

**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 September 30, 2019

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: 001-16073

Great Elm Capital Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

800 South Street, Suite 230, Waltham MA

(Address of principal executive offices)

94-3219054

(I.R.S. Employer Identification No.)

02453

(Zip Code)

(617) 375-3006

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, par value \$0.001 per share

Trading Symbol(s)
GEC

Name of each exchange on which registered

**The Nasdaq Stock Market LLC
(Nasdaq Global Select Market)
Nasdaq Global Select Market
Nasdaq Global Select Market**

**Preferred Stock Purchase Rights
Units, par value \$0.001 per share**

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 every Interactive Data File required to be submitted 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 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

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 6, 2019, there were 25,392,337 shares of the registrant's common stock outstanding

Table of Contents

| | |
|--|----|
| <u>PART I. FINANCIAL INFORMATION</u> | 3 |
| Item 1. <u>Financial Statements</u> | 3 |
| <u>Unaudited Condensed Consolidated Balance Sheets as of September 30, 2019 and June 30, 2019</u> | 3 |
| <u>Unaudited Condensed Consolidated Statements of Operations for the three months ended September 30, 2019 and 2018</u> | 4 |
| <u>Unaudited Condensed Consolidated Statement of Stockholders' Equity and Contingently Redeemable Non-Controlling Interest for the three months ended September 30, 2019</u> | 5 |
| <u>Unaudited Condensed Consolidated Statement of Stockholders' Equity and Contingently Redeemable Non-Controlling Interest for the three months ended September 30, 2018</u> | 6 |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2019 and 2018</u> | 7 |
| <u>Unaudited Notes to Condensed Consolidated Financial Statements</u> | 9 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 38 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 47 |
| Item 4. <u>Controls and Procedures</u> | 47 |
| <u>PART II. OTHER INFORMATION</u> | 48 |
| Item 1. <u>Legal Proceedings</u> | 48 |
| Item 1A. <u>Risk Factors</u> | 48 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 48 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 48 |
| Item 4. <u>Mine Safety Disclosures</u> | 48 |
| Item 5. <u>Other Information</u> | 48 |
| Item 6. <u>Exhibits</u> | 49 |
| <u>SIGNATURES</u> | 50 |

Unless the context otherwise requires, “we”, “us”, “our”, “GEC”, the “Company” and terms of similar import refer to Great Elm Capital Group, Inc. and/or its subsidiaries. Our corporate website address is www.greatelmcap.com. The information contained in, or accessible through, our corporate website does not constitute part of this report.

Cautionary Statement Regarding Forward-Looking Information

This report and certain information incorporated herein by reference, contain forward-looking statements under the Private Securities Litigation Reform Act of 1995. Such statements often include words such as “may,” “will,” “should,” “believe,” “expect,” “seek,” “anticipate,” “intend,” “estimate,” “plan,” “target,” “project,” “forecast,” “envision” and other similar phrases. Although we believe the assumptions and expectations reflected in these forward-looking statements are reasonable, these assumptions and expectations may not prove to be correct and we may not achieve the financial results or benefits anticipated. These forward-looking statements are not guarantees of actual results. Our actual results may differ materially from those suggested in the forward-looking statements. These forward-looking statements involve a number of risks and uncertainties, some of which are beyond our control, including, without limitation:

- our ability to profitably manage Great Elm Capital Corp. (NASDAQ: **GECC**), a business development company that we manage through our investment management business;
- the dividend rate that GECC will pay;
- our ability to continue to develop and grow our durable medical equipment, investment management and real estate businesses;
- our ability to raise capital to fund our business plan;
- our ability to make acquisitions and manage any businesses we may acquire;
- conditions in the equity capital markets and debt capital markets as well as the economy generally;
- our ability to maintain the security of electronic and other confidential information;
- serious disruptions and catastrophic events;
- competition, mostly from larger, well-financed organizations (both domestic and foreign), including operating companies, global asset managers, investment banks, commercial banks, and private equity funds;
- outcomes of litigation and proceedings and the availability of insurance, indemnification and other third-party coverage of any losses suffered in connection therewith;
- maintaining our contractual arrangements and relationships with third parties;
- our ability to attract, assimilate and retain key personnel;
- compliance with laws, regulations and orders;
- changes in laws and regulations governing our operations; and
- other factors described in our Annual Report on Form 10-K for the fiscal year ended June 30, 2019 under “Risk Factors” or as set forth from time to time in our Securities and Exchange Commission (SEC) filings.

These forward-looking statements speak only as of the time of filing of this report and we do not undertake to update or revise them as more information becomes available. You are cautioned not to place undue reliance on these forward-looking statements. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect future events or circumstances or to reflect the occurrence of unanticipated events.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

Great Elm Capital Group, Inc.

Condensed Consolidated Balance Sheets (Unaudited)

Dollar amounts in thousands (except per share data)

| <u>ASSETS</u> | <u>September 30, 2019</u> | <u>June 30, 2019</u> |
|--|---------------------------|----------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 10,102 | \$ 12,122 |
| Restricted cash | 753 | 708 |
| Accounts receivable | 8,442 | 8,832 |
| Related party receivables | 1,340 | 1,421 |
| Investments, at fair value (cost \$30,000) | 16,127 | 17,110 |
| Inventories | 1,544 | 1,336 |
| Prepaid and other current assets | 728 | 871 |
| Total current assets | 39,036 | 42,400 |
| Real estate assets, net | 54,105 | 54,411 |
| Property and equipment, net | 1,225 | 1,367 |
| Equipment held for rental, net | 9,017 | 9,140 |
| Identifiable intangible assets, net | 16,857 | 17,576 |
| Goodwill | 50,433 | 50,397 |
| Right of use assets | 6,138 | 6,239 |
| Other assets | 1,328 | 1,196 |
| Total assets | \$ 178,139 | \$ 182,726 |
| <u>LIABILITIES, NON-CONTROLLING INTEREST AND STOCKHOLDERS' EQUITY</u> | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,638 | \$ 5,158 |
| Accrued expenses and other liabilities | 4,309 | 3,951 |
| Related party payables | 1,012 | 1,940 |
| Current portion of lease liabilities | 1,485 | 1,423 |
| Current portion of long term debt | 9,071 | 2,159 |
| Current portion of related party notes payable | 1,494 | 2,066 |
| Current portion of equipment financing debt | 1,664 | 1,371 |
| Total current liabilities | 24,673 | 18,068 |
| Lease liabilities, net of current portion | 4,935 | 5,110 |
| Long term debt, net of current portion | 53,911 | 61,635 |
| Related party notes payable, net of current portion | 27,934 | 28,302 |
| Equipment financing debt, net of current portion | 89 | 104 |
| Other liabilities | 588 | 513 |
| Total liabilities | 112,130 | 113,732 |
| Commitments and Contingencies | | |
| Contingently redeemable non-controlling interest | 3,832 | 3,912 |
| Stockholders' equity | | |
| Preferred stock, \$0.001 par value; 5,000 authorized and zero outstanding | - | - |
| Common stock, \$0.001 par value; 350,000,000 shares authorized and 26,115,600 shares issued and 25,382,503 outstanding at September 30, 2019; and 26,086,086 shares issued and 25,352,989 outstanding at June 30, 2019 | 25 | 25 |
| Additional paid-in-capital | 3,305,708 | 3,305,415 |
| Accumulated deficit | (3,247,463) | (3,244,374) |
| Total Great Elm Capital Group, Inc. stockholders' equity | 58,270 | 61,066 |
| Non-controlling interests | 3,907 | 4,016 |
| Total stockholders' equity | 62,177 | 65,082 |
| Total liabilities, non-controlling interest and stockholders' equity | \$ 178,139 | \$ 182,726 |

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

Great Elm Capital Group, Inc.
Condensed Consolidated Statements of Operations (Unaudited)
Dollar amounts in thousands (except per share data)

| | For the three months ended September 30, | |
|---|---|-------------------|
| | 2019 | 2018 |
| Revenues: | | |
| Durable medical equipment sales and services revenue | \$ 7,745 | \$ 2,784 |
| Durable medical equipment rental income | 5,486 | 1,307 |
| Investment management revenues | 867 | 940 |
| Real estate rental income | 1,273 | 1,442 |
| Total revenues | <u>15,371</u> | <u>6,473</u> |
| Operating costs and expenses: | | |
| Cost of durable medical equipment sold and services | 3,463 | 944 |
| Cost of durable medical equipment rentals (includes depreciation expense of \$2,051 and \$280 for the three months ended September 30, 2019 and 2018, respectively) | 2,265 | 290 |
| Durable medical equipment other operating expenses | 6,849 | 1,861 |
| Investment management expenses | 691 | 1,449 |
| Real estate expenses | 124 | 295 |
| Depreciation and amortization | 1,067 | 710 |
| Selling, general and administrative | 1,786 | 3,367 |
| Total operating costs and expenses | <u>16,245</u> | <u>8,916</u> |
| Operating loss | (874) | (2,443) |
| Dividends and interest income | 514 | 547 |
| Unrealized gain (loss) on investment in GECC | (983) | 905 |
| Interest expense | (1,696) | (995) |
| Other income, net | 3 | 45 |
| Loss from continuing operations, before income taxes | (3,036) | (1,941) |
| Income tax expense | (242) | - |
| Loss from continuing operations | <u>(3,278)</u> | <u>(1,941)</u> |
| Discontinued operations: | | |
| Loss from discontinued operations, net of tax | - | (68) |
| Net loss | <u>\$ (3,278)</u> | <u>\$ (2,009)</u> |
| Less: net income (loss) attributable to non-controlling interest | (189) | (5) |
| Net income (loss) attributable to Great Elm Capital Group | <u>\$ (3,089)</u> | <u>\$ (2,004)</u> |
| Basic income (loss) per share | | |
| Continuing operations | \$ (0.12) | \$ (0.08) |
| Discontinued operations | - | - |
| Net income (loss) | <u>\$ (0.12)</u> | <u>\$ (0.08)</u> |
| Diluted income (loss) per share from: | | |
| Continuing operations | \$ (0.12) | \$ (0.08) |
| Discontinued operations | - | - |
| Net income (loss) | <u>\$ (0.12)</u> | <u>\$ (0.08)</u> |
| Weighted average shares outstanding | | |
| Basic | 25,373 | 25,054 |
| Diluted | 25,373 | 25,054 |

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

Great Elm Capital Group, Inc.

Condensed Consolidated Statements of Stockholders' Equity and Contingently Redeemable Non-controlling Interest (Unaudited)

Dollar and share amounts in thousands

| | Common Stock | | Additional | Accumulated | Total Great | Non- | Total | Contingently |
|---|--------------|--------|-------------|----------------|---------------|-------------|---------------|--------------|
| | Shares | Amount | Paid-in | Deficit | Elm Capital | controlling | Stockholders' | Redeemable |
| | | | Capital | | Group Inc. | Interest | Equity | Non- |
| | | | | | Stockholders' | | | controlling |
| | | | | | Equity | | | Interest |
| BALANCE, June 30, 2019 | 25,353 | \$ 25 | \$3,305,415 | \$ (3,244,374) | \$ 61,066 | \$ 4,016 | \$ 65,082 | \$ 3,912 |
| Net income (loss) | - | - | - | (3,089) | (3,089) | (109) | (3,198) | (80) |
| Issuance of common stock related to vesting of restricted stock | 30 | 0 | 0 | - | 0 | - | 0 | - |
| Stock-based compensation | - | - | 293 | - | 293 | - | 293 | - |
| BALANCE, September 30, 2019 | 25,383 | 25 | 3,305,708 | (3,247,463) | 58,270 | 3,907 | 62,177 | 3,832 |

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

Great Elm Capital Group, Inc.

Condensed Consolidated Statements of Stockholders' Equity and Contingently Redeemable Non-controlling Interest (Unaudited)

Dollar and share amounts in thousands

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Total Great Elm Capital Group Inc. Stockholders' Equity | Non- controlling Interest | Total Stockholders' Equity | Contingently Redeemable Non- controlling Interest |
|--|--------------|--------|----------------------------------|------------------------|---|---------------------------------|----------------------------------|---|
| | Shares | Amount | | | | | | |
| BALANCE, June 30, 2018 | 24,719 | \$ 25 | \$3,302,886 | \$ (3,238,547) | \$ 64,364 | \$ 222 | \$ 64,586 | \$ - |
| Net income (loss) | - | - | - | (2,004) | (2,004) | (15) | (2,019) | 10 |
| Adoption of accounting standard | - | - | - | (2,919) | (2,919) | - | (2,919) | - |
| Acquisition of Great Elm DME, Inc. | - | - | - | - | - | 3,632 | 3,632 | 3,632 |
| Issuance of common stock related to warrants exercise | 420 | 0 | 1,409 | - | 1,409 | - | 1,409 | - |
| Issuance of common stock related to vesting of restricted stock | 4 | 0 | 0 | - | 0 | - | 0 | - |
| Stock-based compensation | - | - | 490 | - | 490 | - | 490 | - |
| BALANCE, September 30, 2018 | 25,143 | 25 | 3,304,785 | (3,243,470) | 61,340 | 3,840 | 65,180 | 3,642 |

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

Great Elm Capital Group, Inc.
Condensed Consolidated Statements of Cash Flows (Unaudited)
Dollar amounts in thousands

| | For the three months ended September 30, | |
|---|---|-------------|
| | 2019 | 2018 |
| Cash flows from operating activities: | | |
| Net loss | \$ (3,278) | \$ (2,009) |
| (Gain) loss from discontinued operations | - | 68 |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 3,118 | 990 |
| Stock-based compensation | 293 | 673 |
| Unrealized (gain) loss on investments | 983 | (905) |
| Non-cash interest and amortization of debt issuance costs | 234 | 194 |
| Deferred tax benefit related to continuing operations | - | - |
| Other non-cash expense, net | 294 | 34 |
| Gain on sale of equipment held for rental | (185) | - |
| Change in fair value of contingent consideration | (195) | - |
| Changes in operating assets and liabilities: | | |
| Related party receivable | 81 | 230 |
| Accounts receivable | 390 | (450) |
| Inventories | (208) | (152) |
| Prepaid assets, deposits, and other assets | (312) | (701) |
| Operating leases | (306) | (31) |
| Related party payable | (733) | 7 |
| Accounts payable, accrued liabilities and other liabilities | 945 | 1,699 |
| Net cash provided by (used in) operating activities - continuing operations | 1,121 | (353) |
| Net cash provided by (used in) operating activities - discontinued operations | - | (68) |
| Net cash provided by (used in) operating activities | 1,121 | (421) |
| Cash flows from investing activities: | | |
| Acquisition of business, net of cash acquired | - | (41,821) |
| Purchases of equipment held for rental | (2,078) | (401) |
| Proceeds from sale of equipment held for rental | 669 | - |
| Purchases of property and equipment | (17) | (37) |
| Proceeds from sale of property and equipment | 37 | - |
| Net cash used in investing activities - continuing operations | (1,389) | (42,259) |
| Net cash used in investing activities - discontinued operations | - | - |
| Net cash used in investing activities | (1,389) | (42,259) |

