(201)	(500)
Net loss	\$ (5,237)	\$ (8,543)
Basic and diluted net loss per share:	\$ (0.09)	\$ (0.16)
Weighted average common shares used in basic and diluted earnings per share	55,260	54,991

See accompanying notes to unaudited condensed consolidated financial statements



**Table of Contents****MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)****(unaudited)**

	<b>Three Months Ended October 31,</b>	
	<b>2017</b>	<b>2016</b>
Net loss	\$ (5,237)	\$ (8,543)
Other comprehensive loss:		
Foreign currency translation adjustment	272	(1,269)
Pension liability adjustments, net of tax	26	397
Net unrealized holding gain (loss) on securities, net of tax	(13)	10
Other comprehensive gain (loss)	285	(862)
Comprehensive loss	\$ (4,952)	\$ (9,405)

See accompanying notes to unaudited condensed consolidated financial statements

**Table of Contents**

**MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
Cash flows from operating activities:		
Net loss	\$ (5,237)	\$ (8,543)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	1,892	2,022
Amortization of deferred financing costs	177	155
Accretion of debt discount	1,041	941
Share-based compensation	292	192
Non-cash (gains) losses, net	(1,422)	488
Gains on investments in affiliates and impairments	(201)	(500)
Changes in operating assets and liabilities:		
Trade accounts receivable, net	(3,808)	(18,208)
Inventories	2,926	(6,691)
Prepaid expenses and other current assets	(390)	(1,235)
Accounts payable, accrued restructuring and accrued expenses	(1,879)	429
Refundable and accrued income taxes, net	1,409	(371)
Other assets and liabilities	(1,353)	1,540
Net cash used in operating activities	(6,553)	(29,781)
Cash flows from investing activities:		
Additions to property and equipment	(2,464)	(1,828)
Proceeds from the disposition of property and equipment	4,247	
Proceeds from the sale of Trading Securities	13,775	907
Proceeds from investments in affiliates	201	500
Net cash provided by (used in) investing activities	15,759	(421)
Cash flows from financing activities:		
Repayments on capital lease obligations	(79)	(62)
Net proceeds from revolving line of credit		4,978
Proceeds from issuance of common stock	3	7
Net cash provided by (used in) financing activities	(76)	4,923
Net effect of exchange rate changes on cash and cash equivalents	(32)	(227)

Edgar Filing: ModusLink Global Solutions Inc - Form 10-Q

Net increase (decrease) in cash and cash equivalents	9,098	(25,506)
Cash and cash equivalents at beginning of period	110,670	130,790
Cash and cash equivalents at end of period	\$ 119,768	\$ 105,284

See accompanying notes to unaudited condensed consolidated financial statements

**Table of Contents**

**MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**(1) NATURE OF OPERATIONS**

ModusLink Global Solutions, Inc. (together with its consolidated subsidiaries, ModusLink Global Solutions or the Company ), through its wholly owned subsidiaries, ModusLink Corporation ( ModusLink ) and ModusLink PTS, Inc. ( ModusLink PTS ), is a leader in global supply chain business process management serving clients in markets such as consumer electronics, communications, computing, medical devices, software, and retail. The Company designs and executes critical elements in its clients' global supply chains to improve speed to market, product customization, flexibility, cost, quality and service. These benefits are delivered through a combination of industry expertise, innovative service solutions, integrated operations, proven business processes, expansive global footprint and world-class technology.

The Company has an integrated network of strategically located facilities in various countries, including numerous sites throughout North America, Europe and Asia. The Company previously operated under the names CMGI, Inc. and CMG Information Services, Inc. and was incorporated in Delaware in 1986.

**(2) BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for fair presentation have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended July 31, 2017, which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ) on October 16, 2017. The results for the three months ended October 31, 2017 are not necessarily indicative of the results to be expected for the full fiscal year. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

All significant intercompany transactions and balances have been eliminated in consolidation.

The Company considers events or transactions that occur after the balance sheet date but before the issuance of financial statements to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. For the period ended October 31, 2017, the Company evaluated subsequent events for potential recognition and disclosure through the date these financial statements were filed.

**(3) RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of 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. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The effective date will be the first quarter of fiscal year 2019 using one of two retrospective application methods or a cumulative effect approach. The Company and its outside consultants are evaluating the potential effects on the consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15 Presentation of Financial Statements - Going Concern (Subtopic 205-40), which amends the accounting guidance related to the evaluation of an entity's ability to continue as a going concern. The amendment establishes management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern in connection with preparing financial statements for each annual and interim reporting period. The update also gives guidance to determine whether to disclose information about relevant conditions and events when there is substantial doubt about an entity's ability to continue as a going concern. The Company adopted this guidance as of the first quarter of fiscal year 2018. Its adoption did not have an effect on the Company's consolidated financial statements.

## **Table of Contents**

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory (Topic 330), which provides guidance related to inventory measurement. The new standard requires entities to measure inventory at the lower of cost and net realizable value thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The Company adopted this guidance beginning the first quarter of fiscal year 2018. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which requires companies to classify all deferred tax assets and liabilities as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. This guidance allowed for adoption on either a prospective or retrospective basis. The Company had elected to early adopt this guidance in fiscal year 2017 on a prospective basis and, as a result, prior consolidated balance sheets were not retrospectively adjusted. The adoption of this guidance did increase the assets and liabilities balance on the Company's consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to today's accounting. This ASU will be effective for the Company beginning in the first quarter of fiscal year 2020. The Company is currently evaluating the effect the guidance will have on the Company's financial statement disclosures, results of operations and financial position.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). The amendments in this update relate to when another party, along with the Company, are involved in providing a good or service to a customer and are intended to improve the operability and understandability of the implementation guidance on principal versus agent. Revenue recognition guidance requires companies to determine whether the nature of its promise is to provide that good or service to the customer (i.e., the Company is a principal) or to arrange for the good or service to be provided to the customer by the other party (i.e., the Company is an agent). This ASU will be effective for the Company beginning in the first quarter of fiscal year 2019. The Company and its outside consultants are evaluating the potential effects on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The Company retrospectively adopted this guidance during the first quarter of fiscal year 2018 by utilizing the modified retrospective transition method. The adoption of this ASU did not materially impact the Company's consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, Restricted Cash. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Entities will also have to disclose the nature of their restricted cash and restricted cash equivalent balances, which is similar to what is required today for SEC Registrants. This ASU will be effective for the Company beginning in the first quarter of fiscal year 2019. The Company is currently in the process of assessing what impact this new standard may have on its consolidated financial statements but does not believe that implementing this standard will have a significant impact on the Company's current presentation and disclosures.

In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715), which requires that the service cost component of net periodic pension and postretirement benefit cost be presented in the same line item as other employee compensation costs, while the other components be presented separately as non-operating income (expense). This ASU will be effective for the Company beginning in the first quarter of fiscal year 2019. The Company is currently in the process of assessing what impact this new standard may have on its consolidated financial statements.

#### **(4) INVENTORIES**

Inventories are stated at the lower of cost or net realizable value. Cost is determined by both the moving average and the first-in, first-out methods. Materials that the Company typically procures on behalf of its clients that are included in inventory include materials such as compact discs, printed materials, manuals, labels, hardware accessories, hard disk drives, phone chassis, consumer packaging, shipping boxes and labels, power cords and cables for client-owned electronic devices.

**Table of Contents**

Inventories consisted of the following:

	<b>October 31, 2017</b>	<b>July 31, 2017</b>
	<b>(In thousands)</b>	
Raw materials	\$ 22,964	\$ 24,129
Work-in-process	939	713
Finished goods	7,632	9,527
	<b>\$ 31,535</b>	<b>\$ 34,369</b>

The Company continuously monitors inventory balances and records inventory provisions for any excess of the cost of the inventory over its estimated net realizable value. The Company also monitors inventory balances for obsolescence and excess quantities as compared to projected demands. The Company's inventory methodology is based on assumptions about average shelf life of inventory, forecasted volumes, forecasted selling prices, contractual provisions with its clients, write-down history of inventory and market conditions. While such assumptions may change from period to period, in determining the net realizable value of its inventories, the Company uses the best information available as of the balance sheet date. If actual market conditions are less favorable than those projected, or the Company experiences a higher incidence of inventory obsolescence because of rapidly changing technology and client requirements, additional inventory provisions may be required. Once established, write-downs of inventory are considered permanent adjustments to the cost basis of inventory and cannot be reversed due to subsequent increases in demand forecasts. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, gross profit margins may be favorably impacted.



**Table of Contents****(5) INVESTMENTS***Trading Securities*

During the three months ended October 31, 2017, the Company received \$13.8 million in proceeds associated with the sale of publicly traded securities ( Trading Securities ), which included a cash gain of \$4.6 million. During the three months ended October 31, 2017, the Company recognized \$2.7 million in net non-cash net losses associated with its Trading Securities. During the three months ended October 31, 2016, the Company received \$0.9 million in proceeds associated with the sale of Trading Securities, which included an immaterial cash gain. During the three months ended October 31, 2016, the Company recognized \$0.9 million in net non-cash net losses associated with its Trading Securities. These losses were recorded as a component of Other gains (losses), net on the Statement of Operations.

As of October 31, 2017, the Company did not have any investments in Trading Securities. As of July 31, 2017, the Company had \$11.9 million in investments in Trading Securities.

