

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Financial Statements and Independent Accountants' Compilation
Report

Year ended June 30, 2022

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INDEPENDENT ACCOUNTANTS' COMPILATION REPORT

To the Board of Directors and Shareholders of
Thirty Three Threads, Inc. and subsidiary
Vista, California

Management is responsible for the accompanying consolidated financial statements of Thirty Three Threads, Inc. and subsidiary (the Company), which comprise the consolidated balance sheet as of June 30, 2022, and the related consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. We did not audit or review the consolidated financial statements, nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these consolidated financial statements.

Hutchinson and Bloodgood LLP

San Diego, California
October 21, 2022

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Balance Sheet
June 30, 2022

	2022
ASSETS	
Current assets	
Cash	\$ 1,314,260
Accounts receivable, net	1,785,658
Other receivables	59,127
Prepaid expenses	439,385
Inventories, net	<u>5,007,005</u>
Total current assets	<u>8,605,435</u>
Property and equipment, net	<u>302,394</u>
Other assets	
Goodwill	3,558,137
Intangible assets, net	1,977,965
Operating lease right-of-use asset, net	839,693
Deposits	<u>26,535</u>
Total other assets	<u>6,402,330</u>
Total assets	<u>\$ 15,310,159</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Balance Sheet (Continued)
June 30, 2022

	2022
LIABILITIES	
Current liabilities	
Line of credit	\$ 1,844,804
Accounts payable	5,098,349
Accrued expenses	57,923
Other current liabilities	650,848
Allowance for estimated returns	78,524
Subordinated convertible notes payable, current portion	500,000
Subordinated note payable, current portion	350,000
Notes payable - related parties, current portion	115,813
Notes payable - federal government, current portion	3,324
Operating lease obligation, current portion	193,627
Finance leases obligation, current portion	32,913
Total current liabilities	<u>8,926,125</u>
Long-term liabilities	
Subordinated convertible notes payable, net of current portion	1,805,791
Subordinated note payable, net of current portion	2,896,801
Notes payable - related parties, net of current portion	30,519
Notes payable - federal government, net of current portion	143,474
Operating leases obligation, net of current portion	648,979
Finance leases obligation, net of current portion	62,659
Total liabilities	<u>14,514,348</u>
SHAREHOLDERS' EQUITY	
Series A convertible preferred stock, no par value, 1,863,354 shares authorized, 1,552,795 shares issued and outstanding.	2,425,000
Common stock, no par value, 50,000,000 shares authorized, 14,072,131 issued and outstanding.	1,993,946
Additional paid-in capital	146,272
Stock subscription receivable	(37,087)
Shareholder note receivable	(412,811)
Accumulated deficit	(3,317,653)
Accumulated other comprehensive loss	(1,856)
Total shareholders' equity	<u>795,811</u>
Total liabilities and shareholders' equity	<u>\$ 15,310,159</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Statement of Operations and Comprehensive Loss
Year ended June 30, 2022

	2022
REVENUES	\$ 23,369,002
COST OF REVENUES	<u>8,448,246</u>
Gross profit	<u>14,920,756</u>
OPERATING EXPENSES	
Selling, general, and administrative expenses	16,192,092
Depreciation and amortization	<u>296,269</u>
Total operating expenses	<u>16,488,361</u>
Loss from operations	<u>(1,567,605)</u>
OTHER INCOME (EXPENSE)	
Forgiveness of debt	577,800
Interest and other income	63,673
Interest expense	(396,927)
Loss on disposal of assets	<u>(722)</u>
Total other income (expense), net	<u>243,824</u>
Net loss before income tax	<u>(1,323,781)</u>
Income taxes	<u>--</u>
Net loss	<u>(1,323,781)</u>
OTHER COMPREHENSIVE LOSS	
Foreign currency translation adjustment	<u>(515)</u>
Total comprehensive loss	<u><u>\$ (1,324,296)</u></u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Statement of Shareholders' Equity
Year ended June 30, 2022