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

Great Elm Capital Group, Inc.
Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)
Dollar amounts in thousands

| | For the three months ended September 30, | |
|--|---|------------------|
| | 2019 | 2018 |
| Cash flows from financing activities: | | |
| Proceeds on revolving line of credit | - | 5,555 |
| Principal payments on revolving line of credit | (500) | - |
| Principal payments on long term debt | (524) | (485) |
| Proceeds from note payable to seller | - | 16,500 |
| Principal payments on related party notes payable | (961) | - |
| Principal payments on equipment financing | (580) | - |
| Proceeds from equipment financing | 858 | - |
| Debt financing costs | - | (430) |
| Proceeds from issuance of common stock, gross | - | 1,409 |
| Net cash provided by financing activities - continuing operations | (1,707) | 22,549 |
| Net cash provided by financing activities - discontinued operations | - | - |
| Net cash provided by financing activities | (1,707) | 22,549 |
| Net decrease in cash, cash equivalents and restricted cash | (1,975) | (20,131) |
| Cash, cash equivalents and restricted cash at beginning of year | 12,830 | 43,540 |
| Cash, cash equivalents and restricted cash at end of year | <u>\$ 10,855</u> | <u>\$ 23,409</u> |
| | | |
| Cash paid for interest | \$ 2,240 | \$ 471 |
| Non-cash investing and financing activities | | |
| Assumption of borrowings in connection with acquisition | \$ - | \$ 9,275 |
| Issuance of non-controlling interests in subsidiary in connection with acquisition | - | 7,265 |
| Preferred stock issued to seller in acquisition | - | 5,266 |
| Contingent consideration issued in connection with acquisition | - | 1,225 |
| Lease liabilities and right of use assets arising from operating leases | 198 | - |

The following table reconciles the amounts shown for cash and cash equivalents and restricted cash in the condensed consolidated balance sheets to the amounts shown for cash, cash equivalents and restricted cash in the condensed consolidated statements of cash flows.

| | September 30, 2019 | June 30, 2019 |
|--|---------------------------|----------------------|
| Cash and cash equivalents | 10,102 | 12,122 |
| Restricted cash | 753 | 708 |
| Cash, cash equivalents and restricted cash | <u>10,855</u> | <u>12,830</u> |

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

Great Elm Capital Group, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2019

1. Organization

Great Elm Capital Group, Inc. (the **Company**) is a holding company incorporated in Delaware. The Company currently has four operating segments: durable medical equipment, investment management, real estate and general corporate. The Company is pursuing business development opportunities in durable medical equipment, investment management, real estate and other industries.

On September 7, 2018, the Company, through its subsidiary, Great Elm DME Holdings, Inc. (**DME Holdings**), acquired an 80.1% equity interest in Great Elm DME, Inc. (**DME Inc.**) an entity formed to acquire and combine two companies Valley Healthcare Holding, LLC (**Valley**) and Northwest Medical, Inc. (**Northwest**), which both specialize in the distribution of respiratory care equipment, including primarily positive air pressure equipment and supplies, ventilators and oxygen equipment and operate in Arizona, Nebraska Oregon, Washington and Alaska. On June 12, 2019, the Company expanded its durable medical equipment business through the acquisition of certain assets and liabilities of Midwest Respiratory Care, Inc. (**Midwest**).

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. Wholly-owned subsidiaries include Great Elm Capital Management, Inc. (**GECM**), Great Elm Opportunities GP, Inc., Great Elm FM Acquisition, Inc., DME Holdings and Great Elm DME Manager, LLC. Majority-owned subsidiaries include GECC GP Corp., Great Elm FM Holdings, Inc., CRIC IT Fort Myers, LLC and DME Inc. and its seven wholly-owned subsidiaries.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and footnotes which are normally included in the Company's Form 10-K. These financial statements reflect all adjustments (consisting of normal recurring items or items discussed herein) that management believes are necessary to fairly state results for the interim periods presented. Results of operations for interim periods are not necessarily indicative of annual results of operations. The condensed consolidated balance sheet as of June 30, 2019, presented herein, has been derived from the Company's audited consolidated financial statements as of and for the year-ended June 30, 2019.

Use of Estimates

The preparation of these financial statements in accordance with accounting principles generally accepted in the United States of America (**US GAAP**) requires the Company to make estimates and assumptions that affect the reported amounts in the financial statements and disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates all of these estimates and assumptions. The most important of these estimates and assumptions relate to revenue recognition, recognition of rental income, estimates for contractual allowances, estimates for allowance for doubtful accounts, the valuation of excess and obsolete inventories, depreciable lives of equipment, impairment of long lived tangible and intangible assets, valuation allowance for deferred tax assets, fair value measurements including stock-based compensation and contingent consideration, estimates associated with the application of acquisition accounting, and the value of lease liabilities and corresponding right to use assets. Although these and other estimates and assumptions are based on the best available information, actual results could be different from these estimates.

Principles of Consolidation

The Company consolidates the assets, liabilities, and operating results of its wholly-owned subsidiaries; majority-owned subsidiaries; and subsidiaries in which we hold a controlling financial interest as of the financial statement date. In most cases, a controlling financial interest reflects ownership of a majority of the voting interests. We consolidate a variable interest entity (**VIE**) when we possess both the power to direct the activities of the VIE that most significantly impact its economic performance and we are either obligated to absorb the losses that could potentially be significant to the VIE or we hold the right to receive benefits from the VIE that could potentially be significant to the VIE.

All intercompany accounts and transactions have been eliminated in consolidation.

Non-controlling interests in the Company's subsidiaries are reported as a component of liabilities for mandatorily redeemable interests, temporary equity for contingently redeemable interests or permanent equity, separate from the Company's equity. See Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary. Results of operations attributable to the non-controlling interests are included in the Company's condensed consolidated statements of operations.

Segments

The Company has four operating segments: durable medical equipment, investment management, real estate and general corporate. The Company regularly reviews each segment for purposes of allocating resources and assessing performance.

Accounts receivable

Substantially all of the accounts receivable balance relates to the durable medical equipment business. Accounts receivable are customer obligations due under normal sales and rental terms and represent the amount estimated to be collected from the customers and, if applicable, the third-party private insurance provider or government program (collectively, **Payors**), based on the contractual agreements. The Company does not require collateral in connection with its customer transactions and aside from verifying insurance coverage, does not perform credit checks on patient customers. Revenue and accounts receivable have been constrained to the extent that billed amounts exceed the amounts estimated to be collected. The constrained transaction price relates primarily to expected billing adjustments with the Payors and patient customers. Management's evaluation of variable consideration takes into account such factors as past experience, information about specific receivables, Payors and patient customers. The revenue reserves related to constraints on variable consideration were \$4.3 million and \$3.4 million as of September 30, 2019 and June 30, 2019, respectively. During the three months ended September 30, 2019, the Company recognized a reduction to revenue of \$0.9 million related to such constraints. See Note 3 – Revenue.

The assessment of variable consideration to be constrained is based on estimates, and ultimate losses may vary from current estimates. As adjustments to these estimates become necessary, they are reported in earnings in the periods in which they become known. There were no material adjustments to revenues made in the three months ended September 30, 2019 relating to prior periods. Changes in constraints on variable consideration are recorded as a component of net revenues.

The Company generally does not allow returns from providers for reasons not covered under the manufacturer's standard warranty. Therefore, there is no provision for sales return reserves. The Company does not have significant bad debt experience with Payors, and therefore the allowance for doubtful accounts is immaterial.

As of September 30, 2019 and June 30, 2019, the Company had unbilled receivables of approximately \$1.6 million and \$0.7 million, respectively, that relate to transactions where the Company has the ultimate right to invoice a Payor under the terms of the arrangement. These unbilled amounts are included in accounts receivable in the condensed consolidated balance sheets.

Net Income (Loss) per Share

The following table presents the calculation of basic and diluted earnings (loss) per share:

| <i>(in thousands, except per share amounts)</i> | For the three months ended September 30, | |
|---|---|-------------|
| | 2019 | 2018 |
| Loss from continuing operations | \$ (3,278) | \$ (1,941) |
| Income (loss) from discontinued operations, net of tax | - | (68) |
| Net income (loss) | \$ (3,278) | \$ (2,009) |
| Less: net loss attributable to non-controlling interest | (189) | (5) |
| Net income (loss) attributable to Great Elm Capital Group | \$ (3,089) | \$ (2,004) |
| Weighted average shares basic and diluted: | | |
| Weighted average shares of common stock outstanding | 25,373 | 25,054 |
| Weighted average shares used in computing income (loss) per share | 25,373 | 25,054 |
| Basic and diluted income (loss) per share from: | | |
| Income (loss) from continuing operations | \$ (0.12) | \$ (0.08) |
| Income (loss) from discontinued operations | - | - |
| Net income (loss) | \$ (0.12) | \$ (0.08) |

As of September 30, 2019 and 2018, the Company had 3,290,624 and 3,439,497 potential shares of Company common stock issuable upon exercise of the stock options, respectively, that are not included in the diluted net loss per share calculations because to do so would be antidilutive.

As of September 30, 2019 and 2018, the Company had an aggregate of 732,909 issued shares and 761,617 issued shares, respectively, that are subject to forfeiture by the employee at a nominal price if service and performance milestones are not met. The Company does not account for such shares as being outstanding for accounting purposes since they are unvested and subject to forfeiture.

Restrictions on Subsidiary Dividends

In the GP Corp. Note Agreement, GECC GP Corp. agreed not to declare any dividends until the GP Corp. Note is satisfied. In the Senior Note and Subordinated Note, CRIC IT Fort Myers, LLC is restricted from paying any dividends until the Notes are satisfied. The ability of DME Inc. to pay dividends is subject to compliance with the restricted payment covenants under the Corbel Facility and DME Revolver.

Concentration of Risk

The Company's net investment revenue and receivables for the periods presented were attributable to the management of one investment vehicle, GECC, which is also a related party. See Note 5 – Related Party Transactions.

The Company's real estate rental revenue from continuing operations is derived from one tenant.

The Company's durable medical equipment revenue and related accounts receivable are concentrated with third-party Payors. For the three months ended September 30, 2019, two government program payors constituted approximately 28% and 6% of consolidated revenues, respectively. As of September 30, 2019, receivables from those government program payors constituted 20% and 11% of our ending accounts receivable, respectively. An additional third-party payor constituted another 11% of consolidated accounts receivable as of September 30, 2019.

Recently Issued Accounting Standards

Current Expected Credit Losses In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, which changes the impairment model for financial instruments, including trade receivables from an incurred loss method to a new forward looking approach, based on expected losses. The estimate of expected credit losses will require entities to incorporate considerations of historical experience, current information and reasonable and supportable forecasts. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is evaluating the potential impact that the adoption of this ASU will have on its consolidated financial statements.

Fair Value Measurements In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, resulting in various disclosures related to fair value measurements being eliminated, modified or supplemented. ASU 2018-13 is effective for interim and annual periods beginning after December 15, 2019, with an option to early adopt any eliminated or modified disclosures, and to delay adoption of the additional disclosures, until the effective date. The Company early adopted the eliminated and modified disclosures of ASU 2018-13 during the three months ended September 30, 2018 and, as a result, updated its financial statement disclosures accordingly. A modified narrative description of measurement uncertainty for level 3 fair value measurements was applied prospectively, with all other amendments applied retrospectively. The Company is evaluating the potential impact adopting the supplemental disclosures will have on its consolidated financial statements.

3. Revenue

The revenues from each major source of revenue are summarized in the following table:

| <i>(in thousands)</i> | For the three months ended September 30, | |
|---|--|-----------------|
| | 2019 | 2018 |
| Product and Services Revenue | | |
| <i>Investment Management</i> | | |
| Management Fees | \$ 758 | \$ 768 |
| Administration Fees | 109 | 172 |
| | <u>867</u> | <u>940</u> |
| <i>Durable Medical Equipment</i> | | |
| Equipment Sales | 6,361 | 2,300 |
| Service Revenues | 1,384 | 484 |
| | <u>7,745</u> | <u>2,784</u> |
| Total product and services revenue | \$ 8,612 | \$ 3,724 |
| Rental Revenues | | |
| <i>Real Estate</i> | | |
| Rental Income | 1,273 | 1,442 |
| <i>Durable Medical Equipment</i> | | |
| Medical Equipment Rental Income | 5,486 | 1,307 |
| Total rental revenue | 6,759 | 2,749 |
| Total | \$ 15,371 | \$ 6,473 |

Revenue Accounting Under Topic 606

In determining the appropriate amount of revenue to be recognized under Topic 606, the Company performed the following steps: (i) identified the promised goods or services in the contract; (ii) determined whether the promised goods or services are performance obligations including whether they are distinct in the context of the contract; (iii) measured the transaction price, including the constraint on variable consideration; (iv) allocated the transaction price to the performance obligations; and (v) recognized revenue when (or as) the Company satisfies each performance obligation.

Durable Medical Equipment Revenue

Equipment Sales and Services Revenues

The Company sells durable medical equipment, replacement parts and supplies to customers and recognizes revenue at the point control is transferred through delivery to the customer. Each piece of equipment, part or supply is distinct and separately priced thus they each represent a single performance obligation. The revenue is allocated amongst the performance obligations based upon the relative standalone selling price method, however, items are typically all delivered or supplied together. The customer and, if applicable, the Payors are generally charged at the time that the product is sold, although separate layers of insurance coverage may need to be invoiced before final billings may occur.

The Company also provides sleep study services to customers and recognizes revenue when the results of the sleep study are complete as that is when the performance obligation is met.

The transaction price on both equipment sales and sleep studies is the amount that the Company expects to receive in exchange for the goods and services provided. Due to the nature of the durable medical equipment business, billing adjustments customarily occur during the collections process when explanations of benefits are received by Payors, and as amounts are deferred to secondary Payors or to patient responsibility. As such, we constrain the transaction price for the difference between the gross charge and what we believe we will collect from Payors and from patients. The transaction price therefore is predominantly based on contractual payment rates determined by the Payors. The Company does not generally contract with uninsured customers. We determine our estimates of billing adjustments based upon contractual agreements, our policies and historical experience. While the rates are fixed for the product or service with the customer and the Payors, such amounts typically include co-payments, co-insurance and deductibles, which vary in amounts, from the patient customer. The Company includes in the transaction price only the amount that the Company expects to be entitled, which is substantially all of the Payor billings at contractual rates. The transaction price is initially constrained by the amount of customer co-payments we estimate will not be collected.

Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenue and accounts receivable. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain Payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application or claim denial. The Company constrains revenue for these estimated adjustments. There were no material changes in estimates recorded in the three months ended September 30, 2019, relating to prior periods.

The payment terms and conditions of customer contracts vary by customer type and the products and services offered.

The Company may provide shipping services prior to the point of delivery and has concluded that the services represent a fulfilment activity and not a performance obligation. Returns and refunds are not accepted on either equipment sales or sleep study services. The Company does not offer warranties to customers in excess of the manufacturer's warranty. Any taxes due upon sale of the products or services are not recognized as revenue. The Company does not incur contract acquisition costs. The Company does not have any partially or unfilled performance obligations related to contracts with customers. As such, the Company has no contract liabilities as of September 30, 2019 and June 30, 2019.