**(6) ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

The following table reflects the components of Accrued expenses and Other current liabilities :

	<b>October 31, 2017</b>	<b>July 31, 2017</b>
	<b>(In thousands)</b>	
Accrued taxes	\$ 3,403	\$ 2,272
Accrued compensation	7,549	10,678
Accrued interest	496	1,366
Accrued audit, tax and legal	2,397	2,759
Accrued contract labor	2,386	1,632
Accrued other	18,357	19,191
	<b>\$ 34,588</b>	<b>\$ 37,898</b>

	<b>October 31, 2017</b>	<b>July 31, 2017</b>
	<b>(In thousands)</b>	
Accrued pricing liabilities	\$ 18,882	\$ 18,882
Other	6,524	7,259
	<b>\$ 25,406</b>	<b>\$ 26,141</b>

As of October 31, 2017 and July 31, 2017, the Company had accrued pricing liabilities of approximately \$18.9 million for both periods. As previously reported by the Company, several adjustments were made to its historic financial statements for periods ending on or before January 31, 2012, the most significant of which related to the treatment of

vendor rebates in its pricing policies. Where the retention of a rebate or a mark-up was determined to have been inconsistent with a client contract (collectively referred to as pricing adjustments ), the Company concluded that these amounts were not properly recorded as revenue. Accordingly, revenue was reduced by an equivalent amount for the period that the rebate was estimated to have affected. A corresponding liability for the same amount was recorded in that period (referred to as accrued pricing liabilities). The Company believes that it may not ultimately be required to pay all of the accrued pricing liabilities, due in part to the nature of the interactions with its clients. The remaining accrued pricing liabilities at October 31, 2017 will be derecognized when there is sufficient information for the Company to conclude that such liabilities have been extinguished, which may occur through payment, legal release, or other legal or factual determination.

**Table of Contents****(7) RESTRUCTURING, NET**

Restructuring and other costs for the three months ended October 31, 2017 primarily included continuing charges for personnel reductions and facility consolidations in an effort to streamline operations across our global supply chain operations. The remaining contractual obligations primarily relate to facility lease obligations for vacant space resulting from the previous restructuring activities of the Company. The Company anticipates that these contractual obligations will be substantially fulfilled by the end of December 2017.

The Company had an immaterial amount of restructuring activity during the three months ended October 31, 2017. The \$1.4 million restructuring charge recorded during the three months ended October 31, 2016 primarily consisted of \$0.2 million, \$0.4 million and \$0.5 million of employee-related costs in the Americas, Asia and Europe, respectively, related to the workforce reduction of 50 employees in our global supply chain. Of this amount, \$0.3 million related to contractual obligations.

The following tables summarize the activities related to the restructuring accrual by expense category and by reportable segment for the three months ended October 31, 2017:

	<b>Employee Related Expenses</b>	<b>Contractual Obligations</b>	<b>Total</b>
	<b>(In thousands)</b>		
Accrued restructuring balance at July 31, 2017	\$ 100	\$ 86	\$ 186
Restructuring adjustments	11	26	37
Cash paid		(66)	(66)
Non-cash adjustments	8		8
Accrued restructuring balance at October 31, 2017	\$ 119	\$ 46	\$ 165

**Table of Contents**

	Americas	Asia	Europe	e-Business	Consolidated Total
	(In thousands)				
Accrued restructuring balance at July 31, 2017	\$ 51	\$	\$ 23	\$ 112	\$ 186
Restructuring adjustments	27	1	2	7	37
Cash paid				(66)	(66)
Non-cash adjustments	8	(1)	(25)	26	8
Accrued restructuring balance at October 31, 2017	\$ 86	\$	\$	\$ 79	\$ 165

The net restructuring charges for the three months ended October 31, 2017 and 2016 would have been allocated as follows had the Company recorded the expense and adjustments within the functional department of the restructured activities:

	Three Months Ended October 31, 2017      2016 (In thousands)	
Cost of revenue	\$ 8	\$ 581
Selling, general and administrative	29	793
	\$ 37	\$ 1,374

**(8) DEBT***Notes Payable*

On March 18, 2014, the Company entered into an indenture (the "Indenture") with Wells Fargo Bank, National Association, as trustee, relating to the Company's issuance of \$100 million of 5.25% Convertible Senior Notes (the "Notes"). The Notes bear interest at the rate of 5.25% per year, payable semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2014. The Notes will mature on March 1, 2019, unless earlier repurchased by the Company or converted by the holder in accordance with their terms prior to such maturity date.

Holders of the Notes may convert all or any portion of their notes, in multiples of \$1,000 principal amount, at their option at any time prior to the close of business or the business day immediately preceding the maturity date. Each \$1,000 of principal of the Notes will initially be convertible into 166.2593 shares of our common stock, which is equivalent to an initial conversion price of approximately \$6.01 per share, subject to adjustment upon the occurrence of certain events, or, if the Company obtains the required consent from its stockholders, into shares of the Company's common stock, cash or a combination of cash and shares of its common stock, at the Company's election. If the Company has received stockholder approval, and it elects to settle conversions through the payment of cash or payment or delivery of a combination of cash and shares, the Company's conversion obligation will be based on the volume weighted average prices ("VWAP") of its common stock for each VWAP trading day in a 40 VWAP trading day observation period. The Notes and any of the shares of common stock issuable upon conversion have not been registered. As of October 31, 2017, the if-converted value of the Notes did not exceed the principal value of the Notes.

Holders will have the right to require the Company to repurchase their Notes, at a repurchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest, upon the occurrence of certain fundamental changes, subject to certain conditions. No fundamental changes occurred during the three months ended October 31, 2017.

The Company may not redeem the Notes prior to the mandatory date, and no sinking fund is provided for the Notes. The Company will have the right to elect to cause the mandatory conversion of the Notes in whole, and not in part, at any time on or after March 6, 2017, if the last reported sale price of its common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including the trading day immediately preceding the date on which the Company notifies holders of its election to mandatorily convert the Notes, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which the Company notifies holders of its election to mandatorily convert the notes.

**Table of Contents**

The Company has valued the debt using similar nonconvertible debt as of the original issuance date of the Notes and bifurcated the conversion option associated with the Notes from the host debt instrument and recorded the conversion option of \$28.1 million in stockholders' equity prior to the allocation of debt issuance costs. The initial value of the equity component, which reflects the equity conversion feature, is equal to the initial debt discount. The resulting debt discount on the Notes is being accreted to interest expense at the effective interest rate over the estimated life of the Notes. The equity component is included in the additional paid-in-capital portion of stockholders' equity on the Company's consolidated balance sheet. In addition, the debt issuance costs of \$3.4 million are allocated between the liability and equity components in proportion to the allocation of the proceeds. During the first quarter of fiscal year 2017, the Company adopted ASU No. 2015-03. As such, the issuance costs allocated to the liability component (\$2.5 million) are capitalized as a reduction of the principal amount of the Notes payable on the Company's balance sheet and amortized, using the effective-interest method, as additional interest expense over the term of the Notes. The issuance costs allocated to the equity component is recorded as a reduction to additional paid-in capital.

The fair value of the Company's Notes payable, calculated as of the closing price of the traded securities, was \$65.3 million and \$63.9 million as of October 31, 2017 and July 31, 2017, respectively. This value does not represent the settlement value of these long-term debt liabilities to the Company. The fair value of the Notes payable could vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The Notes payable are traded and their fair values are based upon traded prices as of the reporting dates. As of October 31, 2017 and July 31, 2017, the net carrying value of the Notes was \$60.9 million and \$59.8 million, respectively.

	<b>October 31, 2017</b>	<b>July 31, 2017</b>
	<b>(In thousands)</b>	
Carrying amount of equity component (net of allocated debt issuance costs)	\$ 26,961	\$ 26,961
Principal amount of Notes	\$ 67,625	\$ 67,625
Unamortized debt discount	(6,186)	(7,227)
Unamortized debt issuance costs	(548)	(640)
<b>Net carrying amount</b>	<b>\$ 60,891</b>	<b>\$ 59,758</b>

As of October 31, 2017, the remaining period over which the unamortized discount will be amortized is 16 months.

	<b>Three Months Ended October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(In thousands)</b>	
Interest expense related to contractual interest coupon	\$ 914	\$ 935
Interest expense related to accretion of the discount	1,041	941
Interest expense related to debt issuance costs	92	83
	<b>\$ 2,047</b>	<b>\$ 1,959</b>

During each of the three months ended October 31, 2017 and 2016, we recognized interest expense of \$2.0 million related to the Notes. The effective interest rate on the Notes, including amortization of debt issuance costs and accretion of the discount, is 13.9%. The notes bear interest of 5.25%.

*PNC Bank Credit Facility*

On June 30, 2014, two direct and wholly owned subsidiaries of the Company (the Borrowers ) entered into a revolving credit and security agreement (as amended, the Credit Agreement ), as borrowers and guarantors, with PNC Bank and National Association, as lender and as agent, respectively.

The Credit Agreement has a five (5) year term which expires on June 30, 2019. It includes a maximum credit commitment of \$50.0 million, is available for letters of credit (with a sublimit of \$5.0 million) and has a \$20.0 million uncommitted accordion feature. The actual maximum credit available under the Credit Agreement varies from time to time and is determined by calculating the applicable borrowing base, which is based upon applicable percentages of the values of eligible accounts receivable and eligible inventory minus reserves determined by the Agent (including other reserves that the Agent may establish from time to time in its permitted discretion), all as specified in the Credit Agreement.