	Series A Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Stock Subscription Receivable	Shareholder Note Receivable	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount	Shares	Amount						
Balance at June 30, 2021	683,230	\$ 1,045,000	13,815,984	\$ 1,482,444	\$ 73,576	\$ (37,087)	\$ (413,883)	\$ (1,993,802)	\$ (1,341)	\$ 154,907
Compensation expense in connection with options granted	--	--	--	--	48,413	--	--	--	--	48,413
Warrants issued in conjunction with note payable	--	--	--	--	93,907	--	--	--	--	93,907
Shareholders' distributions	--	--	--	--	--	--	--	(70)	--	(70)
Collection on shareholder note receivable net of accrued interest of \$3,928.	--	--	--	--	--	--	1,072	--	--	1,072
Conversion of note payable for preferred shares	621,118	1,000,000	--	--	--	--	--	--	--	1,000,000
Net proceeds from issuance of preferred share	248,447	380,000	--	--	--	--	--	--	--	380,000
Net proceeds from issuance of common stock	--	--	6,147	11,502	(69,624)	--	--	--	--	(58,122)
Issuance of shares for acquisition of Vooray International Inc.	--	--	250,000	500,000	--	--	--	--	--	500,000
Net loss	--	--	--	--	--	--	--	(1,323,781)	--	(1,323,781)
Exchange differences on translating foreign operations	--	--	--	--	--	--	--	--	(515)	(515)
Balance at June 30, 2022	<u>1,552,795</u>	<u>\$ 2,425,000</u>	<u>14,072,131</u>	<u>\$ 1,993,946</u>	<u>\$ 146,272</u>	<u>\$ (37,087)</u>	<u>\$ (412,811)</u>	<u>\$ (3,317,653)</u>	<u>\$ (1,856)</u>	<u>\$ 795,811</u>

See Notes to the Consolidated Financial Statements.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Statement of Cash Flows
Year ended June 30, 2022

	2022
CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	\$ (1,323,781)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	296,269
Loss on disposal of assets	722
Forgiveness of debt	(577,800)
Recovery of bad debt	(25,556)
Provision for inventory reserve	(37,516)
Stock compensation expense	48,413
Amortization of right-of-use assets	212,703
Amortization of loan discounts	47,140
Interest income on shareholder note receivable	(3,928)
Gain on modification of operating lease	(48,424)
Decrease (increase) in...	
Accounts receivable	(987,916)
Inventory	(712,069)
Other receivables and prepaid expenses	8,996
Deposits	(623)
Increase (decrease) in...	
Accounts payable	1,731,664
Accrued expenses	57,923
Other current liabilities	105,661
Operating lease obligation	(209,791)
Net cash used in operating activities	<u>(1,417,913)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property and equipment	(124,298)
Purchase of intangible assets	(350,553)
Cash paid for acquisition of Vooray trademarks	(1,000,000)
Proceeds from disposal of property and equipment	<u>3,613</u>
Net cash used in investing activities	<u>\$ (1,471,238)</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Consolidated Statement of Cash Flows (Continued)
Year ended June 30, 2022

	2022
CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds (payments) on line of credit, net	\$ 844,804
Proceeds from note payable	2,291,093
Payments on note payable	(792,696)
Principal payments on finance lease obligations	(31,191)
Proceeds from issuance of preferred stock, net	380,000
Proceeds from issuance of common stock, net	(58,122)
Proceeds from issuance of warrants	93,907
Distributions to shareholder	(70)
Payment received on loan to shareholder	5,000
	<u>2,732,725</u>
Net cash provided by financing activities	<u>(515)</u>
Net effect of exchange rate changes	<u>(156,941)</u>
Net decrease in cash and cash equivalents	<u>1,471,201</u>
Cash and cash equivalents, beginning of year	<u>1,471,201</u>
Cash and cash equivalents, end of year	<u><u>\$ 1,314,260</u></u>

SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash transactions:

Acquisition of finance leased equipment	\$ 73,721
Purchase price of Vooray International Inc. in exchange for note payable and shares	\$ 4,000,000
Note converted to preferred stock	\$ 1,000,000
Net modification to right of use asset	48,424
Modification to right of use asset	772,396
Cash paid during the year for:	
Interest	\$ 255,880
Income taxes	\$ --