Included in sales and services revenue are unbilled amounts for which the revenue recognition criteria had been met as of period end but were not yet billed to the Payor. The estimate of net unbilled rental revenue recognized is based on historical trends and estimates of future collectability. As of September 30, 2019 and June 30, 2019, net unbilled sales and services revenue is approximately \$0.9 million and \$0.5 million, respectively, and is included in accounts receivable.

Investment Management Revenue

The Company recognizes revenue from its investment management business at amounts that reflect the consideration to which it expects to be entitled in exchange for providing services to its customer. Investment management revenue primarily consists of fees based on a percentage of assets under management; fees based on the performance of managed assets; and administrative fees; as follows:

Management Fees

The Company earns management fees based on the investment management agreement GECM has with GECC. The performance obligation is satisfied over time as the services are rendered, since GECC simultaneously receives and consumes the benefits provided as GECM performs services. Under GECC's investment management agreement with GECM, the base management fee from GECC is calculated at an annual rate of 1.50% of GECC's average adjusted gross assets. The base management fee is calculated based on the average value of GECC's gross assets, excluding cash and cash equivalents, at the end of the two most recently completed calendar quarters, and is recognized over time as the services are provided. Management fees are billed quarterly in arrears.

Incentive Fees

The Company earns incentive fees based on the investment management agreements GECM has with GECC and separately managed accounts. Where an investment management agreement includes both management fees and incentive fees, the performance obligation is considered to be a single obligation for both fees. Incentive fees are variable consideration associated with the GECC investment management agreement. Incentive fees are recognized based on investment performance during the period, subject to the achievement of minimum return levels or high-water marks, in accordance with the terms of the respective investment management agreements. Incentive fees range from 5.0% to 20.0% of the performance -based metric specified within each agreement. Because of the uncertainty of when incentive fees will be collected due to market conditions and investment performance, incentive fees are fully constrained and not recorded until received and the probability of significant reversal of the fees is eliminated in accordance with the respective investment management agreements.

Administration Fees

The Company earns administration fees based on the administration agreement GECM has with GECC whereby GECC reimburses GECM for costs incurred in performing administrative functions for GECC. This revenue is recognized over time as the services are performed. Administrative fees are billed quarterly in arrears, which is consistent with the timing of the delivery of services and reflect agreed upon rates for the services provided. The services are accounted for as a single performance obligation that is a series of distinct services with substantially the same pattern of transfer as the services are provided on a daily basis.

Revenue Accounting Under Topic 842

Durable Medical Equipment Revenue

Equipment Rental Revenue

Under FASB Accounting Standards Codification Topic 842, *Leases*, (**Topic 842**) rental income from operating leases is recognized on a straight-line basis, based on contractual lease terms with fixed and determinable increases over the non-cancellable term of the related lease when collectability is reasonably assured. The Company leases durable medical equipment to customers for a fixed monthly amount on a month-to-month basis. The contractual length of the lease term varies based on the type of equipment that is rented to the customer, but generally is from 10 to 36-months. In the case of capped rental agreements, title to the equipment transfers to the customer at the end of the contractual rental period. The customer has the right to cancel the lease at any time during the rental period for a subsequent month's rental and payments are generally billed in advance on a month-to-month basis. Under Topic 842, rental income from operating leases is recognized on a month-to-month basis, based on contractual lease terms when collectability is reasonably assured. Certain customer co-payments are included in revenue when considered probable of payment.

The lease term begins on the date products are delivered to patients and are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including Medicare, private payors, and Medicaid. Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenue and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain Payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application or claim denial. There were no material changes in estimates recorded in the three months ended September 30, 2019, relating to prior periods.

Although invoicing typically occurs at the beginning of the monthly rental period, we recognize revenue from rentals on a daily basis. Since rental agreements can commence at any time during a given month, we defer revenue related to the remaining monthly rental period as of period end. Deferred revenue related to rentals was \$0.8 million and \$0.9 million as of September 30, 2019 and June 30, 2019, respectively.

Included in rental revenue are unbilled amounts for which the revenue recognition criteria had been met as of period end but were not yet billed to the Payor. Net unbilled rental revenue is recognized to the extent payment is probable. As of September 30, 2019 and June 30, 2019, net unbilled rental revenue is approximately \$0.7 million and \$0.2 million, respectively, and is included in accounts receivable.

Real Estate Revenue

Rental Revenue

Consistent with the leases of durable medical equipment, the Company recognizes rental revenue on a straight-line basis over the non-cancelable term of the lease. Under the terms of the lease, the Company may recover from the tenant certain expenses, including: real estate taxes, insurance and other operating expenses. The recovery of these expenses is recognized in rental income in the accompanying condensed consolidated statements of operations, in the same periods as the expenses are incurred. These expenses recognized in both revenue and expense may fluctuate from period to period based on actual expense amounts.

4. Acquisition

In September 2018, through its subsidiary, DME Holdings, the Company acquired an 80.1% interest in DME Inc., an entity formed to acquire and combine two previously unrelated durable medical equipment distribution companies, Valley and Northwest, which both specialize in the distribution of sleep and respiratory care equipment, including positive air pressure equipment and supplies, ventilators, and oxygen equipment. The medical distribution companies operate in Alaska, Arizona, Nebraska, Oregon and Washington. The Company expects to achieve significant synergies and costs reductions through the combination of these companies in this acquisition. Operating results of the acquired businesses have been included in the consolidated statements of operations since September 1, 2018 as the impact of including the period prior to September 7, 2018 was immaterial to the condensed consolidated financial statements.

On the date of Acquisition, the Company allocated the consideration given to the individual assets acquired and the liabilities assumed based on a preliminary estimate of their fair values. The assessment of fair value initially reported, as of June 30, 2019, was preliminary as the Company had not finalized its fair value estimates.

During the twelve months ended September 30, 2019, the Company obtained and considered additional information related to the assets acquired and liabilities assumed, and recorded measurement period adjustments to the allocation of the purchase price noted below.

The acquisition date fair value of the consideration transferred is summarized in the following table:

| <i>(in thousands)</i> | As Previously Reported⁽¹⁾ | Adjustment | As Adjusted |
|---|---|-------------------|--------------------|
| Cash | \$ 25,321 | \$ - | \$ 25,321 |
| Net working capital adjustment | (254) | - | (254) |
| Increase in note payable to seller ⁽²⁾ | 16,500 | - | 16,500 |
| Debt assumed | 9,275 | - | 9,275 |
| Preferred stock in DME Holdings | 5,266 | - | 5,266 |
| Contingent consideration | 961 | - | 961 |
| Total Consideration | <u>\$ 57,069</u> | <u>\$ -</u> | <u>\$ 57,069</u> |

(1) As reported in our Form 10-K for the twelve months ended June 30, 2019.

(2) Included in related party note payable on the condensed consolidated balance sheet.

As a result of the adjustment to net working capital adjustment, \$0.2 million in shares of preferred stock in DME Holdings were cancelled and forfeited and the remaining difference between the adjustment and the value of the preferred stock cancelled and forfeited was paid by the sellers to DME Holdings.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition, which was finalized during the three months ended September 30, 2019.

| <i>(in thousands)</i> | As Previously Reported⁽¹⁾ | Adjustment | As Adjusted |
|-----------------------------|---|-------------------|--------------------|
| Accounts receivable | \$ 6,021 | \$ - | \$ 6,021 |
| Inventories | 1,405 | - | 1,405 |
| Other assets | 503 | - | 503 |
| Fixed assets | 852 | - | 852 |
| Equipment held for rent | 7,947 | - | 7,947 |
| Goodwill | 44,741 | 36 | 44,777 |
| Tradename | 8,800 | - | 8,800 |
| Non-compete agreements | 1,260 | (80) | 1,180 |
| Right of use asset | 4,205 | - | 4,205 |
| Current liabilities | (5,955) | - | (5,955) |
| Operating lease liabilities | (4,285) | - | (4,285) |
| Deferred tax liabilities | (1,160) | 44 | (1,116) |
| Non-controlling interest | (7,265) | - | (7,265) |
| Net Assets Acquired | <u>\$ 57,069</u> | <u>\$ -</u> | <u>\$ 57,069</u> |

(1) As reported in our Form 10-K for the twelve months ended June 30, 2019.

The outstanding balances of the note payable to seller, debt assumed on the revolving credit facility, and the preferred stock in DME Holdings approximates fair value based upon current rates and terms available for similar instruments.

The trade name was determined to have a fair value of \$8.8 million. The valuation of the trade name was based on a relief from royalty method. The key assumptions in applying the relief from royalty approach are as follows: royalty rate of 3.0% and a discount rate of 14%.

The non-compete agreements were determined to have a fair value of \$1.2 million. The valuation of the non-compete agreements was based on a lost profits method. The key assumptions in applying the lost profits method are as follows; probability adjusted EBITDA of the acquired businesses and a discount rate of 14%.

Of the \$10.0 million of acquired identifiable intangible assets, \$8.8 million was assigned to tradenames and \$1.2 million was assigned to non-compete assets, which are associated with the former sellers of the businesses. All tradenames acquired have an expected life of 10 years over which they will be amortized on a straight-line basis, which matches the pattern of economic use of these assets. The non-compete agreements have a weighted-average expected life of 4.2 years. All non-compete agreements will be amortized on a straight-line basis, which approximates the pattern of economic use. Neither tradenames nor the non-compete agreements have renewal terms or are expected to have any net realizable value at the end of their useful lives.

The contingent consideration arrangement requires the Company to pay up to \$2.4 million of additional consideration to the acquired companies' former shareholders if certain earnings before interest, taxes, depreciation and amortization (**EBITDA**) thresholds, as adjusted per the terms of the purchase agreement, are achieved for the 12 months ended December 31, 2018 and 2019. Under the Transaction Agreement, payment of the contingent consideration for any period is subject to satisfaction of the applicable EBITDA, as adjusted threshold. The fair value of the contingent consideration arrangement at the acquisition date was \$1.0 million. The Company estimated the fair value of the contingent consideration using a Monte Carlo simulation model. The key assumptions in applying the Monte Carlo simulation model as follows: 33.5% volatility and weighted-average cost of capital of 14%, and related EBITDA forecasts of the acquired businesses. The contingent consideration is included within the current portion of related party payables in the condensed consolidated balance sheets.

These fair value measurements are based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in ASC Topic 820, *Fair Value Measurement*.

Upon a subsequent sale of DME Inc., certain members of the DME Inc. management team will be entitled to a contingent bonus based on a percentage of the proceeds of the sale less the Company's invested capital in DME Inc.

The \$44.8 million of goodwill was assigned to the durable medical equipment segment and is attributable primarily to expected synergies and the assembled workforce of the acquired businesses. Approximately \$29.2 million of the goodwill is expected to be deductible for income tax purposes.

The fair value of the 19.9% non-controlling interest in acquired companies is estimated to be \$7.3 million. The fair value of the non-controlling interest was estimated based on the purchase price paid by the Company for its 80.1% of the acquired business since the non-controlling interest holders hold equity in DME Inc., which allows the holders to share in at least the same benefits inured from the acquisition as the Company.

The amount of \$1.1 million related to deferred tax liabilities relates primarily to identifiable intangible assets fair valued in purchase accounting that have no tax basis, as well as temporary differences of other acquired assets and liabilities.

The Company recognized \$2.1 million of acquisition costs that were expensed in the year ended June 30, 2019. These costs are included in selling, general and administrative expenses in the accompanying condensed consolidated statement of operations. The Company also incurred \$0.5 million in costs associated with issuing debt to finance the cost of the acquired businesses, which are debt issuance costs that are amortized over the term of the debt using the effective interest rate method.

Supplemental Pro Forma Information (unaudited)

The pro forma results presented below were prepared pursuant to the requirements of ASC Topic 805, *Business Combinations*, and give effect to the acquisition as if it had been consummated on July 1, 2017. The pro forma results have been prepared for comparative purposes only and do not necessarily represent what revenue or results of operations would have been had the acquisition been completed on July 1, 2017. In addition, these results are not intended to be a projection of future operating results and do not reflect synergies that might be achieved by the Company.

| <i>(in thousands)</i> | For the three months ended September 30, 2018 | |
|--|--|--------|
| Revenues | \$ | 14,767 |
| Net loss | | (696) |
| Net loss attributable to Great Elm Capital Group | | (594) |

These pro forma results presented include adjustments to historical operating results include the following activity related to the acquisition: (a) interest expenses incurred on the debt paid down and borrowed upon closing; (b) amortization of intangible assets acquired; and (c) reclassification of non-recurring transaction costs to the prior period.

Acquisition of Midwest Respiratory Care, Inc. Assets and Liabilities

In June 2019, through its majority-owned subsidiary, DME Inc., the Company acquired certain assets and liabilities of Midwest related to its durable medical equipment business which specializes in the distribution of sleep and respiratory care equipment, including positive air pressure equipment and supplies, ventilators, and oxygen equipment. The medical distribution business operates in Nebraska, Kansas and Iowa. The acquisition is accounted for as a business combination. The Company expects to achieve synergies and costs reductions through integrating these operations into our existing DME operations. Operating results of the acquired businesses have been included in the consolidated statements of operations since June 12, 2019.

On the date of Acquisition, the Company allocated the consideration given to the individual assets acquired and the liabilities assumed based on a preliminary estimate of their fair values. The Company is in the process of obtaining finalized third-party valuations of certain intangible assets and gathering information on all assets acquired and liabilities assumed, thus, all amounts are preliminary and are subject to change as these provisional estimates are finalized.

The acquisition date fair value of the cash consideration transferred was \$6.3 million, of which \$3.4 million was funded by additional debt under our existing Corbel Facility and \$0.7 million was contributed by the non-controlling interests in DME Inc.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition.

| <i>(in thousands)</i> | Amount |
|-----------------------------|-----------------|
| Inventories | \$ 7 |
| Other assets | 1 |
| Fixed assets | 52 |
| Equipment held for rent | 447 |
| Goodwill | 5,656 |
| Non-compete agreements | 180 |
| Right of use asset | 238 |
| Operating lease liabilities | (238) |
| Net Assets Acquired | <u>\$ 6,343</u> |

The non-compete agreements are associated with the sellers of the business and were determined to have a fair value of \$0.2 million. The agreements have a weighted-average expected life of 5 years and will be amortized on a straight-line basis, which approximates the pattern of economic use. The non-compete agreements have no renewal terms and are not expected to have any net realizable value at the end of their useful lives. The valuation of the non-compete agreements was based on a lost profits method. The key assumptions in applying the lost profits method are as follows; probability adjusted EBITDA of the acquired business and a discount rate of 27%.

These fair value measurements are based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in ASC Topic 820, Fair Value Measurement.

The \$5.7 million of goodwill was assigned to the durable medical equipment segment and is attributable primarily to expected synergies and the assembled workforce of the acquired business. None of the goodwill is expected to be deductible for income tax purposes.