**Table of Contents**

Generally, borrowings under the Credit Agreement bear interest at a rate per annum equal to, at the Borrowers' option, either (a) LIBOR (adjusted to reflect any required bank reserves) for an interest period equal to one, two or three months (as selected by the Borrowers) plus a margin of 2.25% per annum or (b) a base rate determined by reference to the highest of (1) the base commercial lending rate publicly announced from time to time by PNC Bank, National Association, (2) the sum of the Federal Funds Open Rate in effect on such day plus one half of one percent (0.5%) per annum, or (3) the LIBOR rate (adjusted to reflect any required bank reserves) in effect on such day plus 1.00% per annum. In addition to paying interest on outstanding principal under the Credit Agreement, the Borrowers are required to pay a commitment fee, in respect of the unutilized commitments thereunder, of 0.25% per annum, paid quarterly in arrears. The Borrowers are also required to pay a customary letter of credit fee equal to the applicable margin on revolving credit LIBOR loans and fronting fees.

Obligations under the Credit Agreement are guaranteed by the Borrowers' existing and future direct and indirect wholly-owned domestic subsidiaries, subject to certain limited exceptions; and the Credit Agreement is secured by security interests in substantially all the Borrowers' assets and the assets of each subsidiary guarantor, whether owned as of the closing or thereafter acquired, including a pledge of 100.0% of the equity interests of each subsidiary guarantor that is a domestic entity (subject to certain limited exceptions) and 65.0% of the voting equity interests of any direct first tier foreign entity owned by either Borrower or by a subsidiary guarantor. The Company is not a borrower or a guarantor under the Credit Agreement.



**Table of Contents**

The Credit Agreement contains certain customary negative covenants, which include limitations on mergers and acquisitions, the sale of assets, liens, guarantees, investments, loans, capital expenditures, dividends, indebtedness, changes in the nature of business, transactions with affiliates, the creation of subsidiaries, changes in fiscal year and accounting practices, changes to governing documents, compliance with certain statutes, and prepayments of certain indebtedness. The Credit Agreement also contains certain customary affirmative covenants (including periodic reporting obligations) and events of default, including upon a change of control. The Credit Agreement requires compliance with certain financial covenants providing for maintenance of specified liquidity, maintenance of a minimum fixed charge coverage ratio and/or maintenance of a maximum leverage ratio following the occurrence of certain events and/or prior to taking certain actions, all as more fully described in the Credit Agreement. The Company believes that the Credit Agreement provides greater financial flexibility to the Company and the Borrowers and may enhance their ability to consummate one or several larger and/or more attractive acquisitions and should provide our clients and/or potential clients with greater confidence in the Company's and the Borrowers' liquidity. During the three months ended October 31, 2017, the Company did not meet the criteria that would cause its financial covenants to be applicable. As of October 31, 2017 and July 31, 2017, the Company did not have any balance outstanding on the PNC Bank credit facility.

**(9) CONTINGENCIES**

On May 12, 2017, the Excise Tax Branch of the Internal Revenue Service (the "IRS") initiated a claim associated with the Company's compliance with the self-assessment of excise tax on Ozone Depleting Chemicals. The Company has objected to the IRS' assessments on a number of technical and substantive grounds, and plans to vigorously defend itself against the claim. Currently the Company is unable to determine the probability of an unfavorable outcome or a range of outcomes. Accordingly, the Company has not recorded a reserve associated with this matter.

**(10) OTHER GAINS (LOSSES), NET**

The following table reflects the components of Other gains (losses), net :

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(In thousands)</b>	
Foreign currency exchange gain (losses)	\$ (635)	\$ 397
Gains (losses) on Trading Securities	1,876	(917)
Other, net	181	32
	\$ 1,422	\$ (488)

The Company recorded foreign exchange losses of approximately \$(0.6) million during the three months ended October 31, 2017. For the three months ended October 31, 2017, the net losses primarily related to realized and unrealized losses from foreign currency exposures and settled transactions of approximately \$(0.4) million and \$(0.3) million in Asia and Europe, respectively. The Company recorded foreign exchange gains of approximately \$0.4 million during the three months ended October 31, 2016. For the three months ended October 31, 2016, the net gains primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$0.7 million and \$(0.2) million in the Corporate and Europe, respectively.

During the three months ended October 31, 2017 and 2016, the Company recognized \$2.7 million and \$0.9 million in net non-cash losses, respectively, associated with its Trading Securities. During the three months ended October 31, 2017, the Company recognized \$4.6 million in net cash gains associated with its Trading Securities.

**(11) INCOME TAXES**

The Company operates in multiple taxing jurisdictions, both within and outside of the United States. For the three months ended October 31, 2017, the Company was profitable in certain jurisdictions, resulting in an income tax expense using enacted rates in those jurisdictions. As of October 31, 2017 and July 31, 2017, the total amount of the liability for unrecognized tax benefits related to federal, state and foreign taxes was approximately \$0.7 million for both periods.

---

**Table of Contents****Uncertain Tax Positions**

In accordance with the Company's accounting policy, interest related to unrecognized tax benefits is included in the provision of income taxes line of the Condensed Consolidated Statements of Operations. As of October 31, 2017 and July 31, 2017, the liabilities for interest expense related to uncertain tax positions were immaterial. The Company did not accrue for penalties related to income tax positions as there were no income tax positions that required the Company to accrue penalties. The Company does not expect any unrecognized tax benefits to reverse in the next twelve months. The Company is subject to U.S. federal income tax and various state, local and international income taxes in numerous jurisdictions. The federal and state tax returns are generally subject to tax examinations for the tax years ended July 31, 2013 through July 31, 2017. To the extent the Company has tax attribute carryforwards, the tax year in which the attribute was generated may still be adjusted upon examination by the Internal Revenue Service or state tax authorities to the extent utilized in a future period. In addition, a number of tax years remain subject to examination by the appropriate government agencies for certain countries in the Europe and Asia regions. In Europe, the Company's 2009 through 2016 tax years remain subject to examination in most locations, while the Company's 2005 through 2016 tax years remain subject to examination in most Asia locations.

**Net Operating Loss**

The Company has certain deferred tax benefits, including those generated by net operating losses and certain other tax attributes (collectively, the Tax Benefits). The Company's ability to use these Tax Benefits could be substantially limited if it were to experience an ownership change, as defined under Section 382 of the Internal Revenue Code of 1986, as amended (the Code). In general, an ownership change would occur if there is a greater than 50-percentage point change in ownership of securities by stockholders owning (or deemed to own under Section 382 of the Code) five percent or more of a corporation's securities over a rolling three-year period.

**Tax Benefit Preservation Plan**

On October 17, 2011, the Company's Board of Directors adopted a Tax Benefit Preservation Plan between the Company and American Stock Transfer & Trust Company, LLC, as rights agent (as amended from time to time, the Tax Plan). The Tax Plan reduces the likelihood that changes in the Company's investor base would have the unintended effect of limiting the Company's use of its Tax Benefits. The Tax Plan is intended to require any person acquiring shares of the Company's securities equal to or exceeding 4.99% of the Company's outstanding shares to obtain the approval of the Board of Directors. This would protect the Tax Benefits because changes in ownership by a person owning less than 4.99% of the Company's stock are considered and included in one or more public groups in the calculation of ownership change for purposes of Section 382 of the Code. On October 9, 2014, the Tax Plan was amended by our Board of Directors to extend the expiration of the Tax Plan until October 17, 2017. Following the stockholders' approval of the Protective Amendment (as described below) at the Company's 2014 Annual Meeting, the Tax Plan was further amended so that it expired at the close of business on December 31, 2014.

**Protective Amendment**

On December 29, 2014, the Company filed an Amendment to its Restated Certificate of Incorporation (the Protective Amendment) with the Delaware Secretary of State to protect the significant potential long-term tax benefits presented by its net operating losses and other tax benefits (collectively, the NOLs). The Protective Amendment was approved by the Company's stockholders at the Company's 2014 Annual Meeting of Stockholders held on December 9, 2014. As a result of the filing of the Protective Amendment with the Delaware Secretary of State, the Company amended its Tax Benefit Preservation Plan so that it expired at the close of business on December 31, 2014.

The Protective Amendment limits certain transfers of the Company's common stock, to assist the Company in protecting the long-term value of its accumulated NOLs. The Protective Amendment's transfer restrictions generally restrict any direct or indirect transfers of the common stock if the effect would be to increase the direct or indirect ownership of the common stock by any person (as defined in the Protective Amendment) from less than 4.99% to 4.99% or more of the common stock, or increase the percentage of the common stock owned directly or indirectly by a Person owning or deemed to own 4.99% or more of the common stock. Any direct or indirect transfer attempted in violation of the Protective Amendment will be void as of the date of the prohibited transfer as to the purported transferee. The Board of Directors of the Company has discretion to grant waivers to permit transfers otherwise restricted by the Protective Amendment. In accordance with the Protective Amendment, Handy & Harman ( HNH ), a related party, requested, and the Company granted HNH and its affiliates, a waiver under the Protective Amendment to permit their acquisition of up to 45% of the Company's outstanding shares of common stock in the aggregate (subject to proportionate adjustment, the 45% Cap ), in addition to acquisitions of common stock in connection with the exercise of certain warrants of the Company (the Warrants ) held by Steel Partners Holdings L.P. ( SPH ), an affiliate of HNH, as well as a limited waiver under Section 203 of the Delaware General Corporation Law for this purpose. Notwithstanding the foregoing, HNH and its affiliates (and any group of which HNH or any of its affiliates is a member) are not permitted to acquire securities that would result in an ownership change of the Company for purposes of Section 382 of the Internal Revenue Code of 1986, as amended, that would have the effect of impairing any of the Company's NOLs. The foregoing waiver was approved by the independent directors of the Company.