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 1. ORGANIZATION, OPERATION AND BASIS OF PRESENTATION

Thirty Three Threads, Inc. (Thirty Three Threads), formerly known as ToeSox, Inc., was originally incorporated, in the state of California, in 2004 but then changed its name in 2015. Thirty Three Threads is engaged in the design, development, manufacturing and distribution of functional footwear, apparel and accessories. Thirty Three Threads purchased the assets of Tavi Noir in September 2015, purchased the assets of Vooray International, Inc. (Vooray) in January 2022, and owns the brands and related intellectual property for ToeSox, Tavi (FKA Tavi Noir), Vooray and Base 33. Products are manufactured in China and imported to a warehouse in Mexico or shipped directly to international distributors. The ToeSox, Tavi and Base 33 product lines include numerous styles of specialty socks, gloves, apparel and accessories that are marketed primarily to yoga, Pilates, barre, dance and other athletic enthusiasts. The Vooray product lines include various athletic bag products. Sales are generated primarily in the United States with international sales in Canada as well as Asia Pacific (APAC), Europe, Middle East, and Africa (EMEA).

In February 2021, the Company opened a subsidiary, Thirty Three Threads AG (AG), in Switzerland. The AG office oversees all accounts in the EMEA market and all AG financial results are consolidated with Thirty Three Threads.

Basis of Presentation: The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The financial statements are presented in United States dollars.

Principles of Consolidation: The consolidated financial statements include the accounts of Thirty Three Threads, Inc. and its wholly-owned subsidiary Thirty Three Threads AG, a Swiss company. All material intercompany balances have been eliminated in consolidation.

Fiscal Year: The Company operates and reports using a fiscal year ended June 30 of each year. The Company's current fiscal year ran from July 1, 2021 through June 30, 2022 (fiscal year).

Going Concern: Management has prepared the financial report on a going concern basis, which assumes continuity of normal business activities and the realization of assets and settlement of liabilities in the ordinary course of business.

As reflected in the consolidated financial statements, the Company had a net loss from continuing operations and net cash used in operating activities of continuing operations for the year ended June 30, 2022. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company is continuing to expand operations while generating revenue and reinforcing its positive relationships with key vendors and customers. The Company's current cash position may not be sufficient to support the Company's daily operations, however, management anticipates receiving additional funding from private investors via equity sales and loans.

While management believes the Company's strategy is viable for continuing operations, generating sufficient revenue, and raising additional funds, there can be no assurances to that effect.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 1. ORGANIZATION, OPERATION AND BASIS OF PRESENTATION (CONTINUED)

Going Concern (Continued): The ability of the Company to continue as a going concern is dependent upon the Company's ability to further implement its business plan, generate sufficient revenue and its ability to raise additional funds by way of a public or private offering.

The consolidated financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates: The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's knowledge of current events and actions, they may ultimately differ from actual events. Significant estimates made include the allowance for doubtful accounts, which is estimated based on current and historical customer practices; stock option expense, which is calculated based on the fair value of each option award estimated on the grant date using the Black-Scholes valuation model; inventory obsolescence, which is estimated based on projected and historical inventory movement; and lease liability and right-of-use asset, which is calculated based on certain assumptions such as borrowing rate, likelihood of lease extensions to occur, and asset valuation. Actual results could materially differ from those estimates.

Financial Instruments: The Company's financial instruments consist of cash, accounts receivable, other receivables, accounts payable, accrued expenses and other liabilities, line of credit and notes and leases payable. The carrying values are considered to be representative of their fair market value, due to the short maturity of these instruments. The carrying value of the long-term portion of the notes and leases payable represents fair value as the terms approximate those currently available for similar debt instruments.

Cash and Cash Equivalents: For purposes of financial statement presentation, the Company classifies all highly liquid financial instruments with an original maturity of three months or less as cash equivalents.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable: The Company carries its accounts receivable at invoiced amounts less allowances for doubtful accounts and other deductions. The Company does not accrue interest on its trade receivables. Management evaluates the ability to collect accounts receivable based on a combination of factors. An allowance for doubtful accounts is maintained based on the length of time receivables are past due or the status of a customer's financial position. Receivables are considered past due based upon the credit terms extended to customers. Receivables are written off to expense in the period deemed uncollectible after collection efforts have proven unsuccessful. The Company recorded an allowance for doubtful accounts of \$16,007 at June 30, 2022.