Supplemental Pro Forma Information (unaudited)

The pro forma results presented below were prepared pursuant to the requirements of ASC Topic 805, *Business Combinations*, and give effect to the acquisition as if it had been consummated on July 1, 2017. The pro forma results have been prepared for comparative purposes only and do not necessarily represent what revenue or results of operations would have been had the acquisition been completed on July 1, 2017. In addition, these results are not intended to be a projection of future operating results and do not reflect synergies that might be achieved by the Company.

| <i>(in thousands)</i> | For the three months ended September 30, 2018 |
|--|--|
| Revenues | \$ 7,308 |
| Net loss | (1,798) |
| Net loss attributable to Great Elm Capital Group | (1,835) |

These pro forma results presented include adjustments to historical operating results include the following activity related to the acquisition: (a) interest expense and debt financing costs incurred on the debt borrowed upon closing; (b) amortization of intangible assets acquired; and (c) reclassification of non-recurring transaction costs to the prior period.

The amounts of revenue and net loss of the combined acquired durable medical equipment businesses included in the Company's condensed consolidated statement of operations three months ended September 30, 2019 is \$13.2 million and \$0.8 million, respectively.

5. Related Party Transactions

Related party transactions are measured in part by the amount of consideration paid or received as established and agreed by the parties. Consideration paid for such services in each case is the negotiated value.

Durable Medical Equipment

In connection with the acquisition of the durable medical equipment businesses in September 2018, DME Inc. and its subsidiaries entered into a term loan agreement with Corbel Capital Partners SBIC, L.P. (**Corbel**) (the **Corbel Facility**). Jeffrey S. Serota, a member of the Company's Board of Directors, serves as Vice Chairman to Corbel Capital Partners. Corbel previously held an interest in Northwest and was one of the sellers in our acquisition of the business. As a result of the acquisition, at September 30, 2019 Corbel holds preferred stock of DME Holdings and a non-controlling interest in DME Inc. Pursuant to the Corbel Facility, Corbel was paid a structuring fee, will be paid an ongoing quarterly monitoring fee, and may be paid a deferred structuring fee if the loans are subject to early repayment. See Note 11 - Borrowings for additional information on the Corbel Facility and Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary.

In connection with the acquisition of the durable medical equipment businesses, the Company issued non-controlling interests in DME Inc. to the former owners, including Corbel discussed above. See Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary. Additionally, the Company has a contingent liability to the sellers for \$0.9 million, which is included in the current portion of related party payables on the balance sheet. See Note 4 – Acquisition for additional details.

Investment Management

The Company's wholly-owned subsidiary, GECM, has agreements to provide administrative services and manage the investment portfolio for GECC. Under these agreements, GECM receives administrative fees, management fees based on GECC's assets (other than cash and cash equivalents) and incentive fees if GECC has net capital gains or if its net investment income exceeds a specified hurdle rate. Fees under the agreements began to accrue on November 4, 2016. See Note 3 – Revenue for additional discussions of the fee arrangements.

All of the Company's investment management revenue recognized for the periods presented was generated from the management and administration of GECC. Additionally, the Company receives dividends from its investment in GECC and earns unrealized profits and losses based on the mark-to-market performance of GECC. See Note 8 – Fair Value Measurements.

The following tables summarize activity and outstanding balances between GECC and the Company.

| <i>(in thousands)</i> | For the three months ended September 30, | |
|--|---|-------------|
| | 2019 | 2018 |
| Change in unrealized gain (loss) on investment in GECC | \$ (983) | \$ 905 |
| GECC dividends recorded in the period | 490 | 490 |

| <i>(in thousands)</i> | As of As of September 30, | |
|---|----------------------------------|-------------|
| | 2019 | 2018 |
| Dividends receivable from GECC | \$ 163 | \$ 163 |
| Investment management revenues receivable from GECC | 1,079 | 962 |

Outstanding receivables are included in related party receivables in the condensed consolidated balance sheets.

The Company is the beneficial owner of approximately 19.5% of the outstanding shares of GECC, and the Company's Chief Executive Officer is also the Chief Executive Officer of GECC and Chief Investment Officer of GECM, in addition to being a member of the board of directors of the Company and chairman of the board of GECC. The Company's President and Chief Operating Officer is also the Chief Operating Officer, Chief Compliance Officer and General Counsel of GECM and the Chief Compliance Officer of GECC.

GECM has a profit sharing agreement with the Company's majority-owned subsidiary GECC GP Corp. (**Profit Sharing Agreement**). Under the Profit Sharing Agreement, GECM's profit from GECC is paid to GECC GP Corp. Since its inception in November 2016, GECM has operated at a cumulative loss through September 30, 2019; correspondingly, no profits were available to GECC GP Corp. under the Profit Sharing Agreement. Certain employees of the Company have a non-controlling interest in GECC GP Corp. See Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary.

The Company's wholly-owned subsidiary, Great Elm Opportunities GP, Inc. (**GEO GP**) serves as the general partner of Great Elm Opportunities Fund I, LP (**GEOF**). As the general partner, GEO GP provides administrative services and manages the investment portfolio of GEOF. Based on the performance of GEOF's investment portfolio, GEO GP may be entitled to certain incentive allocations. GEOF began investing in July 2018 and through September 30, 2019 no incentive allocations have been made to GEO GP.

MAST Capital Management, LLC is the beneficial owner of approximately 7.9% of the Company's outstanding common stock as of September 30, 2019. See Note 11 - Borrowings for additional discussion of the GP Corp. Note.

Real Estate

In connection with the acquisition of the real estate business in March 2018, the Company issued the former owner a 19.9% interest in Great Elm FM Holdings, Inc. (**GE FM Holdings**). See Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary.

6. Fixed Assets

The Company's fixed assets consist of its leased real estate assets, medical equipment held for rental, furniture and fixtures, and leasehold improvements used in its operations. The following tables detail the Company's fixed assets:

| <i>(in thousands)</i> | September 30, 2019 | | June 30, 2019 | |
|-----------------------------------|---------------------------|---------------|----------------------|---------------|
| Real Estate Assets | | | | |
| Buildings | \$ | 43,355 | \$ | 43,355 |
| Land and site improvements | | 9,170 | | 9,170 |
| Tenant improvements | | 3,500 | | 3,500 |
| | | <u>56,025</u> | | <u>56,025</u> |
| Accumulated depreciation | | (1,920) | | (1,614) |
| Net carrying amount | \$ | 54,105 | \$ | 54,411 |
| Property and Equipment | | | | |
| Leasehold improvements | \$ | 786 | \$ | 774 |
| Vehicles | | 186 | | 239 |
| Computer equipment and software | | 187 | | 187 |
| Furniture and fixtures | | 338 | | 331 |
| Sleep study equipment | | 227 | | 232 |
| | | <u>1,724</u> | | <u>1,763</u> |
| Accumulated depreciation | | (499) | | (396) |
| Net carrying amount | \$ | 1,225 | \$ | 1,367 |
| Equipment Held for Rental | | | | |
| Medical equipment held for rental | \$ | 14,554 | \$ | 13,294 |
| Accumulated depreciation | | (5,537) | | (4,154) |
| Net carrying amount | \$ | 9,017 | \$ | 9,140 |

The following table reconciles depreciation expense included in the following lines of the condensed consolidated statements of operations to total depreciation expense for each period presented.

| <i>(in thousands)</i> | For the three months ended September 30, | | | |
|---|---|--------------|-------------|------------|
| | 2019 | | 2018 | |
| Depreciation and amortization | \$ | 428 | \$ | 366 |
| Cost of durable medical equipment rentals | | 2,051 | | 280 |
| Total depreciation expense | \$ | <u>2,479</u> | \$ | <u>646</u> |

7. Lessor Operating Leases

Medical Equipment Leases

Through its majority-owned subsidiary DME Inc., and the subsidiaries of DME Inc., the Company owns medical equipment which is leased to customers. The Company's customers consist primarily of patients through their clinical providers including medical centers, clinics and hospices and the Company has lease arrangements with these patients. In addition, the arrangements between the Company and its customers are impacted by arrangements between the Company and Payors. The Payors may cover a portion or all of the rental payments under the agreements between the Company and its customers. The patient is responsible for any residual co-payments.

The lease terms may be for a pre-determined time period, generally 10 months to 36 months; however, the customer may cancel the lease at any time and for any reason without penalty and therefore, the Company treats all leases as month-to-month leases. Upon termination of the lease, the equipment, if not aged beyond its useful life, may be

refurbished and subsequently sold or leased to another customer. As the leases are month-to-month, there are no future lease receivables under the terms of the current leases.

Real Estate Leases

The Company's majority-owned subsidiary CRIC IT Fort Myers LLC (**Property Owner**) owns a fee simple interest in two Class A office buildings, Gartner I and Gartner II (collectively, the **Property**). The Property is fully leased, on a triple net basis, to Gartner, Inc. (**Gartner**) until March 31, 2030, which may be extended at the option of Gartner in accordance with the terms of the lease. The Gartner I lease contains two five-year extensions and the Gartner II lease contains three five-year extensions (collectively, the **Leases**). Under the terms of the Leases, the renewal rates are equal to 95% of the then fair market rent, and the tenant does not have a purchase option at the end of the lease term. The leases require Gartner to make a base monthly lease payment of approximately \$0.4 million as calculated on a straight line basis over the remaining expected lease term plus additional rent payments for additional costs. Additional rental payments are due for Property Owner costs, such as property taxes, management fees, and insurance costs, as incurred. See Note 3 – Revenue for additional discussion of rental revenues.

The Property is subject to mortgage, security agreement and assignment of leases and rents with the senior and subordinated lenders, which is further described in Note 11 - Borrowings. The Property Owner has assigned all rights, title and interest in and to the Property and the Leases to the senior and subordinated lenders and all amounts received are paid to a trust which funds the operating costs associated with the Property. The Company does not have rights to these rent payments while the borrowings remain outstanding.

The Company expects to derive value from the residual value at the end of the existing lease term by further leasing the assets or through a sale transaction.

Rental income from real estate leases is summarized in the following table:

| <i>(in thousands)</i> | For the years ended September 30, | |
|--|-----------------------------------|----------|
| | 2019 | 2018 |
| Revenues from base rents | \$ 1,151 | \$ 1,151 |
| Revenues from additional rental payments | 122 | 291 |
| Total rental revenues | \$ 1,273 | \$ 1,442 |

The following table summarizes the base rents for the remaining lease term:

| <i>(in thousands)</i> | Base Rent Payments |
|--|--------------------|
| For the nine months ending June 30, 2020 | \$ 3,099 |
| For the year ending June 30, 2021 | 4,213 |
| For the year ending June 30, 2022 | 4,312 |
| For the year ending June 30, 2023 | 4,419 |
| For the year ending June 30, 2024 | 4,529 |
| Thereafter | 28,673 |
| Total base rent | \$ 49,245 |

8. Fair Value Measurements

Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

US GAAP provides a framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

- *Level 1:* Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- *Level 2:* Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- *Level 3:* Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

All financial assets or liabilities that are measured at fair value on a recurring and non-recurring basis have been segregated into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date. The assets and liabilities measured at fair value on a recurring and non-recurring basis are summarized in the tables below:

| <i>(in thousands)</i> | Fair Value as of September 30, 2019 | | | |
|------------------------------------|-------------------------------------|-------------|---------------|------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Investment in GECC | \$ 16,127 | \$ - | \$ - | \$ 16,127 |
| Total assets | <u>\$ 16,127</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 16,127</u> |
| Liabilities: | | | | |
| Contingent consideration liability | \$ - | \$ - | \$ 940 | \$ 940 |
| Total liabilities | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 940</u> | <u>\$ 940</u> |

| <i>(in thousands)</i> | Fair Value as of June 30, 2019 | | | |
|------------------------------------|--------------------------------|-------------|-----------------|------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Investment in GECC | \$ 17,110 | \$ - | \$ - | \$ 17,110 |
| Total assets | <u>\$ 17,110</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 17,110</u> |
| Liabilities: | | | | |
| Contingent consideration liability | \$ - | \$ - | \$ 1,135 | \$ 1,135 |
| Total liabilities | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 1,135</u> | <u>\$ 1,135</u> |

The following is a reconciliation of changes in contingent consideration, a Level 3 liability, for the three months ended September 30, 2019:

| <i>(in thousands)</i> | |
|----------------------------------|---------------|
| Balance as of June 30, 2019 | \$ 1,135 |
| Additions | - |
| Payments | - |
| Change in fair value | (195) |
| Balance as of September 30, 2019 | <u>\$ 940</u> |

The following is a reconciliation of changes in contingent consideration, a Level 3 liability, for the three months ended September 30, 2018:

| | |
|----------------------------------|-----------------|
| <i>(in thousands)</i> | |
| Balance as of June 30, 2018 | \$ - |
| Additions | 1,225 |
| Payments | - |
| Change in fair value | - |
| Balance as of September 30, 2018 | <u>\$ 1,225</u> |

Contingent consideration is included within the current portion of related party payables in the condensed consolidated balance sheets. The contingent consideration arrangement requires the Company to pay up to \$2.4 million of additional consideration to the acquired companies' former shareholders if certain EBITDA thresholds, as adjusted per the terms of the purchase agreement, are achieved for the 12 months ended December 31, 2018 and 2019. The Company estimated the fair value of the contingent consideration using a Monte Carlo simulation model. The key assumptions in applying the Monte Carlo simulation model as of September 7, 2018 are as follows: 33.5% volatility and weighted average cost of capital of 14% and related EBITDA forecasts of the acquired businesses for the twelve months ended December 31, 2018 and 2019. A fair value of \$1.0 million was calculated as of the acquisition date.

In June 2019, in conjunction with the Midwest acquisition, there was an amendment to the Transaction Agreement which adjusted certain terms of the related EBITDA target calculation for the 12 months ended December 31, 2019, making it easier to achieve. As part of this amendment, a payment of \$0.3 million was made to certain former shareholders. The fair value of the remaining contingent consideration was updated to \$1.1 million as of June 30, 2019. As of September 30, 2019, the fair value of the contingent consideration was updated to \$0.9 million, resulting in a \$0.2 million benefit which is included in sales, general and administrative expenses. The valuation as of September 30, 2019 utilized a 21.9% volatility rate and weighted average cost of capital of 12% and estimate of forecasted adjusted EBITDA of the business.

The ultimate payout of the contingent consideration will be based on actual results achieved. As the fair value of the contingent consideration changes until finalized with the results for the twelve months ended December 31, 2019, these changes may have a material impact on earnings. The Company determined that the EBITDA achieved, as adjusted per terms of the contract, for the 12 months ended December 31, 2018 was below the earnout threshold for payout, however, final determination is subject to a review process with the sellers. A full or partial contingent consideration payment of up to \$2.1 million may be due to the sellers following completion of the review process or if the applicable targets are met during the 12 months ended December 31, 2019.

The Company is the beneficial owner of approximately 19.5% (or 1,966,667 shares) of the outstanding shares of GECC and values its ownership based on the NASDAQ-listed market price of GECC common stock (a Level 1 input in accordance with the US GAAP fair value hierarchy).

The Company recognizes transfers between levels of the hierarchy based on the fair values of the respective financial instruments at the end of the reporting period in which the transfer occurred. There were no transfers between levels of the fair value hierarchy during the three months ended September 30, 2019 and 2018.