**Table of Contents****(12) EARNINGS PER SHARE**

The Company calculates earnings per share in accordance with ASC Topic 260, Earnings per Share. The following table reconciles earnings per share for the three months ended October 31, 2017 and 2016:

	<b>Three Months Ended October 31,</b>	
	<b>2017</b>	<b>2016</b>
Net loss	\$ (5,237)	\$ (8,543)
Weighted average common shares outstanding	55,260	54,991
Weighted average common equivalent shares arising from dilutive stock options and restricted stock		
Weighted average number of common and potential common shares	55,260	54,991
Basic and diluted net loss per share	\$ (0.09)	\$ (0.16)

Basic earnings per common share is calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings per common share, if any, gives effect to diluted stock options (calculated based on the treasury stock method), non-vested restricted stock shares purchased under the employee stock purchase plan and shares issuable upon debt conversion (calculated using an as-if converted method).

For the three months ended October 31, 2017 and 2016, approximately 14.1 million and 14.9 million, respectively, common stock equivalent shares were excluded from the denominator in the calculation of diluted earnings per share as their inclusion would have been antidilutive.

**(13) SHARE-BASED PAYMENTS**

The following table summarizes share-based compensation expense related to employee stock options, employee stock purchases and non-vested shares for the three months ended October 31, 2017 and 2016, which was allocated as follows:

	<b>Three Months Ended October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(In thousands)</b>	
Cost of revenue	\$ 11	\$ 16
Selling, general and administrative	281	176
	\$ 292	\$ 192

At October 31, 2017, there was an immaterial amount of unrecognized compensation cost related to Stock Options issued under the Company's plans. At October 31, 2016, there was approximately \$1.6 million of total unrecognized

compensation cost related to non-vested share-based compensation awards under the Company's plans.

**Table of Contents****(14) COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) combines net income (loss) and other comprehensive items. Other comprehensive items represent certain amounts that are reported as components of stockholder's equity in the accompanying condensed consolidated balance sheets.

Accumulated other comprehensive items consist of the following:

	<b>Foreign currency items</b>	<b>Pension items</b>	<b>Unrealized gains (losses) on securities</b>	<b>Total</b>
	<b>(In thousands)</b>			
Accumulated other comprehensive income (loss) at July 31, 2017	\$ 7,522	\$ (3,376)	\$ 167	\$ 4,313
Foreign currency translation adjustment	272			272
Pension liability adjustments		26		26
Net unrealized holding losses on securities			(13)	(13)
<b>Net current-period other comprehensive income (loss)</b>	<b>272</b>	<b>26</b>	<b>(13)</b>	<b>285</b>
Accumulated other comprehensive income (loss) at October 31, 2017	\$ 7,794	\$ (3,350)	\$ 154	\$ 4,598

**(15) SEGMENT INFORMATION**

The Company has four operating segments: Americas; Asia; Europe; and e-Business. Based on the information provided to the Company's chief operating decision-maker ( CODM ) for purposes of making decisions about allocating resources and assessing performance and quantitative thresholds, the Company has determined that it has four reportable segments: Americas, Asia, Europe and e-Business. The Company also has Corporate-level activity, which consists primarily of costs associated with certain corporate administrative functions such as legal and finance, which are not allocated to the Company's reportable segments. The Corporate-level balance sheet information includes cash and cash equivalents, trading securities, Notes payables and other assets and liabilities which are not identifiable to the operations of the Company's operating segments. All significant intra-segment amounts have been eliminated.

Management evaluates segment performance based on segment net revenue, operating income (loss) and adjusted operating income (loss), which is defined as the operating income (loss) excluding net charges related to depreciation, amortization of intangible assets, long-lived asset impairment, share-based compensation and restructuring. These items are excluded because they may be considered to be of a non-operational or non-cash nature. Historically, the Company has recorded significant impairment and restructuring charges and therefore management uses adjusted operating income to assist in evaluating the performance of the Company's core operations.

Summarized financial information of the Company's continuing operations by operating segment is as follows:





**Table of Contents**

	<b>Three Months Ended October 31, 2017      2016 (In thousands)</b>	
<b>Net revenue:</b>		
Americas	\$ 14,839	\$ 25,878
Asia	43,512	42,873
Europe	38,390	45,181
e-Business	5,781	7,395
	\$ 102,522	\$ 121,327
<b>Operating income (loss):</b>		
Americas	\$ (2,199)	\$ (3,856)
Asia	4,169	1,777
Europe	(2,860)	(2,591)
e-Business	(1,445)	344
Total Segment operating income (loss)	(2,335)	(4,326)
Corporate-level activity	(1,495)	(1,316)
Total operating loss	(3,830)	(5,642)
Total other expense	521	2,352
Loss before income taxes	\$ (4,351)	\$ (7,994)
	<b>October 31, 2017</b>	<b>July 31, 2017</b>
	<b>(In thousands)</b>	
<b>Total assets:</b>		
Americas	\$ 20,760	\$ 21,876
Asia	63,387	63,819
Europe	62,001	64,639
e-Business	18,226	20,703
Sub-total - segment assets	164,374	171,037
Corporate	111,886	110,261
	\$ 276,260	\$ 281,298

Summarized financial information of the Company's net revenue from external customers by group of services is as follows:

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(In thousands)</b>	
Supply chain services	\$ 96,741	\$ 113,932
e-Business services	5,781	7,395
	<b>\$ 102,522</b>	<b>\$ 121,327</b>

As of October 31, 2017, approximately \$8.8 million, \$3.1 million, \$2.1 million and \$2.2 million of the Company's long-lived assets were located in the U.S.A., Netherlands, Singapore and China, respectively. As of July 31, 2017, approximately \$9.3 million, \$3.3 million, \$2.4 million and \$2.2 million of the Company's long-lived assets were located in the U.S.A., Netherlands, Singapore and China, respectively.

For the three months ended October 31, 2017, the Company's net revenues within U.S.A., China, Netherlands and Czech Republic were \$15.2 million, \$34.8 million, \$15.2 million and \$21.7 million, respectively. For the three months ended October 31, 2016, the Company's net revenues within U.S.A., China, Netherlands and Czech Republic were \$26.9 million, \$36.2 million, \$16.9 million and \$26.3 million, respectively.

---

**Table of Contents****(16) RELATED PARTY TRANSACTIONS**

On December 24, 2014, the Company entered into a Management Services Agreement with SP Corporate Services LLC ( SP Corporate ), effective as of January 1, 2015 (as amended, the Management Services Agreement ). SP Corporate is an indirect wholly owned subsidiary of SPH and is a related party. Pursuant to the Management Services Agreement, SP Corporate provided the Company and its subsidiaries with the services of certain employees, including certain executive officers, and other corporate services.

The Management Services Agreement had an initial term of six months. On June 30, 2015, the Company entered into an amendment that extended the term of the Management Services Agreement to December 31, 2015 and provided for automatic renewal for successive one year periods, unless and until terminated in accordance with the terms set forth therein, which include, under certain circumstances, the payment by the Company of certain termination fees to SP Corporate. On March 10, 2016, the Company entered into a Second Amendment to the Management Services Agreement with SPH Services, Inc. ( SPH Services ) pursuant to which SPH Services assumed rights and responsibilities of SP Corporate and the services provided by SPH Services to the Company were modified pursuant to the terms of the amendment. SPH Services is the parent of SP Corporate and an affiliate of SPH Group Holdings LLC. On March 10, 2016, the Company entered into a Transfer Agreement with SPH Services pursuant to which the parties agreed to transfer to the Company certain individuals who provide corporate services to the Company (the Transfer Agreement ). SPH Services has since changed its name to Steel Services Ltd. ( Steel Services ). On September 1, 2017, the Company entered into a Third Amendment to the Management Services Agreement, which reduced the fixed monthly fee paid by the Company to Steel Services under the Management Services Agreement from \$175,000 per month to \$95,641 per month. The monthly fee is subject to review and adjustment by agreement between the Company and Steel Services for periods commencing in fiscal 2016 and beyond. Additionally, the Company may be required to reimburse Steel Services and its affiliates for all reasonable and necessary business expenses incurred on our behalf in connection with the performance of the services under the Management Services Agreement, including travel expenses. The Management Services Agreement provides that, under certain circumstances, the Company may be required to indemnify and hold harmless Steel Services and its affiliates and employees from any claims or liabilities by a third party in connection with activities or the rendering of services under the Management Services Agreement. Total expenses incurred related to this agreement for the three months ended October 31, 2017 and 2016 were \$0.5 million and \$0.5 million, respectively. As of October 31, 2017 and July 31, 2017, amounts due to SP Corporate and Steel Services were \$0.2 million and \$0.3 million, respectively.

The Related Party Transactions Committee of the Board (the Related Party Transactions Committee ) approved the entry into the Management Services Agreement (and the amendments thereto) and the Transfer Agreement. The Audit Committee of the Board of Directors (the Audit Committee ) approved the third amendment to the Management Services Agreement. The Related Party Transactions Committee held the responsibility to review, approve and ratify related party transactions from November 20, 2014, until October 11, 2016. On October 11, 2016, the Board adopted a Related Person Transaction Policy that is administered by the Audit Committee and applies to all related party transactions. As of October 11, 2016, the Audit Committee reviews all related party transactions on an ongoing basis and all such transactions must be approved or ratified by the Audit Committee.