Inventories: Inventories are comprised of purchased finished goods and are stated at the lower of weighted average cost or net realizable value. Management periodically reviews inventory for excess quantities and obsolescence and evaluates quantities on hand for physical condition and functionality as these characteristics may be impacted by customer demand for current products and new product introductions. The Company has recorded a reserve for obsolete and excess inventories of \$500,025 at June 30, 2022.

Property and Equipment: Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets, generally 3 to 15 years. Maintenance, repairs, and expenditures for renewals and betterments not determined to extend the useful lives or to increase materially the productivity of the properties to which they are applied are charged to income as incurred. Other renewals and betterments are capitalized.

Intangible Assets: The Company amortizes intangible assets with finite lives on a straight-line basis over their estimated useful lives, generally 3 to 15 years. Intangible assets deemed to have an indefinite life are not amortized, instead they are reviewed at least annually for impairment. The Company capitalizes all legal costs to register, purchase, and renew its intangible assets. Amortization of intangible assets with finite lives is provided for on a straight-line basis over their estimated useful lives. Amortization expense related to intangible assets with finite lives amounted to \$160,101 for the year ended June 30, 2022.

Goodwill: In January 2022, the Company acquired the rights to the Vooray brand. The purchase was accounted for as an acquisition in accordance with Accounting Standards Codification (ASC) 805, *Business Combinations*. Goodwill represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired by the Company. The goodwill is deemed to have an indefinite life and is not amortized. Goodwill is tested for impairment at the entity level if a triggering event occurs. Based on impairment tests as of June 30, 2022, the Company determined that there was no impairment of its intangible assets with indefinite lives.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of Assets: In the event that facts and circumstances indicate that the carrying amount of tangible or intangible long-lived assets or groups of assets may be impaired, an evaluation of recoverability is performed. If an evaluation is required, the estimated future undiscounted cash flows associated with the assets would be compared to the assets' carrying amount to determine if an impairment loss should be recorded. If the assets' carrying amount exceeds the estimated future undiscounted cash flows associated with the assets, an impairment loss equal to the amount by which the assets' carrying amount exceeds their fair value is recognized. Based on impairment tests as of June 30, 2022, the Company determined that there was no impairment of its intangible assets with indefinite lives.

Accrued Expenses and Other Liabilities: In accordance with applicable accounting guidance, the Company accrues liabilities that are impacted by estimates related to general operating expenses, such as payroll and royalty expenses. Management estimates reflect the probable liability as of the balance sheet date. In determining the adequacy of estimated liabilities, the Company performs ongoing evaluations based on available information.

Lease Accounting: Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of fixed lease payments over the lease term. Leases are classified as financing or operating which drive the expense recognition pattern. The Company has elected to exclude short-term leases.

For leases with terms greater than 12 months, a related asset and obligation at the present value of lease payments over the term is recorded. If the rate implicit in the lease is not available, the incremental borrowing rate is used, which is based on the estimated interest rate for collateralized borrowing over a similar term of the lease at commencement date.

For purposes of determining straight-line rent expense, the lease term is calculated from the date the Company first takes possession of the facility, including any periods of free rent and any renewal option periods that the Company is reasonably certain of exercising. Contractually specified minimum rent and annual rent increases are included in the measurement of the right-of-use asset and related lease liability. The Company may be required to pay directly, or reimburse the lessor, for some maintenance and operating costs. Such amounts are generally variable and therefore not included in the measurement of the right-of-use asset and related lease liability but are instead recognized as variable lease expense in the consolidated statements of operations when they are incurred.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition: The Company has various contracts with customers. The Company's contracts specify that revenues from product sales are recognized at the time the product is shipped, primarily FOB shipping point, which is when the transfer of control of goods has occurred, and at which point title passes. There are contracts with other shipping terms, such as FOB destination, and revenue is recognized according to those specific terms. Revenue is recorded net of estimated returns and sales discounts given to customers. The Company does not allow for unapproved returns, except in the event of defective merchandise, and has established an allowance for returns based on historical experience which have averaged less than four percent. The Company recorded an allowance for estimated returns from customers of \$78,524 at June 30, 2022. In addition, the Company has contracts with customers wherein the customers receive sales discounts. The Company evaluated the status of these contracts, as of June 30, 2022, and does not believe that any additional discounts will be given through the end of the contract periods. The Company sells its products to domestic and international distributors, directly to customers through its online store, and through commission agreements with various studio fitness chains and retailers. See Note 13. for geographic detail of revenue.