See Note 11 - Borrowings for additional discussion related to the fair value of notes payable. The carrying value of all other financial assets and liabilities approximate their fair values.

9. Goodwill and Other Intangible Assets

The Company's investment management and real estate segments include identifiable intangible assets acquired through acquisitions in prior years. In connection with the acquisition of the durable medical equipment businesses, the Company has also recognized goodwill and identifiable intangible assets associated with the tradenames and non-compete agreements. See Note 4 – Acquisition.

Goodwill of \$50.4 million presented on the condensed consolidated balance sheet consists only of the goodwill acquired as part of the acquisitions of the durable medical equipment businesses in September 2018 and June 2019. See Note 4 – Acquisition for additional details.

The changes in the carrying value of goodwill are as follows:

| | |
|--------------------------------|---------------|
| <i>(in thousands)</i> | |
| Balance, June 30, 2019 | \$ 50,397 |
| Purchase accounting adjustment | 36 |
| Balance, September 30, 2019 | <u>50,433</u> |

The following tables provide details associated with the Company's identifiable intangible assets subject to amortization (dollar amounts in thousands):

| <i>(in thousands)</i> | As of September 30, 2019 | | | As of June 30, 2019 | | |
|----------------------------------|--------------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Durable Medical Equipment | | | | | | |
| Tradename | \$ 8,800 | \$ (953) | \$ 7,847 | \$ 8,800 | \$ (733) | \$ 8,067 |
| Non-compete agreements | 1,360 | (328) | 1,032 | 1,440 | (210) | 1,230 |
| | 10,160 | (1,281) | 8,879 | 10,240 | (943) | 9,297 |
| Investment Management | | | | | | |
| Investment management agreement | 3,900 | (1,492) | 2,408 | 3,900 | (1,336) | 2,564 |
| Assembled workforce | 526 | (201) | 325 | 526 | (180) | 346 |
| | 4,426 | (1,693) | 2,733 | 4,426 | (1,516) | 2,910 |
| Real Estate | | | | | | |
| In-place lease | 6,028 | (783) | 5,245 | 6,028 | (659) | 5,369 |
| Total | \$ 20,614 | \$ (3,757) | \$ 16,857 | \$ 20,694 | \$ (3,118) | \$ 17,576 |

Aggregate Amortization Expense *(in thousands)*:

| | 2019 | 2018 |
|--|--------|--------|
| For the three months ended September 30, | \$ 639 | \$ 344 |

Estimated Future Amortization Expense *(in thousands)*:

| | |
|--|----------|
| For the nine months ending June 30, 2020 | \$ 1,703 |
| For the year ending June 30, 2021 | 2,150 |
| For the year ending June 30, 2022 | 1,977 |
| For the year ending June 30, 2023 | 1,891 |
| For the year ending June 30, 2024 | 1,699 |

10. Lessee Operating Leases

All of the Company's leases are operating leases. Certain of the leases have both lease and non-lease components. The Company has elected to account for each separate lease component and the non-lease components associated with that lease component as a single lease component for all classes of underlying assets. The following table provides additional details of the leases presented in the balance sheets:

| <i>(in thousands)</i> | <u>September 30, 2019</u> | <u>June 30, 2019</u> |
|---|---------------------------|----------------------|
| Facilities | | |
| Right of use assets | \$ 5,970 | \$ 6,066 |
| Current portion of lease liabilities | 1,430 | 1,371 |
| Lease liabilities, net of current portion | 4,822 | 4,989 |
| Total liabilities | \$ 6,252 | \$ 6,360 |
| Weighted-average remaining life | 4.3 years | 4.4 years |
| Weighted-average discount rate | 11.6% | 11.7% |
| Vehicles | | |
| Right of use assets | \$ 75 | \$ 80 |
| Current portion of lease liabilities | 19 | 18 |
| Lease liabilities, net of current portion | 56 | 62 |
| Total liabilities | \$ 75 | \$ 80 |
| Weighted-average remaining life | 3.4 years | 3.7 years |
| Weighted-average discount rate | 12.3% | 12.3% |
| Equipment | | |
| Right of use assets | \$ 93 | \$ 93 |
| Current portion of lease liabilities | 36 | 34 |
| Lease liabilities, net of current portion | 57 | 59 |
| Total liabilities | \$ 93 | \$ 93 |
| Weighted-average remaining life | 2.6 years | 2.6 years |
| Weighted-average discount rate | 12.5% | 12.5% |

As of September 30, 2019, the Company had remaining right of use assets of \$6.1 million and lease liabilities of \$6.4 million (consisting of \$1.5 million in current portion of lease liabilities and \$4.9 million in lease liabilities, net of current portion on the condensed consolidated balance sheet) related to the leases discussed herein.

Operating lease costs are included in the operating expense associated with the business segment leasing the asset on the statements of operations and are included in cash flows from operating activities on the statements of cash flows. Certain operating leases include variable lease costs which are not material and are included in operating lease costs. Additional details are presented in the following table:

| <i>(in thousands)</i> | For the three months ended September 30, | |
|--------------------------------|---|-------------|
| | 2019 | 2018 |
| Facilities | | |
| Operating lease cost | \$ 528 | \$ 219 |
| Cash paid for operating leases | 498 | 213 |
| Vehicles | | |
| Operating lease cost | \$ 7 | \$ 2 |
| Cash paid for operating leases | 7 | 2 |
| Equipment | | |
| Operating lease cost | \$ 11 | \$ - |
| Cash paid for operating leases | 11 | - |

The following table summarizes the Company's undiscounted cash payment obligations for its operating leases:

| <i>(in thousands)</i> | |
|--|----------|
| For the nine months ending June 30, 2020 | \$ 1,599 |
| For the year ending June 30, 2021 | 2,075 |
| For the year ending June 30, 2022 | 1,822 |
| For the year ending June 30, 2023 | 1,187 |
| For the year ending June 30, 2024 | 831 |
| Thereafter | 645 |
| Total lease payments | \$ 8,159 |
| Imputed interest | (1,739) |
| Total lease liabilities | \$ 6,420 |

Durable Medical Equipment

As part of the acquisitions discussed in Note 4 – Acquisition, the Company assumed leases for facilities, vehicles and equipment. Subsequent to the acquisitions, the Company has entered into additional similar leases.

The facility leases include offices, retail and warehouse space and sleep labs. The leases have original or amended terms ranging from 60 to 183 months, some of which include an additional option to extend the lease for up to 180 months. At the date of acquisition, the remaining lease terms ranged from 3 to 96 months. Certain of these leases have variable rental payments tied to a consumer price index or include additional rental payments for maintenance costs, taxes and insurance, which are accounted for as variable rent.

The vehicles leases have original lease terms of 60 months from the commencement date of each lease with no option to extend. Each lease may be terminated by the lessee with 30-days' notice after the first 13 months of the lease subject to certain early termination costs, including residual value guarantees. The lease costs include variable payments for taxes and other fees.

Equipment leases consist of office equipment with original lease terms ranging from 36 to 48 months from the commencement date of each lease and may include an option to extend or purchase at the end of the lease term. Certain of these leases include additional rental costs for taxes, insurance and additional fees in addition to the base rental costs.

The Company entered into a lease for office space located in Waltham, MA. This office space is allocated between the investment management and general corporate segments. On the commencement date of the lease, the non-cancellable term was for eighty-eight months from the occupancy date of June 1, 2017 and contains an option to extend for an additional sixty-month period.

The lease payments commenced on October 1, 2017, four months after the Company began to occupy the space. On an annual basis, the lease payments increase at an average rate of approximately 2.4% from \$28 to \$32 thousand per month.

11. Borrowings

Related party borrowings of the Company's subsidiaries are summarized in the following table:

| <i>(in thousands)</i> | Subsidiaries | September 30, 2019 | June 30, 2019 |
|--|---------------------------|-------------------------------|----------------------|
| Corbel Facility | DME Inc. and subsidiaries | \$ 26,622 | \$ 27,584 |
| GP Corp. Note | GECC GP Corp. | 3,148 | 3,148 |
| Total principal | | \$ 29,770 | \$ 30,732 |
| Unamortized debt issuance cost | | (342) | (364) |
| Total long-term related party notes payable | | 29,428 | 30,368 |
| Less current portion of related party notes payable | | (1,494) | (2,066) |
| Related party notes payable, net of current portion | | \$ 27,934 | \$ 28,302 |

The Company's subsidiaries' other outstanding borrowings are summarized in the following table:

| <i>(in thousands)</i> | Subsidiaries | September 30, 2019 | June 30, 2019 |
|---|---------------------------|-------------------------------|----------------------|
| DME Revolver | DME Inc. and subsidiaries | \$ 6,900 | \$ 7,401 |
| Equipment Financing | DME Inc. and subsidiaries | 1,753 | 1,475 |
| Senior Note | CRIC IT | 51,638 | 52,161 |
| Subordinated Note | CRIC IT | 3,401 | 3,277 |
| Total principal | | \$ 63,692 | \$ 64,314 |
| Unamortized debt premiums | | 3,219 | 3,205 |
| Unamortized debt discounts and issuance costs | | (2,176) | (2,250) |
| Total other outstanding borrowings | | 64,735 | 65,269 |
| Less current portion of other outstanding borrowings | | (10,735) | (3,530) |
| Other outstanding borrowings, net of current portion | | \$ 54,000 | \$ 61,739 |

The Company incurred interest expense of \$1.7 million and \$1.0 million for the three months ended September 30, 2019 and 2018, respectively.

The Company's aggregate future required principal debt repayments are summarized in the following table:

| <i>(in thousands)</i> | Principal Due |
|---|----------------------|
| For the nine months ending June 30, 2020 | \$ 4,209 |
| For the year ending June 30, 2021 | 10,919 |
| For the year ending June 30, 2022 | 4,042 |
| For the year ending June 30, 2023 | 4,195 |
| For the year ending June 30, 2024 | 24,288 |
| Thereafter | 58,677 |
| Total | \$ 106,330 |
| | |
| Outstanding principal on related party borrowings | \$ 29,770 |
| Outstanding principal on other borrowings | 63,692 |
| Future interest to be paid-in-kind | 12,868 |
| Total future required principal payments | \$ 106,330 |

Additional details of each borrowing by operating segment are discussed below.

Durable Medical Equipment

In September 2018, in conjunction with the acquisition of 80.1% of Great Elm DME, Inc., the Company assumed a secured note (**Corbel Facility**) with a principal balance of \$8.5 million, which was amended and increased to \$25 million concurrent with the closing of the acquisition described in Note 4 – Acquisition. In addition, the Company assumed and expanded a revolving line of credit agreement (**DME Revolver**) with a principal balance of \$0.8 million, which was amended and increased to \$6.3 million at the date of acquisition.

The Company amended and borrowed an additional \$3.4 million under the Corbel Facility in June 2019. As of September 30, 2019 the outstanding principal balance was \$26.6 million. The Corbel Facility matures on August 31, 2023, accrues interest at a variable rate of three-month LIBOR plus 10% per annum and is secured by the assets of the durable medical equipment business. At September 30, 2019 the interest rate was 12.1%. The Corbel Facility requires quarterly interest payments and principal payments of \$0.3 million through the maturity date with the final principal balance due at maturity. In addition, beginning with the quarter ending December 31, 2018, the Company is required to make additional quarterly principal payments based on a percentage of excess cash flows generated by the durable medical equipment business operations. The Company has the option to prepay the borrowings outstanding in whole or in part subject to certain prepayment penalties ranging from 1% - 5% of the early payment of the principal, based on the time that the loan has been outstanding through the first five years of the loan.

The Corbel Facility is held by a related party, Corbel, which holds a non-controlling interest in DME Inc. and preferred stock issued by DME Holdings. In connection with the issuance of the amended Corbel Facility, the borrowers paid Corbel a one-time structuring fee of \$375,000, which is included in debt issuance costs for the three months ended September 30, 2018. See Note 5 – Related Party Transactions and Note 13 – Non-Controlling Interests and Preferred Stock of Subsidiary.

DME Inc. is required to pay to Corbel, as agent of the Corbel Facility, a quarterly monitoring fee of \$25,000 while the borrowings remain outstanding. In addition, if the borrowing is repaid with proceeds of debt in full or in part at any time within the first three years from the date of issuance, the borrower shall pay an additional fee to the agent, ranging from 2.10% to 3.50% depending on the date of repayment based on the period outstanding, of the aggregate repaid principal amount.

Principal payments and interest expense incurred on the Corbel Facility are summarized in the following table:

| <i>(in thousands)</i> | For the three months ended September 30, | |
|-----------------------|--|------|
| | 2019 | 2018 |
| Principal payments | \$ 961 | \$ - |
| Interest expense | 855 | 197 |

The DME Revolver had a balance of \$6.9 million at September 30, 2019 and allows for borrowings up to \$10 million, subject to a fixed percentage of qualifying accounts receivables and inventories related to the durable medical equipment business operations. Borrowings under the line of credit are due on August 30, 2020 and accrue interest at a variable rate of the prime rate plus 0.4% per annum. At September 30, 2019 the interest rate was 5.4%. Interest is payable monthly in arrears. The Company has the option to prepay the borrowings without any penalty. If the DME Revolver is terminated within the first year, a termination fee equal to 3% of the original credit limit will be due. The Company has classified all borrowings under the DME Revolver as current in the condensed consolidated balance sheets based on the maturity date of the facility.

The borrowings under the DME Revolver are collateralized by the assets of the durable medical equipment business and the Company is required to meet certain financial covenants.

The Corbel Facility and DME Revolver each include covenants that restrict DME Inc. business operations to its current business, limit additional indebtedness, liens, asset dispositions and investments, require compliance and maintenance of licenses and government approvals and other customary conditions. Events of default include the failure to pay amounts when due, bankruptcy, or violation of covenants, including a change in control of DME Inc. DME Inc. must also comply with a fixed-charge coverage and leverage ratio financial covenants, which are based in part on the DME Inc. EBITDA levels.

As of September 30, 2019, the fair value approximates the carrying value for both the Corbel Facility and the DME Revolver.

Beginning in April 2019, DME Inc's operating subsidiaries also utilize equipment financing debt to fund certain inventory and equipment purchases from suppliers. These equipment financing debt agreements are entered into with 3rd party banks and are generally payable in equal installments over terms of one to three years, depending on the nature of the underlying purchases being financed. The debt is secured by the inventory and equipment, as applicable, of the operating subsidiaries entering into the agreements, and the long-term agreements have implicit interest rates between 7 – 8%. During the three months ended September 30, 2019, the Company financed \$0.9 million in inventory and equipment through such financing agreements.

Investment Management

The GP Corp. Note matures in November 2026, accrues interest at a variable rate of three-month LIBOR plus 3.0% per annum and is secured by a profit sharing agreement related to GECC's management of GECC. At September 30, 2019 the interest rate was 5.1%. The GP Corp. Note requires quarterly interest only payments and annual principal payments of \$0.08 million, based on the Company's fiscal year ending June 30.