Mutual Securities, Inc. ( Mutual Securities ) serves as the broker and record-keeper for all the transactions associated with the Trading Securities. An officer of SP Corporate and of the General Partner of SPH is a registered principal of Mutual Securities. Commissions charged by Mutual Securities are generally commensurate with commissions charged by other institutional brokers, and the Company believes its use of Mutual Securities is consistent with its desire to obtain best price and execution. During the three months ended October 31, 2017 and 2016, Mutual Securities received an immaterial amount in commissions associated with these transactions.

**(17) FAIR VALUE MEASUREMENT OF ASSETS AND LIABILITIES**

ASC Topic 820 provides that fair value is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants based on the highest and best use of the asset or liability. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 requires the Company to use valuation techniques to measure fair value that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets

**Table of Contents**

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborated inputs

Level 3: Unobservable inputs for which there is little or no market data and which require the Company to develop its own assumptions about how market participants would price the assets or liabilities

The carrying value of cash and cash equivalents, accounts receivable, funds held for clients, accounts payable, current liabilities and the revolving line of credit approximate fair value because of the short maturity of these instruments. The carrying value of capital lease obligations approximates fair value, as estimated by using discounted future cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. The fair values of the Company's Trading Securities are estimated using quoted market prices. The Company values foreign exchange forward contracts using observable inputs which primarily consist of an income approach based on the present value of the forward rate less the contract rate multiplied by the notional amount. The defined benefit plans have 100% of their assets invested in bank-managed portfolios of debt securities and other assets. Conservation of capital with some conservative growth potential is the strategy for the plans. The Company's pension plans are outside the United States, where asset allocation decisions are typically made by an independent board of trustees. Investment objectives are aligned to generate returns that will enable the plans to meet their future obligations. The Company acts in a consulting and governance role in reviewing investment strategy and providing a recommended list of investment managers for each plan, with final decisions on asset allocation and investment manager made by local trustees.

*Assets and Liabilities that are Measured at Fair Value on a Recurring Basis*

The following tables present the Company's financial assets measured at fair value on a recurring basis as of October 31, 2017 and July 31, 2017, classified by fair value hierarchy:

(In thousands)	Fair Value Measurements at Reporting Date Using			
	October 31, 2017	Level 1	Level 2	Level 3
<u>Assets:</u>				
Money market funds	\$ 95,421	\$ 95,421	\$	\$

(In thousands)	Fair Value Measurements at Reporting Date Using			
	July 31, 2017	Level 1	Level 2	Level 3
<u>Assets:</u>				
Marketable equity securities	\$ 11,898	\$ 11,898	\$	\$
Money market funds	85,683	85,683		

There were no transfers between Levels 1, 2 or 3 during any of the periods presented.

When available, quoted prices were used to determine fair value. When quoted prices in active markets were available, investments were classified within Level 1 of the fair value hierarchy. When quoted prices in active markets were not available, fair values were determined using pricing models, and the inputs to those pricing models were based on observable market inputs. The inputs to the pricing models were typically benchmark yields, reported trades, broker-dealer quotes, issuer spreads and benchmark securities, among others.

*Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis*

The Company's only significant assets or liabilities measured at fair value on a nonrecurring basis subsequent to their initial recognition were the Company's @Ventures investments and certain assets subject to long-lived asset impairment. The Company reviews the carrying amounts of these assets whenever certain events or changes in circumstances indicate that the carrying amounts may not be recoverable.

**Table of Contents***Fair Value of Financial Instruments*

The Company's financial instruments not measured at fair value on a recurring basis include cash and cash equivalents, accounts receivable, accounts payable, funds held for clients and long-term debt and are reflected in the financial statements at cost. With the exception of long-term debt, cost approximates fair value for these items due to their short-term nature.

Included in Trading Securities in the accompanying balance sheet are marketable equity securities. These instruments are valued at quoted market prices in active markets. Included in cash and cash equivalents in the accompanying balance sheet are money market funds. These are valued at quoted market prices in active markets.

The following table presents the Company's debt not carried at fair value:

	October 31, 2017		July 31, 2017		Fair Value Hierarchy
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	
Notes payable	\$ 60,891	\$ 65,300	\$ 59,758	\$ 63,852	Level 1

(In thousands)

The fair value of our Notes payable represents the value at which our lenders could trade our debt within the financial markets, and does not represent the settlement value of these long-term debt liabilities to us. The fair value of the Notes payable could vary each period based on fluctuations in market interest rates, as well as changes to our credit ratings. The Notes payable are traded and their fair values are based upon traded prices as of the reporting dates.

## **Table of Contents**

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

The matters discussed in this report contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended that involve risks and uncertainties. All statements other than statements of historical information provided herein may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. Factors that could cause actual results to differ materially from those reflected in the forward-looking statements include, but are not limited to, those discussed in Part II Item 1A below and elsewhere in this report and the risks discussed in the Company's Annual Report on Form 10-K filed with the SEC on October 16, 2017. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis, judgment, belief or expectation only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof, except as required by applicable securities laws and regulations.

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

#### ***Overview***

ModusLink Global Solutions, Inc. provides comprehensive physical and digital supply chain optimization services (the Supply Chain Business) that are designed to improve clients' revenue, cost, sustainability and customer experience objectives. We provide services to leading companies across a wide spectrum of industries, including consumer electronics, communications, computing, medical devices, software, and retail, among others. The Supply Chain Business operations are supported by a global footprint that includes more than 20 sites across North America, Europe, and the Asia Pacific region.

We operate an integrated physical and digital supply chain system infrastructure that extends from front-end order management through distribution and returns management. This end-to-end solution enables clients to link supply and demand in real-time, improve visibility and performance throughout the supply chain, and provide real-time access to information for greater collaboration and making informed business decisions. We believe that our clients can benefit from our global integrated business solution, especially given the increased usage of connected devices and digitalized solutions.

Historically, a significant portion of our revenue from our Supply Chain Business has been generated from clients in the computer and software markets. These markets, while large in size, are mature and, as a result, gross margins in these markets tend to be lower than other markets the Company operates in. To address this, in addition to the computer and software markets, we have expanded our sales focus to include additional markets such as communications and consumer electronics, with a long-term focus on expanding in growth industries, such as the connected home, and connected healthcare, among others. We believe these markets, and other verticals we operate in, may experience faster growth than our historical markets, and represent opportunities to realize higher gross margins on the services we offer. Companies in these markets often have significant need for a supply chain partner who will be an extension to their business models. We believe the scope of our service offerings, including value-added warehousing and distribution, repair and recovery, aftersales, returns management, financial management, entitlement management, contact center support, material planning and factory supply, and e-Business will increase the overall value of the supply chain solutions we deliver to our existing clients and to new clients.



Many of our clients' products are subject to seasonal consumer buying patterns. As a result, the services we provide to our clients are also subject to seasonality, with higher revenue and operating income typically being realized from handling our clients' products during the first half of our fiscal year, which includes the holiday selling season. Furthermore, many of our clients' have global operations and we believe they have been adversely impacted by continued economic pressures in certain global regions.

Management evaluates operating performance based on net revenue, operating income (loss) and net income (loss) and a measure that we refer to as Adjusted EBITDA, defined as net income (loss) excluding net charges related to interest income, interest expense, income tax expense, depreciation, amortization of intangible assets, SEC inquiry and financial restatement costs, SEC penalties on resolution, strategic consulting and other related professional fees, executive severance and employee retention, restructuring, share-based compensation, impairment of long-lived assets, unrealized foreign exchange gains and losses, net, other non-operating gains and losses, net, and gains and losses on investments in affiliates and impairments. Among the key factors that will influence our performance are successful execution and implementation of our strategic initiatives, global economic conditions, especially in the technology sector, which comprises a predominant proportion of our business, demand for our clients' products, the effect of product form factor changes, technology changes, revenue mix and demand for outsourcing services.

---

**Table of Contents**

As a large portion of our revenue comes from outsourcing services provided to clients such as retail products and consumer electronics companies, our operating performance has been and may continue to be adversely affected by declines in the overall performance within these sectors and uncertainty affecting the world economy. In addition, the drop in consumer demand for products of certain clients has had and may continue to have the effect of reducing our volumes and adversely affecting our revenue, gross margin and overall operating performance. Additionally, the markets for our services are generally very competitive, though we believe we have a compelling and differentiated offering due to the value-added services we provide, our commitment to client management, and our global reach. We also face pressure from our clients to continually realize efficiency gains in order to help our clients maintain their profitability objectives. Increased competition and client demands for efficiency improvements may result in price reductions, reduced gross margins and, in some cases, loss of market share. In addition, our profitability varies based on the types of services we provide and the regions in which we perform them. Therefore, the mix of revenue derived from our various services and locations can impact our gross margin results. Also, form factor changes, which we describe as the reduction in the amount of materials and product components used in our clients' completed packaged product, can also have the effect of reducing our revenue and gross margin opportunities. As a result of these competitive and client pressures the gross margins in our business are low. We have developed plans and will continue to monitor plans to address process improvements and realize other efficiencies throughout our global footprint with a goal to reduce cost, remove waste and improve our overall gross margins. There can be no assurance that these actions will improve gross margins. For the three months ended October 31, 2017 and 2016, our gross margin percentage was 8.9% and 7.7%, respectively. Increased competition as well as industry consolidation and/or low demand for our clients' products and services may hinder our ability to maintain or improve our gross margins, profitability and cash flows. We must continue to focus on margin improvement, through implementation of our strategic initiatives, cost reductions and asset and employee productivity gains in order to improve the profitability of our business and maintain our competitive position. We generally manage margin and pricing pressures in several ways, including efforts to target new markets, expand and enhance our service offerings, improve the efficiency of our processes and to lower our infrastructure costs. We seek to lower our cost to service clients by moving work to lower-cost venues, consolidating and leveraging our global facility footprint, drive process and efficiency reforms and other actions designed to improve the productivity of our operations.