Shipping and Handling Costs: Shipping and handling fees billed to customers are recorded in net revenue. Total shipping revenue for the year ended June 30, 2022 amounted to \$484,187. The costs associated with shipping goods to customers are included in cost of revenue.

Advertising Costs: The Company's policy is to expense advertising costs as incurred. The Company does not incur significant advertising costs substantially in advance of the time advertising takes place. Total advertising costs for the year ended June 30, 2022 was \$1,243,197.

Sales Tax: Taxes collected from the Company's customers are included in accrued expenses and other liabilities until the taxes are remitted to the appropriate taxing authorities. Taxes collected are excluded from revenues.

Income Taxes: The Company records income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. When applicable, a valuation allowance is established to reduce any deferred tax asset when it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

The Company is liable for federal, cantonal and municipal income taxes for the AG company. As of June 30, 2022, the Company has accrued \$36,000 of expense related to this liability.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes (Continued): On an annual basis, management evaluates the financial statement effects, if any, of income tax positions taken or expected to be taken on its income tax returns. Management evaluates the likelihood that, upon examination by the relevant taxing jurisdictions, those income tax positions would be sustained. Based upon that evaluation, if it were more than 50% probable that a material amount of income tax would be recognized at the entity level upon examination by the relevant taxing jurisdictions, a liability would be recognized in the accompanying balance sheet along with any interest and penalties that would result from that assessment.

Stock Based Compensation: The Company follows the guidance of the accounting provisions of ASC 718, Share-based Compensation, which requires the use of the fair-value based method to determine compensation for all arrangements under which employees and others receive shares of stock or equity instruments (warrants and options). The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model that uses assumptions for expected volatility, expected dividends, expected term, and the risk-free interest rate. Management's estimate of expected volatility was based on a sampling of companies with attributes similar to those of the Company.

The risk-free rate was based on the U.S. Treasury rate on instruments with terms similar to the expected lives of the options. Expected lives were determined using the simplified method. The Company has elected to account for forfeitures as they occur.

The fair value of options and warrants granted during the year ended June 30, 2022, were estimated on the date of grant using the following weighted average assumptions:

	<u>2022</u>
Dividend yield	--
Expected volatility	16.41% - 33.32%
Risk-free interest rate	1.45% - 3.38%
Expected lives (in years)	10

Foreign Currency Translation: Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions denominated in foreign currencies are recognized in the income statement. The exchange differences arising from the translation of the assets and liabilities of the subsidiary are reported in other comprehensive income.

Recently Issued Accounting Standards: The following Accounting Standards Updates (ASU) issued by the Financial Accounting Standards Board (FASB) will be effective starting with the Company's consolidated financial statements for the year ending June 30, 2023. Management will evaluate the application of these standards to determine future impact on the Company's financial statements.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Standards (Continued): Accounting for Income Taxes - In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which removes certain exceptions and also adds some requirements to reduce complexity.

Accounting for Stock Compensation - In October 2021, the FASB issued ASU No. 2021-07, *Compensation - Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards*, which provides a practical expedient for determining the current price input of equity-classified share-based awards using the reasonable application of a reasonable valuation method.

Subsequent Events Evaluation: Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are available to be issued. The Company recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Company's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued. Management has evaluated its June 30, 2022 consolidated financial statement for subsequent events through October 21, 2022, the date of issuance of the consolidated financial statement.

NOTE 3. INVENTORIES, NET

Inventories consist of the following as of June 30:

	<u>2022</u>
Inventories at cost	\$ 5,290,192
Purchases in transit	216,838
Less: Inventory reserve	<u>(500,025)</u>
Inventories, net	<u>\$ 5,007,005</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 4. PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

	<u>2022</u>
Leasehold improvements	\$ 25,333
Furniture and fixtures	537,141
Computer equipment	163,396
Machinery and equipment	<u>161,374</u>
Subtotal	887,244
Less: Accumulated depreciation	<u>(584,850)</u>
Property and equipment, net	<u><u>\$ 302,394</u></u>

Depreciation expense on property and equipment for the year ended June 30, 2022 was \$136,168.