The GP Corp. Note is non-recourse to any of the Company's operations or net assets not related to GECC's management services to GECC. The GP Corp. Note may be prepaid at par value at any time with prior written notice to the holders of the GP Corp. Note. Additionally, GECC GP Corp. is required to prepay the GP Corp. Note upon certain material liquidation transactions including any termination of the Profit Sharing Agreement.

The GP Corp. Note is held by MAST Capital, a related party. Payments and interest expense incurred on the GP Corp. Note are summarized in the following table:

| <i>(in thousands)</i> | For the three months ended September 30, | |
|-----------------------|--|------|
| | 2019 | 2018 |
| Principal payments | \$ - | \$ - |
| Interest expense | 44 | 44 |

The Company estimated the fair value of the GP Corp. Note as of September 30, 2019 and June 30, 2019, on a non-recurring basis, using Level 3 inputs. As of September 30, 2019 and June 30, 2019, the carrying value of the note approximated the fair value.

Real Estate

In March 2018, in connection with the acquisition of the real estate business, the Company assumed a senior secured note (**Senior Note**) with a principal balance of \$54.8 million and a subordinated note (**Subordinated Note**) with a principal balance of \$2.7 million at the date of acquisition. The Senior Note was recorded at an estimated fair value of \$52.2 million, reflecting a discount of \$2.6 million from the face amount; and the Subordinated Note was recorded at \$5.8 million, reflecting a premium of \$3.1 million. The discount and premium amortize over the life of the notes.

The Senior Note matures on March 15, 2030, accrues interest at a rate of 3.49% per annum and is secured by a first lien mortgage on the Property and an Assignment of Leases and Rents. The Senior Note requires monthly principal and interest payments through the maturity date, with the last payment of \$18.4 million on March 15, 2030. The principal and interest due on the Senior Note may be prepaid at the option of the borrower, based on an amount determined by discounting the remaining principal and interest payments at a rate equal to an applicable premium in excess of a rate corresponding to the specified U.S. Treasury security over the remaining average life of the Senior Note.

The Subordinated Note matures on March 15, 2030, accrues interest at a rate of 15.0% per annum, and is secured by a second lien mortgage on the Property and an Assignment of Leases and Rents. The Subordinated Note is a capital appreciation note, whereby the monthly interest is capitalized to the principal balance and due at maturity. Accordingly, a \$16.3 million payment is due on March 15, 2030. The principal and interest due on the Subordinate Note may be prepaid at the option of the borrower, based on an amount determined by discounting the remaining principal and interest payments at a rate equal to an applicable premium in excess of a rate corresponding to the specified U.S. Treasury security over the remaining average life of the Subordinated Note.

The note agreements include negative covenants that restrict the Property Owner's business operations to ownership and lease of the Property, limit additional indebtedness, require maintenance of insurance and other customary requirements related to the Property. Events of default include non-payment of amounts when due, inability to pay indebtedness or material change in the business operations or financial condition of the Property Owner or the lease tenant that in the Lender's reasonable determination would reasonably be expected to materially impair the value of the Property, prevent timely repayment of the notes or performance of any material obligations under the note and related agreements. The payments under the notes are also guaranteed on a full and several basis by the non-controlling interest holder of the Property Owner. Both the Senior Note and Subordinated Note are non-recourse to the Company, but are secured by the Property, the rights associated with the Leases and the stock owned by the Company in the Property Owner. See Note 7 – Lessor Operating Leases.

As of September 30, 2019 and June 30, 2019, the fair value approximates the carrying value for both the Senior Note and Subordinated Note.

12. Stockholders' Equity

Performance Shares (Restricted Stock Awards)

The Company did not grant any restricted stock awards during the three months ended September 30, 2019. As of September 30, 2019, the Company had 732,909 restricted stock awards that carry both performance and service requirements in connection with the formation of the investment management business. The vesting of these awards is subject to a five-year service requirement and an investment management cumulative revenue collection target of \$40 million for the five-year period ended November 3, 2021. Additionally, in September 2017, the Company modified the restricted stock awards to include a provision for changes in control.

The Company estimates that approximately 479,504 of the restricted stock awards are probable of vesting under the performance condition. The Company accounts for forfeitures of the restricted stock awards in the period incurred. There were no forfeitures during the three months ended September 30, 2019.

For the three months ended September 30, 2019, the Company recognized compensation cost totaling \$0.03 million associated with the performance-based awards. For the three months ended September 30, 2018, the Company recognized compensation cost totaling \$0.2 million associated with the performance-based awards.

The following table summarizes the Company's restricted stock award activity as of and through September 30, 2019:

| Restricted Stock Awards and Restricted Stock Units | Restricted Stock (in thousands) | Weighted Average Grant Date Fair Value |
|--|------------------------------------|---|
| Outstanding at June 30, 2019 | 782 | \$ 3.89 |
| Granted | 93 | 3.95 |
| Vested | (30) | 3.43 |
| Forfeited | - | - |
| Outstanding at September 30, 2019 | 845 | \$ 3.91 |

Stock Options

During the three months ended September 30, 2019, the Company issued 229,523 stock options with an estimated grant date fair value of \$0.3 million. The Company utilizes a Black-Scholes option pricing model to estimate the fair value of its option awards. The assumptions used to value the stock options granted during the three months ended September 30, 2019 consist of: expected volatility of 49.9% and 58.0%; no expected dividend yields; risk-free rate of 1.54% and 1.90%; and expected term of 4.0 and 6.4 years.

The following table summarizes the Company's option award activity as of and through September 30, 2019:

| Options | Shares (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|--|--------------------------|------------------------------------|--|--|
| Outstanding at June 30, 2019 | 2,656 | \$ 4.33 | 6.49 | \$ 1,590 |
| Options granted | 230 | 4.49 | | |
| Exercised | - | - | | |
| Forfeited, cancelled or expired | (421) | 8.16 | | |
| Outstanding at September 30, 2019 | 2,465 | \$ 3.69 | 6.25 | \$ 206 |
| Exercisable at September 30, 2019 | 1,360 | \$ 3.60 | 5.19 | \$ 135 |
| Vested and expected to vest as of September 30, 2019 | 2,465 | \$ 3.69 | 6.25 | \$ 206 |

During the three months ended September 30, 2019, the Company recognized total stock-based compensation associated with all restricted stock and stock options of \$0.3 million.

As of September 30, 2019, unrecognized compensation costs associated with outstanding stock and stock-linked awards totaled approximately \$3.0 million.

13. Non-Controlling Interests and Preferred Stock of Subsidiary

Holders of non-controlling interests (NCI) or preferred stock in a subsidiary of the Company hold certain rights, which result in the classification of the securities as either liability, temporary equity or permanent equity. The following table summarizes the non-controlling interest and preferred stock of subsidiary balances on the condensed consolidated balance sheets:

| <i>(in thousands)</i> | <u>September 30, 2019</u> | <u>June 30, 2019</u> |
|------------------------------------|---------------------------|----------------------|
| DME Inc. | | |
| NCI classified as temporary equity | 3,832 | 3,912 |
| NCI classified as permanent equity | 3,832 | 3,912 |
| Total DME Inc. | 7,664 | 7,824 |
| GECC GP Corp. | | |
| NCI classified as permanent equity | (668) | (626) |
| GE FM Holdings | | |
| NCI classified as permanent equity | 743 | 730 |
| Total | <u>\$ 7,739</u> | <u>\$ 7,928</u> |

The following table summarizes the net income (loss) attributable to the non-controlling interests on the condensed consolidated statements of operations:

| <i>(in thousands)</i> | <u>For the three months ended September 30,</u> | |
|---|---|---------------|
| | <u>2019</u> | <u>2018</u> |
| DME Holdings | | |
| Preferred stock classified as liability | \$ - | \$ - |
| DME Inc. | | |
| NCI classified as temporary equity | (80) | 10 |
| NCI classified as permanent equity | (80) | 10 |
| Total DME Inc. | (160) | 20 |
| GECC GP Corp. | | |
| NCI classified as permanent equity | (42) | (35) |
| GE FM Holdings | | |
| NCI classified as permanent equity | 13 | 11 |
| Total | <u>\$ (189)</u> | <u>\$ (5)</u> |

Preferred stock in DME Holdings classified as liability

In connection with the acquisition of the acquired businesses on September 7, 2018, the Company issued 5,266 shares of preferred stock in DME Holdings valued at \$1,000 per share at issuance. In January 2019, as a result of adjustments to the net working capital adjustment to the total consideration for the acquisition, 214 shares of preferred stock were cancelled and forfeited. The Company redeemed 1,500 shares of preferred stock in March 2019 and the remaining 3,552 shares of preferred stock were redeemed in June 2019. As of June 30, 2019, there were no shares of preferred stock in DME Holdings outstanding.

Non-controlling interest in DME Inc. classified as temporary equity

In connection with the acquisition of the acquired businesses on September 7, 2018, the Company issued a 9.95% common stock equity ownership in DME Inc. The holder of the interest has a board observer rights for the DME Inc. board of directors, but no voting rights. DME Inc. has the right of first offer if the holder desires to sell the security and in the event of a sale of DME Inc., the holder must sell their securities (drag along rights) and has the right to participate in sales of DME Inc. securities (tag along rights). In addition, upon the seventh anniversary of issuance date, if (i) the holder owns 50% of the common shares issued to it at the closing of the transaction, (ii) an initial public offering of DME Inc. has not commenced and (iii) the holder has not had an earlier opportunity to sell its shares at their fair market value, the holder has the right to request a marketing process for a sale of DME Inc. and has the right to put its common shares to DME Inc. at the price for such shares implied by such marketing process. The Company also has the right to call the holder's common shares at such price. The holder of the non-controlling interest is entitled to participate in earnings of DME Inc. and is not required to fund losses. As the redemption is contingent upon future events outside of the Company's control which are not probable, the Company has classified the non-controlling interest as temporary equity and its fair value on the date of issuance, adjusted for any earnings in DME Inc.

The holder of this non-controlling interest, Corbel, is also the holder of the Corbel Facility and the preferred stock in DME Holdings discussed above. See Note 5 – Related Party Transactions and Note 11 – Borrowings.

Non-controlling interest in DME Inc. classified as permanent equity

In connection with the acquisition of the acquired businesses on September 7, 2018, the Company issued one of the former owners, a 9.95% common stock equity ownership in DME Inc. The rights are consistent with the non-controlling interest classified as temporary equity, other than the holder does not have a contingent put right. Accordingly, Company has classified the non-controlling interest as permanent equity at its fair value on the date of issuance, adjusted for any earnings in DME Inc.

GECC GP Corp. – Non-controlling interest classified as permanent equity

In September 2017, the Company eliminated the vesting provisions and removed the call rights for the GECC GP Corp. stock owned by employees of the Company. As a result of the elimination, the Company recognized stock-based compensation expense of \$1.5 million, equal to the estimated fair value of the non-controlling interest held by our employees in GECC GP Corp.

GE FM Holdings – Non-controlling interest classified as permanent equity

In connection with the acquisition of the real estate business in March 2018, the Company issued the former owner a 19.9% interest in GE FM Holdings.

14. Income Tax

As of June 30, 2019, the Company had net operating loss (NOL) carryforwards for federal and state income tax purposes of approximately \$1.6 billion and \$199 million, respectively. The federal NOL carryforwards generated prior to fiscal year 2018 will expire from 2020 through 2037. The federal NOL carryforwards generated in fiscal year 2018 or later which can be carried forward indefinitely. The state NOL carryforwards will expire from 2029 through 2037. The Company assesses NOL carryforwards based on taxable income on an annual basis.

15. Segment Information

The Company allocates resources based on four operating segments: durable medical equipment, investment management, real estate and general corporate.

The following tables illustrate results of operations by segment:

| | For the three months ended September 30, 2019 | | | | | |
|--|---|-----------------------|-------------|-------------------|---|--------------------|
| <i>(in thousands)</i> | Durable Medical Equipment | Investment Management | Real Estate | General Corporate | Reconciliation to Consolidated Total ⁽¹⁾ | Consolidated Total |
| Revenue: | | | | | | |
| Total revenue | \$ 13,231 | \$ 867 | \$ 1,273 | \$ 23 | \$ (23) | \$ 15,371 |
| Operating costs and expenses: | | | | | | |
| Cost of durable medical equipment sold and services | (3,463) | - | - | - | - | (3,463) |
| Cost of durable medical equipment rentals | (2,265) | - | - | - | - | (2,265) |
| Depreciation and amortization | (457) | (179) | (431) | - | - | (1,067) |
| Stock-based compensation ⁽²⁾ | - | (175) | - | (118) | - | (293) |
| Transaction costs ⁽³⁾ | - | - | - | (91) | - | (91) |
| Other selling, general and administrative | (6,872) | (516) | (124) | (1,577) | 23 | (9,066) |
| Total operating expenses | (13,057) | (870) | (555) | (1,786) | 23 | (16,245) |
| Other income (expense): | | | | | | |
| Interest expense | (996) | (42) | (658) | - | - | (1,696) |
| Other income (expense) | 3 | - | - | (469) | - | (466) |
| Total other income (expense), net | (993) | (42) | (658) | (469) | - | (2,162) |
| Total pre-tax income (loss) from continuing operations | \$ (819) | \$ (45) | \$ 60 | \$ (2,232) | \$ - | \$ (3,036) |

| | For the three months ended September 30, 2018 | | | | | |
|--|---|-----------------------|-------------|-------------------|---|--------------------|
| <i>(in thousands)</i> | Durable Medical Equipment ⁽⁴⁾ | Investment Management | Real Estate | General Corporate | Reconciliation to Consolidated Total ⁽¹⁾ | Consolidated Total |
| Revenue: | | | | | | |
| Total revenue | \$ 4,091 | \$ 940 | \$ 1,442 | \$ 18 | \$ (18) | \$ 6,473 |
| Operating costs and expenses: | | | | | | |
| Cost of durable medical equipment sold and services | (944) | - | - | - | - | (944) |
| Cost of durable medical equipment rentals | (290) | - | - | - | - | (290) |
| Depreciation and amortization | (143) | (136) | (431) | - | - | (710) |
| Stock-based compensation ⁽²⁾ | - | (545) | - | (128) | - | (673) |
| Transaction costs | (542) | - | - | (1,324) | - | (1,866) |
| Other selling, general and administrative | (1,879) | (904) | (295) | (1,373) | 18 | (4,433) |
| Total operating expenses | (3,798) | (1,585) | (726) | (2,825) | 18 | (8,916) |
| Other income (expense): | | | | | | |
| Interest expense | (286) | (44) | (665) | - | - | (995) |
| Other income (expense) | 20 | - | - | 1,477 | - | 1,497 |
| Total other income (expense), net | (266) | (44) | (665) | 1,477 | - | 502 |
| Total pre-tax income (loss) from continuing operations | \$ 27 | \$ (689) | \$ 51 | \$ (1,330) | \$ - | \$ (1,941) |

- (1) The Company's wholly-owned subsidiary, Great Elm DME Manager, LLC (**DME Manager**), provides advisory services to DME Inc. and receives consulting fee from DME Inc. for those services. DME Manager is considered part of the general corporate segment of the Company. The corresponding expense to DME Inc. and revenue to DME Manager are eliminated in consolidation.
- (2) Stock-based compensation attributable to the investment management segment is included in investment management expenses in the condensed consolidated statements of operations. Stock-based compensation attributable to the general corporate segment is included in selling, general and administrative expense in the condensed consolidated statements of operations.
- (3) Transaction costs, which consist of legal and other professional services, are included in selling, general and administrative expense in the condensed consolidated statements of operations.
- (4) Our durable medical equipment business began in September 2018 and there was no related activity prior to that date.