Historically, a limited number of key clients have accounted for a significant percentage of our revenue. For the three months ended October 31, 2017, our top ten clients collectively accounted for approximately 74.7% of our net revenue. We expect to continue to derive the vast majority of our revenue from sales to a small number of key clients, and we plan to expand into new markets and over time, diversify the concentration of revenue across additional clients. In general, we do not have any agreements which obligate any client to buy a minimum amount of services from us or designate us as an exclusive service provider. Consequently, our net revenue is subject to demand variability by our clients. The level and timing of orders placed by our clients vary for a variety of reasons, including seasonal buying by end-users, the introduction of new technologies and general economic conditions. By diversifying into new markets and improving the operational support structure for our clients, we expect to offset the adverse financial impact such factors may bring about.

For the three months ended October 31, 2017, the Company reported net revenue of \$102.5 million, operating loss of \$3.8 million, loss before income taxes of \$4.4 million and net loss of \$5.2 million. For the three months ended October 31, 2016, the Company reported net revenue of \$121.3 million, operating loss of \$5.6 million, loss before income taxes of \$8.0 million and net loss of \$8.5 million. At October 31, 2017, we had cash and cash equivalents of \$119.8 million, and working capital of \$109.2 million.

***Basis of Presentation***

The Company presents its financial information in accordance with accounting principles generally accepted in the United States, U.S. GAAP (or GAAP ). The Company has four operating segments: Americas; Asia; Europe and e-Business. The Company has four reportable segments: Americas; Asia; Europe; and e-Business. The Company also has Corporate-level activity, which consists primarily of costs associated with certain corporate administrative functions such as legal and finance which are not allocated to the Company's reportable segments and administration costs related to the Company's venture capital activities. The corporate-level balance sheet information includes cash and cash equivalents, trading securities, notes payable and other assets and liabilities which are not identifiable to the operations of the Company's operating segments.

All significant intercompany transactions and balances have been eliminated in consolidation.



Edgar Filing: ModusLink Global Solutions Inc - Form 10-Q

e-Business	5,393	93.3%	6,320	85.5%	(927)	(14.7%)
<b>Total</b>	<b>\$ 93,448</b>	<b>91.1%</b>	<b>\$ 111,994</b>	<b>92.3%</b>	<b>\$ (18,546)</b>	<b>(16.6%)</b>

Cost of revenue consists primarily of expenses related to the cost of materials purchased in connection with the provision of supply chain management services as well as costs for salaries and benefits, contract labor, consulting, fulfillment, shipping and applicable facilities costs. Cost of revenue and net revenue for the three months ended October 31, 2017 included materials procured on behalf of our clients of \$60.6 million, as compared to \$68.9 million for the same period in the prior year, a decrease of \$8.3 million. Total cost of revenue decreased by \$18.5 million for the three months ended October 31, 2017, as compared to the three months ended October 31, 2016, primarily due to lower material and labor costs associated with lower volume from clients in the consumer electronics and consumer products industries. Gross margin percentage for the current quarter increased to 8.9% from 7.7% in the prior year quarter, primarily due to a reduction in labor and facility costs related to the Company's turnaround initiatives. The Company's continued focus on operational enhancements coupled with improved productivity had a positive impact on the supply chain management and expenses related to cost of revenue. For the three months ended October 31, 2017, the Company's gross margin percentages within the Americas, Asia and Europe regions were -3.1%, 19.5% and 1.7%, as compared to -3.5%, 16.9% and 4.3%, respectively, for the same period of the prior year. Fluctuations in foreign currency exchange rates had an insignificant impact on gross margin for the quarter ended October 31, 2017.

**Table of Contents**

In the Americas, the 0.4 percentage point improvement in gross margin, from 3.5% to 3.1%, was primarily due to declines in material costs and a reduction in force, offset by a corresponding unfavorable shift in volumes from clients in the consumer electronics and consumer products industries. In Asia, the 2.6 percentage point increase in gross margin, from 16.9% to 19.5%, was primarily the result of a favorable revenue mix associated with clients in the computing and consumer electronics markets and improved efficiencies. In Europe, the 2.6 percentage point decrease in gross margin, from 4.3% to 1.7%, was attributable to an unfavorable revenue mix associated with clients in the consumer electronics market. The gross margin for e-Business was 6.7% for the three months ended October 31, 2017 as compared to 14.5% for the same period of the prior year. This decrease of 7.8 percentage points was due to an unfavorable revenue mix primarily associated with clients in the consumer products and computing industries. The Company was able to improve overall gross margins, despite the decline in margins in Europe and e-Business, primarily due to a reduction in force, improved efficiencies, and other cost reductions related to the Company's turnaround plan.

**Selling, General and Administrative Expenses:**

	<b>Three Months Ended October 31, 2017</b>	<b>As a % of Segment Net Revenue</b>	<b>Three Months Ended October 31, 2016</b>	<b>As a % of Segment Net Revenue</b>	<b>\$ Change</b>	<b>% Change</b>
	<b>(In thousands)</b>					
Americas	\$ 1,709	11.5%	\$ 2,649	10.2%	\$ (940)	(35.5%)
Asia	4,317	9.9%	4,958	11.6%	(641)	(12.9%)
Europe	3,520	9.2%	3,974	8.8%	(454)	(11.4%)
e-Business	1,826	31.6%	704	9.5%	1,122	159.4%
Sub-total	11,372	11.1%	12,285	10.1%	(913)	(7.4%)
Corporate-level activity	1,495		1,316		179	13.6%
<b>Total</b>	<b>\$ 12,867</b>	<b>12.6%</b>	<b>\$ 13,601</b>	<b>11.2%</b>	<b>\$ (734)</b>	<b>(5.4%)</b>

Selling, general and administrative expenses consist primarily of compensation and employee-related costs, sales commissions and incentive plans, information technology expenses, travel expenses, facilities costs, consulting fees, certain strategic costs, fees for professional services, depreciation expense and marketing expenses. Selling, general and administrative expenses during the three months ended October 31, 2017 decreased by approximately \$0.7 million compared to the same period in the prior year. This decrease was primarily due to lower employee related costs (\$0.5 million) associated with the Company's ongoing restructuring efforts, lower costs associated with outsourced services, consulting and professional fees (\$0.4 million), partially offset by an increase in other selling, general and administrative costs (\$0.2 million). Fluctuations in foreign currency exchange rates had an insignificant impact on selling, general and administrative expenses for the quarter ended October 31, 2017.

**Restructuring, net:**

	<b>Three Months Ended</b>	<b>As a % of Segment</b>	<b>Three Months Ended</b>	<b>As a % of Segment</b>	<b>\$ Change</b>	<b>% Change</b>
--	---------------------------	--------------------------	---------------------------	--------------------------	------------------	-----------------

	<b>October 31, 2017</b>	<b>Net Revenue</b>	<b>October 31, 2016</b>	<b>Net Revenue</b>		
					<b>(In thousands)</b>	
Americas	\$ 27	0.2%	\$ 297	1.1%	\$ (270)	(90.9%)
Asia	1	0.0%	509	1.2%	(508)	(99.8%)
Europe	2	0.0%	541	1.2%	(539)	(99.6%)
e-Business	7	0.1%	27	0.4%	(20)	(74.1%)
<b>Total</b>	<b>\$ 37</b>	<b>0.0%</b>	<b>\$ 1,374</b>	<b>1.1%</b>	<b>\$ (1,337)</b>	<b>(97.3%)</b>

The Company had an immaterial amount of restructuring activity during the three months ended October 31, 2017. The \$1.4 million restructuring charge recorded during the three months ended October 31, 2016 primarily consisted of \$0.2 million, \$0.4 million and \$0.5 million of employee-related costs in the Americas, Asia and Europe, respectively, related to the workforce reduction of 50 employees in our global supply chain. Of this amount, \$0.3 million related to contractual obligations.

## **Table of Contents**

### ***Interest Income/Expense:***

During the three months ended October 31, 2017 and 2016, interest income was \$0.2 million for both periods.

During the three months ended October 31, 2017 and 2016, interest expense was \$2.1 million and \$2.0 million, respectively. The interest expense primarily relates to the Company's issuance of the Notes during the third quarter of fiscal year 2014.

### ***Other Gains (Losses), net:***

The Company recorded foreign exchange losses of approximately \$(0.6) million during the three months ended October 31, 2017. For the three months ended October 31, 2017, the net losses primarily related to realized and unrealized losses from foreign currency exposures and settled transactions of approximately \$(0.4) million and \$(0.3) million in Asia and Europe, respectively. The Company recorded foreign exchange gains of approximately \$0.4 million during the three months ended October 31, 2016. For the three months ended October 31, 2016, the net gains primarily related to realized and unrealized gains (losses) from foreign currency exposures and settled transactions of approximately \$0.7 million and \$(0.2) million in the Corporate and Europe, respectively.

During the three months ended October 31, 2017 and 2016, the Company recognized \$2.7 million and \$0.9 million in net non-cash losses, respectively, associated with its Trading Securities. During the three months ended October 31, 2017, the Company recognized \$4.6 million in net cash gains associated with its Trading Securities.

### ***Income Tax Expense:***

During the three months ended October 31, 2017, the Company recorded income tax expense of approximately \$1.1 million, as compared to income tax expense of \$1.0 million for the same period in the prior fiscal year. For the three months ended October 31, 2017 and 2016, the Company was profitable in certain jurisdictions where the Company operates, resulting in an income tax expense using the enacted tax rates in those jurisdictions.

The Company provides for income tax expense related to federal, state, and foreign income taxes. The Company continues to maintain a full valuation allowance against its deferred tax assets in the U.S. and certain of its foreign subsidiaries due to the uncertainty of realizing such benefits.

### ***Liquidity and Capital Resources***

Historically, the Company has financed its operations and met its capital requirements primarily through funds generated from operations, the sale of our securities and borrowings from lending institutions. As of October 31, 2017, the Company had available cash and cash equivalents of \$119.8 million. As of October 31, 2017, the Company had approximately \$16.8 million of cash and cash equivalents held outside of the U.S. Of this amount, approximately \$5.2 million is considered permanently invested due to certain restrictions under local laws, and \$11.6 million is not subject to permanent reinvestment. Due to the Company's U.S. net operating loss carryforward there is no U.S. tax payable upon repatriating the undistributed earnings of foreign subsidiaries considered not subject to permanent investment. Foreign withholding taxes would range from 0% to 10% on any repatriated funds.

On June 30, 2014, two direct and wholly owned subsidiaries of the Company (the Borrowers) entered into a revolving credit and security agreement (the Credit Agreement), as borrowers and guarantors, with PNC Bank and National Association, as lender and as agent, respectively. The Credit Agreement has a five (5) year term which expires on June 30, 2019. It includes a maximum credit commitment of \$50.0 million, is available for letters of credit (with a



sublimit of \$5.0 million) and has a \$20.0 million uncommitted accordion feature. The actual maximum credit available under the Credit Agreement varies from time to time and is determined by calculating the applicable borrowing base, which is based upon applicable percentages of the values of eligible accounts receivable and eligible inventory minus reserves determined by the Agent (including other reserves that the Agent may establish from time to time in its permitted discretion), all as specified in the Credit Agreement. During the three months ended October 31, 2017, the Company did not meet the criteria that would cause its financial covenants to be effective. As of October 31, 2017 and July 31, 2017, the Company did not have any balance outstanding on the Credit Agreement.

---

**Table of Contents**

On March 18, 2014, the Company entered into an indenture (the "Indenture") with Wells Fargo Bank, National Association, as trustee (the "Trustee"), relating to the Company's issuance of \$100 million of 5.25% Convertible Senior Notes (the "Notes"). The Notes bear interest at the rate of 5.25% per year, payable semi-annually in arrears on March 1 and September 1 of each year, beginning on September 1, 2014. The Notes will mature on March 1, 2019, unless earlier repurchased by the Company or converted by the holder in accordance with their terms prior to such maturity date. Holders of the Notes may convert all or any portion of their notes, in multiples of \$1,000 principal amount, at their option at any time prior to the close of business or the business day immediately preceding the maturity date. Each \$1,000 of principal of the Notes will initially be convertible into 166.2593 shares of our common stock, which is equivalent to an initial conversion price of approximately \$6.01 per share, subject to adjustment upon the occurrence of certain events, or, if the Company obtains the required consent from its stockholders, into shares of the Company's common stock, cash or a combination of cash and shares of its common stock, at the Company's election. If the Company has received stockholder approval, and it elects to settle conversions through the payment of cash or payment or delivery of a combination of cash and shares, the Company's conversion obligation will be based on the volume weighted average prices ("VWAP") of its common stock for each VWAP trading day in a 40 VWAP trading day observation period. The Notes and any of the shares of common stock issuable upon conversion have not been registered. Holders will have the right to require the Company to repurchase their Notes, at a repurchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest, upon the occurrence of certain fundamental changes, subject to certain conditions. No fundamental changes occurred during the three months ended October 31, 2017. The Company may not redeem the Notes prior to the maturity date, and no sinking fund is provided for the Notes. The Company will have the right to elect to cause the mandatory conversion of the Notes in whole, and not in part, at any time on or after March 6, 2017, if the last reported sale price of its common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including the trading day immediately preceding the date on which the Company notifies holders of its election to mandatorily convert the Notes, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which the Company notifies holders of its election to mandatorily convert the notes. The repurchase of Notes by the Company is discussed in the Company's Annual Report on Form 10-K for the year ended July 31, 2017. As of October 31, 2017 and July 31, 2017, the net carrying value of the Notes was \$60.9 million and \$59.8 million, respectively. As of October 31, 2017 and July 31, 2017, the principal amount of the Notes was \$67.6 million.

Consolidated working capital was \$109.2 million at October 31, 2017, compared with \$108.7 million at July 31, 2017. Included in working capital were cash and cash equivalents of \$119.8 million at October 31, 2017 and \$110.7 million at July 31, 2017.

Net cash used in operating activities improved significantly for the three months ended October 31, 2017, as compared to the three months ended October 31, 2016. Net cash used in operating activities was \$6.6 million for the three months ended October 31, 2017, as compared to \$29.8 million in the prior year period. The \$23.2 million decrease in the net cash used in operating activities as compared with the same period in the prior year was primarily due to the improved impact in the balances of trade accounts receivable and net inventories compared to the prior year. During the three months ended October 31, 2017, non-cash items within net cash used in operating activities included depreciation expense of \$1.9 million, amortization of deferred financing costs of \$0.2 million, accretion of debt discount of \$1.0 million, share-based compensation of \$0.3 million, non-cash gains, net, of \$1.4 million and gains on investments in affiliates and impairments of \$0.2 million. During the three months ended October 31, 2016, non-cash items within net cash used in operating activities included depreciation expense of \$2.0 million, amortization of deferred financing costs of \$0.2 million, accretion of debt discount of \$0.9 million, share-based compensation of \$0.2 million, non-cash losses, net, of \$0.5 million and gains on investments in affiliates and impairments of \$0.5 million.

The Company believes that its cash flows related to operating activities of continuing operations are dependent on several factors, including profitability, accounts receivable collections, effective inventory management practices, and optimization of the credit terms of certain vendors of the Company. Our cash flows from operations are also dependent on several factors including the overall performance of the technology sector and the market for outsourcing services, as discussed above in the Overview section.

Investing activities provided (used) cash of \$15.8 million and \$(0.4) million during the three months ended October 31, 2017 and 2016, respectively. The \$15.8 million of cash provided by investing activities during the three months ended October 31, 2017 was comprised of \$13.8 million in proceeds from the sale of Trading Securities, \$4.2 million of proceeds from the disposition of property and equipment primarily related to the sale of the Company's Kildare, Ireland building, offset by \$2.5 million in capital expenditures. The \$0.4 million of cash used in investing activities during the three months ended October 31, 2016 was comprised of \$1.8 million in capital expenditures and \$0.9 million in proceeds from the sale of Trading Securities.

Financing activities used cash of \$0.1 million during the three months ended October 31, 2017 and primarily related to payments on capital lease obligations. Financing activities provided cash of \$4.9 million during the three months ended October 31, 2016 and primarily related to \$5.0 in net proceeds and payments associated with the Company's line of credit.

## **Table of Contents**

The Company believes it has access to adequate resources to meet its needs for normal operating costs, capital expenditures, mandatory debt redemptions and working capital for its existing business for at least the next twelve months. These resources include cash and cash equivalents, the PNC Credit Agreement noted above and cash, if any, provided by operating activities. At October 31, 2017 and July 31, 2017, the Company had cash and cash equivalents and Trading Securities of \$119.8 million and \$122.6 million, respectively. At October 31, 2017 and July 31, 2017, the Company had a readily available borrowing capacity under its PNC Bank Credit Facility of \$16.2 million and \$16.0 million, respectively. In order to obtain funding for strategic initiatives, which may include capital expenditures or acquisitions, we may seek to raise additional funds through divestitures, public or private equity offerings, debt financings, or other means. In addition, as part of our strategic initiatives, our management may seek to retire or purchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise if we believe that it is in our best interests. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

Management is utilizing the following strategies to continue to enhance liquidity: (1) continuing to implement process improvements throughout all of the Company's operations, (2) supporting profitable revenue growth both internally and potentially through acquisitions and (3) evaluating from time to time and as appropriate, strategic alternatives with respect to its businesses and/or assets and capital raising opportunities. The Company continues to examine all of its options and strategies, including acquisitions, divestitures and other corporate transactions, to increase cash flow and stockholder value.

### ***Off-Balance Sheet Arrangements***

The Company does not have any significant off-balance sheet arrangements.

### ***Contractual Obligations***

A summary of the Company's contractual obligations is included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2017. The Company's contractual obligations and other commercial commitments did not change materially between July 31, 2017 and October 31, 2017. The Company's gross liability for unrecognized tax benefits and related accrued interest was approximately \$0.7 million as of October 31, 2017. The Company is unable to reasonably estimate the amount or timing of payments for the liability.