The following tables illustrate assets by segment:

| | As of September 30, 2019 | | | | |
|-------------------------------------|--------------------------------------|----------------------------------|--------------------|--------------------------|-------------------|
| <i>(in thousands)</i> | Durable Medical Equipment | Investment Management | Real Estate | General Corporate | Total |
| Fixed assets, net | \$ 10,197 | \$ 45 | \$ 54,105 | \$ - | \$ 64,347 |
| Identifiable intangible assets, net | 8,879 | 2,733 | 5,245 | - | 16,857 |
| Goodwill | 50,433 | - | - | - | 50,433 |
| Other assets | 15,393 | 2,757 | 1,674 | 26,678 | 46,502 |
| Total | \$ 84,902 | \$ 5,535 | \$ 61,024 | \$ 26,678 | \$ 178,139 |

| | As of June 30, 2019 | | | | |
|-------------------------------------|--------------------------------------|----------------------------------|--------------------|--------------------------|-------------------|
| <i>(in thousands)</i> | Durable Medical Equipment | Investment Management | Real Estate | General Corporate | Total |
| Fixed assets, net | \$ 10,464 | \$ 43 | \$ 54,411 | \$ - | \$ 64,918 |
| Identifiable intangible assets, net | 9,297 | 2,910 | 5,369 | - | 17,576 |
| Goodwill | 50,397 | - | - | - | 50,397 |
| Other assets | 17,300 | 3,065 | 1,534 | 27,936 | 49,835 |
| Total | \$ 87,458 | \$ 6,018 | \$ 61,314 | \$ 27,936 | \$ 182,726 |

16. Commitments and Contingencies

From time to time, the Company is involved in lawsuits, claims, investigations and proceedings that arise in the ordinary course of business. The Company maintains insurance to mitigate losses related to certain risks. The Company is not a named party in any other pending or threatened litigation that we expect to have a material adverse impact on our business, results of operations, financial condition or cash flows.

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

Overview

We are a holding company seeking to acquire assets and businesses, where our people and other assets provide a competitive advantage. We currently have four business operating segments: durable medical equipment, investment management, real estate, and general corporate.

In September 2018, we launched our durable medical equipment segment by acquiring two durable medical equipment businesses that specialize in the distribution of respiratory care equipment, including positive air pressure equipment and supplies, ventilators and oxygen equipment, and also provide sleep study services.

Through our investment management business we manage a business development company, Great Elm Capital Corp. (**GECC**), a credit-focused private fund, Great Elm Opportunities Fund I, LP, and separate accounts for an institutional investor. The combined assets under management of these entities at September 30, 2019 was approximately \$235.1 million.

Our real estate business, which we launched in March 2018, has a majority-interest in two Class A office buildings totaling 257,000 square feet situated on 17 acres of land in Fort Myers, Florida (collectively, the **Property**). The Property is fully-leased, on a triple-net basis, to a single tenant through March 31, 2030.

The operations of our general corporate segment encompass our corporate headquarters operations, in addition to management consulting services provided to certain of our subsidiaries.

We continue to explore other opportunities in the durable medical equipment, investment management and real estate sectors, as well as opportunities in other areas that we believe provide attractive risk-adjusted returns on invested capital. As of the date of this report, we have not entered into any firm commitments to make additional acquisitions or investments in any of these areas.

As of June 30, 2019, we had \$1.6 billion of net operating loss (**NOL**) carryforwards for federal income tax purposes.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (**US GAAP**). The preparation of these financial statements requires our management to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These items are monitored and analyzed by our management for changes in facts and circumstances, and material changes in these estimates could occur in the future. During the three months ended September 30, 2019, we did not make material changes in our critical accounting policies or underlying assumptions as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2019 as it relates to recurring transactions.

Results of Operations

The following discussion is reflective of our four business operating segments. The durable medical equipment segment commenced operations in September 2018 and thus the results of operations for this segment for the three months ended September 30, 2019 presented are not comparable to the corresponding period ended September 30, 2018.

The following table provides the results of our consolidated operations for the three months ended September 30, 2019 and 2018:

| <i>(in thousands)</i> | For the three months ended September 30, | | |
|--|---|-----------------------|-------------|
| | 2019 | Percent Change | 2018 |
| Revenue: | | | |
| Total revenue | \$ 15,371 | 137% | \$ 6,473 |
| Operating costs and expenses: | | | |
| Cost of goods sold | (3,463) | 267% | (944) |
| Cost of rentals | (2,265) | 681% | (290) |
| Other selling, general and administrative | (9,450) | 36% | (6,972) |
| Depreciation and amortization | (1,067) | 50% | (710) |
| Total operating expenses | (16,245) | | (8,916) |
| Operating income (loss) | (874) | | (2,443) |
| Other income (expense): | | | |
| Interest expense | (1,696) | 70% | (995) |
| Other income (expense) | (466) | (131)% | 1,497 |
| Total other expense, net | (2,162) | | 502 |
| Total pre-tax income (loss) from continuing operations | \$ (3,036) | | \$ (1,941) |

Revenue

Revenue for the three months ended September 30, 2019 included \$13.2 million from the durable medical equipment business, \$0.9 million from the investment management business and \$1.3 million from the real estate business, while revenue for the three months ended September 30, 2018 included \$4.1 million from the durable medical equipment business, \$0.9 million from the investment management business and \$1.4 million from the real estate business. The increase in total revenue for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, is primarily attributable to the acquisition of the durable medical equipment business in September 2018 thus the current year reflects a full quarter of activity in the current period whereas the inception period was of limited duration.

Operating costs and expenses

The increase in operating costs for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, is primarily attributable to the additional costs associated with the durable medical equipment business, including cost of goods sold and cost of rentals, as well as the general and administrative costs of the durable medical equipment business, depreciation on fixed assets and amortization of the intangible assets associated with the durable medical equipment business.

Other income (expense)

Interest expense increased for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, due to increased borrowings related to our acquisition of the durable medical equipment business in September 2018. Other income and expense consisted of dividend income and unrealized gains or losses on the Company's investment in GECC and interest income earned on cash balances. The period over period decrease is primarily attributable to unrealized gains and losses on the Company's investment in GECC, which is discussed under "—General Corporate" below.

Durable Medical Equipment Business

The key metrics of our durable medical equipment business include:

- Patients and setup growth – which drives revenue growth and takes advantage of scalable operations
- Earnings before interest, taxes, depreciation and amortization (EBITDA)

The following table provides the results of our durable medical equipment business for the three months ended September 30, 2019 and for the period from the inception of the durable medical equipment business to September 30, 2018 (the **inception period**).

| <i>(in thousands)</i> | For the three months ended September 30, 2019 | Percent Change | For the period September 7, 2018 to September 30, 2018 |
|--|--|-----------------------|---|
| Revenue: | | | |
| Total revenue | \$ 13,231 | 223% | \$ 4,091 |
| Operating costs and expenses: | | | |
| Cost of goods sold | (3,463) | 267% | (944) |
| Cost of rentals | (2,265) | 681% | (290) |
| Transaction costs | - | (100)% | (542) |
| Other selling, general and administrative | (6,872) | 266% | (1,879) |
| Depreciation and amortization | (457) | 220% | (143) |
| Total operating expenses | (13,057) | | (3,798) |
| Other income (expense): | | | |
| Interest expense | (996) | 248% | (286) |
| Other income (expense) | 3 | (85)% | 20 |
| Total other expense, net | (993) | | (266) |
| Operating income (loss): | | | |
| Total pre-tax income (loss) from continuing operations | <u>\$ (819)</u> | | <u>\$ 27</u> |

Durable Medical Equipment Revenue

For the three months ended September 30, 2019, durable medical equipment revenue consisted of \$7.7 million in sales of medical equipment and sleep study services and \$5.5 million in rentals of medical equipment. For the inception period ended September 30, 2018, durable medical equipment revenue consisted of \$2.8 million in sales of medical equipment and sleep study services and \$1.3 million in rentals of medical equipment. The increase in revenue for the three months ended September 30, 2019, as compared to the inception period ended September 30, 2018, is primarily attributable to having a full quarter of activity in the current period whereas the inception period was of limited duration.

Durable Medical Equipment Costs and Expenses

Cost of goods sold includes inventory costs for medical equipment sold and direct costs associated with running sleep study services, including staff compensation to perform the studies and the purchase of supplies used in the studies. For the three months ended September 30, 2019, cost of rentals included \$2.1 million of depreciation on medical equipment held for lease with the remaining costs related to maintenance expenses. For the three months ended September 30, 2019, gross margin is 57% as compared to 70% for period from September 7, 2018 to September 30, 2018. The decrease in margin is mainly due to timing and mix of the short comparable period, which is not indicative of typical results for a full fiscal quarter. For the period from inception through June 30, 2019, the gross margin is 59%, which is more consistent with the three months ended September 30, 2019.

General and administrative expenses for the three months ended September 30, 2019 included approximately \$4.8 million of payroll and related costs, \$0.9 million of rental expenses associated with facility and equipment leases and other administrative costs. Depreciation and amortization includes the depreciation of fixed assets, excluding depreciation on the equipment held for rental, which is included in the cost of rentals, and amortization of the intangible assets resulting from the acquisition of the durable medical equipment businesses.

In addition to the operating costs, we recognized interest expense of \$1.0 million for the three months ended September 30, 2019. In addition, management and monitoring expenses, which are payable to Great Elm DME Manager, LLC (**DME Manager**), a subsidiary of the Company in the general corporate segment, and one of the former owners of the durable medical equipment businesses, are included in other selling, general and administrative expense.

The increases in expenses, with the exception of transaction costs, for the three months ended September 30, 2019 as compared to the inception period ended September 30, 2018 are primarily attributable to having a full quarter of activity in the current period whereas the inception period was of limited duration. Transaction costs decreased for the three months ended September 30, 2019 as compared to the inception period ended September 30, 2018 as they primarily relate to one time expenses incurred in the period of acquisition.

Investment Management Business

The key metrics of our investment management business are:

- Assets under management — which provides the basis on which our management fees and performance milestones for vesting of certain equity awards are based; and
- Investment performance — on which our incentive fees (if any) are based and on which we are measured against our competition.

The following table provides the results of our investment management business for the three months ended September 30, 2019 and 2018.

| <i>(in thousands)</i> | For the three months ended September 30, | | |
|--|---|-----------------------|-------------|
| | 2019 | Percent Change | 2018 |
| Revenue: | | | |
| Total revenue | \$ 867 | (8)% | \$ 940 |
| Operating costs and expenses: | | | |
| Stock-based compensation | (175) | (68)% | (545) |
| Consulting agreement | (211) | 3% | (204) |
| Other general and administrative | (305) | (56)% | (700) |
| Depreciation and amortization | (179) | 32% | (136) |
| Total operating expenses | (870) | | (1,585) |
| Other income (expense): | | | |
| Interest expense | (42) | (5)% | (44) |
| Other income (expense) | - | 0% | - |
| Total other expense, net | (42) | | (44) |
| Operating income (loss): | | | |
| Total pre-tax income (loss) from continuing operations | \$ (45) | | \$ (689) |

Investment Management Revenue

For the three months ended September 30, 2019 and 2018, investment management revenue consisted of \$0.8 million in management fees and \$0.1 million in administrative fees and \$0.8 million in management fees and \$0.2 million in administrative fees, respectively.

Investment Management Costs and Expenses

Stock-based compensation decreased by approximately \$0.4 million for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, due to non-recurring stock-based compensation awarded in connection with internal restructuring in September 2017, which resulted in increased stock-based compensation for the subsequent one-year period. The decrease in other general and administrative expenses for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018, is primarily attributable to the decrease in payroll costs of approximately \$0.4 million due to the acquisition of the durable medical equipment businesses in September 2018, which resulted in increased allocation of certain payroll and related costs to the general corporate segment.

Real Estate Business

The key metrics of our real estate business include rental revenues, depreciation on rental properties and interest expense on the related debt.

The following table provides the results of our real estate business for the three months ended September 30, 2019 and 2018.

| (in thousands) | For the three months ended September 30, | | |
|--|--|----------------|----------|
| | 2019 | Percent Change | 2018 |
| Revenue: | | | |
| Total revenue | \$ 1,273 | (12)% | \$ 1,442 |
| Operating costs and expenses: | | | |
| General and administrative | (124) | (58)% | (295) |
| Depreciation and amortization | (431) | 0% | (431) |
| Total operating expenses | (555) | | (726) |
| Other income (expense): | | | |
| Interest expense | (658) | (1)% | (665) |
| Other income (expense) | - | 0% | - |
| Total other expense, net | (658) | | (665) |
| Operating income (loss): | | | |
| Total pre-tax income (loss) from continuing operations | \$ 60 | | \$ 51 |

Real Estate Revenue

Real estate rental revenue for the three months ended September 30, 2019 decreased by approximately \$0.2 million as compared to the three months ended September 30, 2018 as a result of the adoption of updated lease accounting guidance, which excludes from revenue and the corresponding real estate expenses any lessor costs paid directly to third parties by the lessee.

Real Estate Costs and Expenses

General and administrative costs primarily consisted of management fees, insurance, real estate taxes and state sales tax expense. Depreciation and amortization for the three months ended September 30, 2019 and 2018 each includes depreciation on real estate assets of \$0.3 million and the amortization of the related intangible asset of \$0.1 million.

General Corporate

The following table provides the results of our general corporate activities for the three months ended September 30, 2019 and 2018.

| <i>(in thousands)</i> | For the three months ended September 30, | | |
|--|--|----------------|-------------------|
| | 2019 | Percent Change | 2018 |
| Revenue: | | | |
| Total revenue | \$ 23 | 28% | \$ 18 |
| Operating costs and expenses: | | | |
| Stock-based compensation | (118) | (8)% | (128) |
| Transaction costs | (91) | (93)% | (1,324) |
| Other general and administrative | (1,577) | 15% | (1,373) |
| Depreciation and amortization | - | 0% | - |
| Total operating expenses | (1,786) | | (2,825) |
| Other income (expense): | | | |
| Interest expense | - | 0% | - |
| Other income (expense) | (469) | (132)% | 1,477 |
| Total other income (expense), net | (469) | | 1,477 |
| Operating income (loss): | | | |
| Total pre-tax income (loss) from continuing operations | <u>\$ (2,232)</u> | | <u>\$ (1,330)</u> |

General Corporate Revenue

For the three months ended September 30, 2019 and 2018, all revenue was derived from fees earned by DME Manager, which provides consulting services to Great Elm DME, Inc. (**DME Inc.**) Both DME Manager and DME Inc. were formed in connection with the acquisition of the durable medical equipment businesses in September 2018 and there was no corresponding activity prior to this acquisition.