From time to time, the Company agrees to indemnify its clients in the ordinary course of business. Typically, the Company agrees to indemnify its clients for losses caused by the Company. As of October 31, 2017, the Company had no recorded liabilities with respect to these arrangements.

### ***Critical Accounting Policies***

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, inventory, restructuring, share-based compensation expense, long-lived assets, investments, and income taxes. Of the accounting estimates we routinely make relating to our critical accounting policies, those estimates made in the process of: determining the valuation of inventory and related reserves; determining future lease assumptions related to restructured facility lease

obligations; measuring share-based compensation expense; preparing investment valuations; and establishing income tax valuation allowances and liabilities are the estimates most likely to have a material impact on our financial position and results of operations. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. However, because these estimates inherently involve judgments and uncertainties, there can be no assurance that actual results will not differ materially from those estimates.

During the three months ended October 31, 2017, we believe that there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in the Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

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

The Company is exposed to the impact of interest rate changes, foreign currency exchange rate fluctuations and changes in the market values of its investments. The carrying values of financial instruments including cash and cash equivalents, trading securities, accounts receivable, accounts payable and the revolving line of credit, approximate fair value because of the short-term nature of these instruments. The carrying value of capital lease obligations approximates fair value, as estimated by using discounted future cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

## **Table of Contents**

### ***Interest Rate Risk***

As of October 31, 2017 and July 31, 2017, the Company did not have an outstanding balance on the PNC Bank credit facility.

The Company maintains a portfolio of highly liquid cash equivalents typically maturing in three months or less as of the date of purchase. We place our investments in instruments that meet high credit quality standards, as specified in our investment policy and include corporate and state municipal obligations such as commercial paper, certificates of deposit and institutional money market funds.

Our exposure to market risk for changes in interest rates relates primarily to our investment in short-term investments. Our short-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to our investment guidelines and market conditions.

### ***Foreign Currency Risk***

The Company has operations in various countries and currencies throughout the world and its operating results and financial position are subject to exposure from fluctuations in foreign currency exchange rates. From time to time, the Company has used derivative financial instruments on a limited basis, principally foreign currency exchange rate contracts, to minimize the transaction exposure that results from such fluctuations. As of October 31, 2017 and July 31, 2017, there were no foreign currency forward contracts outstanding.

Revenues from our foreign operating segments accounted for approximately 79.8% and 72.5% of total revenues during the three months ended October 31, 2017 and 2016, respectively. A portion of our international sales made by our foreign business units in their respective countries is denominated in the local currency of each country. These business units also incur a portion of their expenses in the local currency.

The primary foreign currencies in which the Company operates include Chinese Renminbi, Euros, Czech Koruna and Singapore Dollars. The income statements of our international operations that are denominated in foreign currencies are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions results in increased revenues and operating expenses for our international operations. Similarly, our revenues and operating expenses will decrease for our international operations when the U.S. dollar strengthens against foreign currencies. While we attempt to balance local currency revenue to local currency expenses to provide in effect a natural hedge, it is not always possible to completely reduce the foreign currency exchange rate risk due to competitive and other reasons.

The conversion of the foreign subsidiaries' financial statements into U.S. dollars will lead to a translation gain or loss which is recorded as a component of other comprehensive income (loss). For the three months ended October 31, 2017 and 2016, we recorded a foreign currency translation gain (loss) of approximately \$0.3 million and \$(1.3) million, respectively, which is recorded within accumulated other comprehensive income in stockholders' equity in our condensed consolidated balance sheet. In addition, certain of our subsidiaries have assets and liabilities that are denominated in currencies other than the relevant entity's functional currency. Changes in the relative exchange rates between the currencies result in remeasurement gains or losses at each balance sheet date and transaction gains or losses upon settlement. For the three months ended October 31, 2017 and 2016, we recorded net realized and unrealized foreign currency transaction and remeasurement gains (losses) of approximately \$(0.6) million and \$0.4 million, respectively, which are recorded in Other gains (losses), net in our condensed consolidated statements of

operations.

Our international business is subject to risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign currency exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. As exchange rates vary, our international financial results may vary from expectations and adversely impact our overall operating results.

---

**Table of Contents****Item 4. Controls and Procedures.***Evaluation of Disclosure Controls and Procedures*

At the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Disclosure controls and procedures means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of October 31, 2017 because of the material weakness in internal control over financial reporting discussed below.

*Management's Report on Internal Control Over Financial Reporting*

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of its financial reporting and the preparation of its financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision of and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the criteria in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based upon that evaluation, management identified a material weakness in the Company's internal control over financial reporting in the prior fiscal year. Because of the material weakness described below, despite significant Audit Committee oversight, management involvement and the engagement of a nationally recognized accounting firm, management concluded that we did not maintain effective internal control over financial reporting in one area, as of October 31, 2017, based on the criteria established by



COSO.

A material weakness is a control deficiency, or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement to the annual or interim financial statements will not be prevented or detected on a timely basis. In its evaluation of the effectiveness of its internal control over financial reporting as of October 31, 2017, management identified that the Company did not maintain effective internal controls over the financial statement close process for the Company's e-Business operating segment.

Notwithstanding the identified material weakness, management believes the consolidated financial statements included in this Quarterly Report on Form 10-Q fairly represent in all material respects our financial condition, results of operations and cash flows at and for the periods presented in accordance with U.S. GAAP.

**Table of Contents**

*Remediation of the Material Weakness in Internal Control Over Financial Reporting*

Management has been actively engaged in the planning for, and implementation of, remediation efforts to address the material weakness throughout the fiscal year 2017 and 2018. These remediation efforts, outlined below, are intended both to address the identified material weakness and to enhance the Company's overall financial control environment.

Management has enhanced the formality and rigor of the reconciliation procedures and the evaluation of certain accounts and transactions, controls, including access controls. This deficiency was not effectively remediated during the three months ended October 31, 2017 primarily due to the number of access rights, segregation of duties and review controls not sufficiently documented for a sufficient period of time, primarily within the e-Business segment.

Management has enhanced the design and precision level of existing monitoring controls to provide additional controls supporting the reporting process.

A significant amount of remediation was performed in implementing additional policies, improved processes and documented procedures relating to our financial statement close processes and procedures within the e-Business and Americas segments.

We will continue to engage a nationally recognized accounting firm to provide assistance and guidance in designing, implementing and testing the Company's internal controls during the year.

Under the direction of the Audit Committee, management will continue to review and make necessary changes to the overall design of the Company's internal control environment, as well as policies and procedures to improve the overall effectiveness of internal control over financial reporting.

Management believes the measures described above and others that will be implemented will remediate the control deficiencies the Company has identified and strengthen its internal control over financial reporting. Management is committed to continuous improvement of the Company's internal control processes and will continue to diligently review the Company's financial reporting controls and procedures. The material weakness in our internal control over financial reporting will not be considered remediated until the remediated controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. We are working to have the material weakness remediated as soon as possible and significant progress has been made to date. We are committed to continuing to improve our internal control processes and will continue to diligently and vigorously review our financial reporting controls and procedures. As management continues to evaluate and work to improve internal control over financial reporting, the Company may decide to take additional measures to address control deficiencies or decide to modify, or in appropriate circumstances not to complete, certain of the remediation measures described above.

*Changes in Internal Control over Financial Reporting*

Other than the changes resulting from the remediation activities described above, there have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the quarter ended October 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over

financial reporting.

## **PART II. OTHER INFORMATION**

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

On May 12, 2017, the Excise Tax Branch of the Internal Revenue Service (the IRS) initiated a claim associated with the Company's compliance with the self-assessment of excise tax on Ozone Depleting Chemicals. The Company has objected to the IRS assessments on a number of technical and substantive grounds, and plans to vigorously defend itself against the claim. Currently the Company is unable to determine the probability of an unfavorable outcome or a range of outcomes. Accordingly, the Company has not recorded a reserve associated with this matter.

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

There have not been any material changes from the risk factors previously disclosed in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended July 31, 2017. In addition to the other information set forth in this report, you should carefully consider the risks and uncertainties discussed in Part I, Item 1A. Risk Factors discussed in our Annual Report, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be not material also may materially and adversely affect our business, financial condition and/or operating results.

**Table of Contents**

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

None.

**Item 3. Default Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

**Exhibit**

<b>Number</b>	<b>Description</b>
10.1	<u>Form of Restricted Stock Unit Agreement Granted Under 2010 Incentive Award Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 5, 2017 (File No. 001-35319)).</u>
10.2	<u>Third Amendment to Management Services Agreement, effective as of September 1, 2017, by and between Steel Services Ltd. and ModusLink Global Solutions, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 29, 2017 (File No. 001-35319)).</u>
31.1*	<u>Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2*	<u>Certification of the Principal Financial Officer and Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1±	<u>Certification of the Principal Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2±	<u>Certification of the Principal Financial Officer and Principal Accounting Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101*	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Unaudited Condensed Consolidated Balance Sheets as of October 31, 2017 and July 31, 2017, (ii) Unaudited Condensed Consolidated Statements of Operations for the Three Months ended October 31, 2017 and 2016, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three Months ended October 31, 2017 and 2016 (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the Three Months ended October 31, 2017 and 2016 and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

- \* Filed herewith.
- ± Furnished herewith.

Table of Contents

**SIGNATURE**

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.

MODUSLINK GLOBAL SOLUTIONS, INC.

Date: December 7, 2017

By: **/S/ LOUIS J. BELARDI**  
**Louis J. Belardi**  
**Principal Financial Officer**

**and Principal Accounting Officer**