General Corporate Costs and Expenses

Our general and administrative costs primarily consisted of professional fees and payroll costs in connection with our general corporate oversight of our subsidiaries and diligence efforts towards identifying asset and business acquisition opportunities. General and administrative costs for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018 increased by approximately \$0.3 million in payroll costs due to the acquisition of the durable medical equipment businesses in September 2018, which resulted in increased overhead allocations to the general corporate segment.

Transaction costs primarily consist of professional fees and payroll costs in connection with our acquisitions of assets and businesses. The decrease in transaction costs for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018 is attributable to the one-time costs incurred in connection with the acquisition of the durable medical equipment businesses in September 2018.

Other Income (Expense)

Other income and expense primarily consisted of dividends and unrealized gains or losses on the Company's investment in GECC and interest income earned on cash balances. The decrease in other income and expense is primarily driven by fluctuations in the fair value of the investment in GECC, which resulted in an unrealized loss of \$1.0 million for the three months ended September 30, 2019, as compared to an unrealized gain of \$0.9 million for the three months ended September 30, 2018, for a period over period net decrease of approximately \$1.9 million.

Income Taxes

As of June 30, 2019, the Company had NOL carryforwards for federal and state income tax purposes of approximately \$1.6 billion and \$199 million, respectively. The federal NOL carryforwards generated prior to fiscal year 2018 will expire from 2020 through 2037. The federal NOL carryforwards generated in fiscal year 2018 or later which can be carried forward indefinitely. The state NOL carryforwards will expire from 2029 through 2037. The Company assesses NOL carryforwards based on taxable income on an annual basis.

The Company's tax provision for the three months ended September 30, 2019 primarily consists of a provision for state taxes of approximately \$0.2 million.

Liquidity and Capital Resources

Cash Flows

Operating cash flows provided by continuing operations for the three months ended September 30, 2019 were \$1.1 million. The net cash inflow in our continuing operations was primarily the result of our net loss of \$3.3 million offset by non-cash charges of \$4.5 million. Additional net cash inflows from operations are attributable to increase of \$0.9 million in accounts payable, accrued liabilities and other liabilities partially offset by outflows due to decreases of \$0.3 million and \$0.7 million related to prepaid assets, deposits, and other assets and related party payables, respectively. The fluctuations in these accounts are due to the timing of cash payments and cash receipts in the normal course of business.

Operating cash flows used in continuing operations for the three months ended September 30, 2018 were \$0.4 million. The net cash outflow in our continuing operations was primarily the result of our net loss, offset by non-cash charges of approximately \$1.0 million, and increases in accounts payable and accrued expenses related to our activity subsequent to our acquisition of the durable medical equipment businesses, partially offset by increases in prepaid expenses, such as insurance, which is paid annually up front in the first quarter of the year, and increased receivables and inventories primarily related to the durable medical equipment businesses acquired during the quarter.

Investing cash flows used in continuing operations for the three months ended September 30, 2019 were \$1.4 million. The net cash outflow primarily consisted of \$2.1 million in purchases of equipment for rental partially offset by proceeds from sale of equipment held for rental and disposal of property and equipment.

Investing cash flows used in continuing operations for the three months ended September 30, 2018 were \$42.3 million. Nearly all of the net cash outflow was used in our acquisition of the durable medical equipment businesses during the quarter.

Financing cash flows used in continuing operations for the three months ended September 30, 2019 were \$1.7 million which primarily consisted of principal payments on long term debt, related party notes payable and our revolving line of credit.

Financing cash flows provided by continuing operations for the three months ended September 30, 2018 were \$22.5 million. Approximately \$16.1 million and \$5.5 million was provided by net proceeds on the note payable from a seller and a revolving line of credit, respectively, established with the acquisition of the durable medical equipment businesses. An additional \$1.4 million was provided by the exercise of warrants by MAST Capital Management, LLC (**MAST Capital**) in July 2018.

Financial Condition

As of September 30, 2019, we had an unrestricted cash balance of \$10.1 million. We also beneficially own 1,966,667 shares of GECC common stock with an estimated fair value of \$16.1 million as of September 30, 2019.

We intend to make acquisitions or investments that we believe will result in the investment of all of our liquid financial resources, to issue equity securities and to incur indebtedness. If we are unsuccessful at raising additional capital resources, through either debt or equity, it is unlikely we will be able execute our strategic growth plan.

Borrowings

As of September 30, 2019, we had a note due to a non-controlling interest holder of DME Inc., Corbel Capital Partners SBIC, L.P. (**Corbel**), totaling \$26.6 million that accrues interest at a rate of three-month LIBOR plus 10.0% (at September 30, 2019, the effective interest rate was 12.1%) through maturity on August 31, 2023 (the **Corbel Facility**). The Corbel Facility requires quarterly interest payments along with principal payments of \$0.3 million plus an additional amount based on excess cash flows, if any, generated by the durable medical equipment business operations. The Corbel Facility is secured by all of the assets of the durable medical equipment business.

The Company has the option to prepay the borrowings outstanding under the Corbel Facility in whole or in part subject to certain prepayment penalties ranging from 1.0% - 5.0% of the early payment of the principal, based on the time that the Corbel Facility has been outstanding through the first five years of the loan.

DME Inc. is required to pay to Corbel, as agent of the Corbel Facility, a quarterly monitoring fee of \$25,000 per quarter while the borrowings remain outstanding. In addition, if the borrowing is repaid with proceeds of debt in full or in part at any time within the first three years from the date of issuance, the borrower shall pay an additional fee to the agent, ranging from 2.10% to 3.50% depending on the date of repayment based on the period outstanding, of the aggregate repaid principal amount.

As of September 30, 2019, we had a credit facility due to Pacific Mercantile Bank totaling \$6.9 million that accrues interest at the prime rate plus 0.4% (at September 30, 2019, the effective rate was 5.4%) through maturity on August 30, 2020 (the **DME Revolver**). The DME Revolver allows for borrowings up to \$10 million. The DME Revolver requires monthly interest payments. The DME Revolver is secured by all of the assets of the durable medical equipment business and the Company is required to meet certain financial covenants.

The Corbel Facility and DME Revolver each include covenants that restrict DME Inc. business operations to its current business, limit additional indebtedness, liens, asset dispositions and investments, require compliance and maintenance of licenses and government approvals and other customary conditions. Events of default include the failure to pay amounts when due, bankruptcy, or violation of covenants, including a change in control of DME Inc. DME Inc. must also comply with a fixed-charge coverage and leverage ratio financial covenants, which are based in part on the DME Inc. EBITDA levels.

As of September 30, 2019, we had a related party GP Corp. Note due to MAST Capital totaling \$3.1 million that accrues interest at a variable rate of three-month LIBOR plus 3.0%, as adjusted for each 90-day period (at September 30, 2019, the effective rate was 5.1%) through maturity on November 3, 2026. The GP Corp. Note requires minimum annual principal payments of \$0.08 million and quarterly interest-only payments. The GP Corp. Note is secured by the profit sharing agreement between one of our wholly-owned subsidiaries, Great Elm Capital Management, Inc. (**GECM**) and GECC GP Corp. (the **Profit Sharing Agreement**) that transfers profits generated by our management of GECC, with no recourse to any of our other assets, entities or operations.

The GP Corp. Note is non-recourse to any of the Company's operations or net assets not related to GECM's management services to GECC. The GP Corp. Note may be prepaid at par value at any time with prior written notice to the holders of the GP Corp. Note. Additionally, GECC GP Corp. is required to prepay the GP Corp. Note upon certain material liquidation transactions including any termination of the Profit Sharing Agreement.

As of September 30, 2019, we had a senior note due to Wells Fargo Bank Northwest, National totaling \$51.6 million that accrues interest at a rate of 3.49% through maturity on March 15, 2030 (the **Senior Note**). The Senior Note requires monthly principal and interest payments through the maturity date. The Senior Note is secured by a first lien mortgage on the Property and an Assignment of Leases and Rents, with no recourse to any of our assets, entities or operations.

The principal and interest due on the Senior Note may be prepaid at the option of the borrower, based on an amount determined by discounting the remaining principal and interest payments at a rate equal to an applicable premium in excess of a rate corresponding to the specified U.S. Treasury security over the remaining average life of the Senior Note.

As of September 30, 2019, we had a subordinated note due to Wells Fargo Bank Northwest, National totaling \$3.4 million that accrues interest at a rate of 15.0% through maturity on March 15, 2030 (the **Subordinated Note**). The Subordinated Note is a capital appreciation note, whereby the monthly interest is capitalized to the principal balance and due at maturity. The Subordinated Note is secured by a second lien mortgage on the Property, and an Assignment of Leases and Rents, with no recourse to any of our assets, entities or operations.

The principal and interest due on the Subordinated Note may be prepaid at the option of the borrower, based on an amount determined by discounting the remaining principal and interest payments at a rate equal to an applicable premium in excess of a rate corresponding to the specified U.S. Treasury security over the remaining average life of the Subordinated Note.

The note agreements for both the Senior Note and the Subordinated Note include negative covenants that restrict the Company's majority-owned subsidiary, CRIC IT Fort Myers LLC's (the **Property Owner**), business operations to ownership and lease of the Property, limit additional indebtedness, require maintenance of insurance and other customary requirements related to the Property. Events of default include non-payment of amounts when due, inability to pay indebtedness or material change in the business operations or financial condition of the Property Owner or the lease tenant that in the lender's reasonable determination would reasonably be expected to materially impair the value of the Property, prevent timely repayment of the notes or performance of any material obligations under the notes and related agreements. The payments under the notes are also guaranteed on a full and several basis by the non-controlling interest holder of the Property Owner. Both the Senior Note and Subordinated Note are non-recourse to the Company, but are secured by the Property, the rights associated with the leases and the stock owned by the Company in the Property Owner.

Off-Balance Sheet Arrangements

As of September 30, 2019, we did not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes in the market risks discussed in Item 7A. of our Annual Report on Form 10-K for the fiscal year ended June 30, 2019.

Item 4. Controls and Procedures.

We evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2019. Disclosure controls and procedures include, without limitation, controls and procedures that are designed to ensure that the information we are required to disclose in reports that we file under the Securities Exchange Act of 1934, as amended, (the **Exchange Act**) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer (**CEO**) and Chief Financial Officer (**CFO**), to allow timely decisions regarding required disclosure. Our CEO and CFO participated in this evaluation and concluded that, as of September 30, 2019, our disclosure controls and procedures were not effective.

As disclosed in our Annual Report on Form 10-K, Item 9A. for the fiscal year ended June 30, 2019, our management concluded that our internal controls over financial reporting were not effective at June 30, 2019. As of that date, material weaknesses were identified in the principals associated with each component of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework.

We have taken numerous actions to remediate the control deficiencies which contributed to the material weaknesses, including engaging an outside consultant to assist us in our remediation efforts, redesign of existing controls, the implementation of new controls and the development of an ongoing control testing plan. When all remedial actions are complete and in operation for a sufficient period of time, we will test the controls to determine whether the applicable controls are operating effectively. The material weaknesses will not be considered remediated until our controls are operational for a period of time, tested and management concludes that these controls are operating effectively.

There were no material changes in our internal control over financial reporting for the quarter ended September 30, 2019, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

We and our board of directors believe that these remediation efforts will result in significant improvements in our control environment. Notwithstanding the identified material weaknesses and the conclusion that our controls were not effective as of June 30, 2019, management believes that the condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented in conformity with US GAAP.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

No changes required to be disclosed.

Item 1A. Risk Factors.

We have disclosed the risk factors affecting our business, financial condition and operating results in the section entitled “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended June 30, 2019. There have been no material changes from the risk factors previously disclosed.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

EXHIBIT INDEX

All references are to filings by GEC, formerly known as Unwired Planet, Inc. (the **Registrant**) with the SEC under File No. 001-16073.

| Exhibit Number | Description |
|-----------------------|---|
| 2.1 | <u>Contract of Purchase and Sale, dated as of March 6, 2018, by and between IT Fort Myers Holdings LLC and Great Elm FM Holdings, Inc. (incorporated by reference to Exhibit 2.1 to the Form 8-K filed on March 6, 2018)</u> |
| 2.2 | <u>Transaction Agreement, dated as of September 7, 2018, by and among Corbel Capital Partners SBIC, L.P., NWMI Manager LLC, Valley Healthcare Holding, LLC and Great Elm DME Holdings, Inc. (incorporated by reference to Exhibit 2.1 to the Form 8-K filed on September 11, 2018)</u> |
| 3.1 | <u>Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on November 15, 2013)</u> |
| 3.2 | <u>Certificate of Ownership and Merger merging Unwired Planet, Inc. with and into Openwave Systems Inc. (incorporated by reference to Exhibit 3.3 to the Form 10-Q filed on May 10, 2012)</u> |
| 3.3 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on January 5, 2016)</u> |
| 3.4 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on January 11, 2016)</u> |
| 3.5 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on June 16, 2016)</u> |
| 3.6 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on October 17, 2017)</u> |
| 3.7 | <u>Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Form 8-K filed on November 15, 2013)</u> |
| 4.1 | <u>Amended and Restated Form of the Registrant's Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Form 10-Q filed on May 15, 2018)</u> |
| 4.2 | <u>Amended and Restated Certificate of Designations of Series A Junior Participating Cumulative Preferred Stock (incorporated by reference to Exhibit 3.1 to the Form 8-A filed on January 29, 2018)</u> |
| 4.3 | <u>Stockholders' Rights Agreement, dated as of January 28, 2018, between the Registrant and Computershare Trust Company, N.A., as Rights Agent (incorporated by reference to Exhibit 4.1 to the Form 8-A filed on January 29, 2018)</u> |
| 31.1* | <u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2* | <u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1* | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 101 | Materials from the Great Elm Capital Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2019, formatted in Extensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Stockholders' Equity and Contingently Redeemable Non-Controlling Interest,, (iv) Condensed Consolidated Statements of Cash Flows, and (v) related Notes to the Condensed Consolidated Financial Statements, tagged in detail (furnished herewith). |

*Filed herewith.

SIGNATURES

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

GREAT ELM CAPITAL GROUP, INC.

Date: November 12, 2019

/s/ Peter A. Reed

Peter A. Reed

Chief Executive Officer

Date: November 12, 2019

/s/ Brent J. Pearson

Brent J. Pearson

Chief Financial Officer

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Peter A. Reed, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Great Elm Capital Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2019

By: /s/ Peter A. Reed
Peter A. Reed
(Principal Executive Officer)

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Brent J. Pearson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Great Elm Capital Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2019

By: /s/ Brent J. Pearson
Brent J. Pearson
(Principal Financial Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Great Elm Capital Group, Inc. (the "Company") for the period ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Peter A. Reed, Principal Executive Officer of the Company, and Brent J. Pearson, Principal Financial Officer of the Company, each certify, pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934 as amended (the "Exchange Act") and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the undersigned's knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Peter A. Reed
Peter A. Reed
(Principal Executive Officer)

By: /s/ Brent J. Pearson
Brent J. Pearson
(Principal Financial Officer)

November 12, 2019