NOTE 5. INTANGIBLE ASSETS, NET

The Company's intangible assets consist of the following as of June 30:

	<u>2022</u>
Computer software	\$ 956,435
Customer lists	300,000
Patents	<u>364,213</u>
Subtotal	1,620,648
Less: Accumulated amortization	<u>(801,670)</u>
Amortizable Intangible assets, net	818,978
Trademarks	1,158,987
Goodwill	<u>3,558,137</u>
Total Intangibles, net	<u><u>\$ 5,536,102</u></u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 5. INTANGIBLE ASSETS, NET (CONTINUED)

Future estimated amortization expense related to amortizable intangible assets is as follows:

Year Ending June 30,	
2023	\$ 204,194
2024	181,149
2025	90,805
2026	44,281
2027	44,281
Thereafter	<u>254,268</u>
	<u>\$ 818,978</u>

Amortization expense was \$160,101 for the year ended June 30, 2022.

NOTE 6. LINE OF CREDIT

The Company maintains a line of credit with a financial institution allowing borrowings up to \$4,000,000, which is due on demand and collateralized by the property and assets of the Company. Borrowings under the line bear a variable interest rate valued monthly (which was 4.75% at June 30, 2022). The outstanding balance on the line of credit was \$1,844,804 at June 30, 2022. The Company is required to maintain certain financial and non-financial covenants in accordance with the line of credit agreement and the line of credit is guaranteed by officers and shareholders of the Company. At June 30, 2022, the Company was in compliance with the covenants.

NOTE 7. NOTES PAYABLE

The following table summarizes the components of notes payable balance at June 30:

	<u>2022</u>
Note payable to the former owners of Vooray of \$3,500,000. The Company shall make quarterly payments of the greater of 20% of the net proceeds from the sale of Vooray branded products or \$87,500, until the seller has received a total of \$3,500,000. The note is subordinated to the line of credit.	\$ 3,246,801
Convertible note payable to a private equity firm, advances of up to \$1,750,000 with interest at 15% per annum. The note is subordinated to the line of credit and secured by all assets and property of the Company. The balance remaining on the loan is due in full by December 31, 2022. On August 21, 2021, an amendment to the note was made that allows for a conversion of the debt to equity at a conversion price of \$1.61 per share.	<u>1,750,000</u>
	<u>\$ 4,996,801</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 7. NOTES PAYABLE (CONTINUE)

	<u>2022</u>
Subtotal from previous page	\$ 4,996,801
Note payable to a private equity firm, advances of up to \$1,135,000 with interest at 10% per annum. The balance remaining on the loan was due in full by September 2022. In September 2022, this Note was extended to be due in full by December 2022.	626,313
Economic Injury Disaster Loan with U.S. Small Business Administration. The note is secured by substantially all assets of the Company and accrues interest at a rate of 3.75% per annum. The Company has used the proceeds for qualifying expenses. The \$150,000 note is due in full July 2050 and includes monthly principal and interest payments of \$731.	146,798
Note payable to a shareholder, initial loan \$201,040 with interest accruing at a rate of 5% per annum. Monthly payments starting at \$4,000 for first three months and \$8,000 thereafter. The note is subordinated to the line of credit and monthly payments have ceased.	113,826
Note payable to a shareholder, initial loan \$50,260 with interest accruing at a rate of 5% per annum. Monthly payments starting at \$1,000 for first three months and \$2,000 thereafter. The note is subordinated to the line of credit and monthly payments have ceased.	<u>32,506</u>
Total	5,916,244
Less: unamortized discount	(70,522)
Less: current portion	<u>(969,137)</u>
Long-term portion	<u>\$ 4,876,585</u>

Future minimum payments under the above notes payable are as follows:

Year ending June 30,	
2023	\$ 969,137
2024	383,969
2025	353,582
2026	353,719
2027	353,861
Thereafter	<u>3,501,976</u>
	<u>\$ 5,916,244</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 8. LEASES

In October 2019, the Company entered into an agreement to lease a building in Vista, California for the period from November 1, 2019 through October 31, 2022. On June 16, 2021, the Company signed an amendment to the lease agreement wherein it was granted two additional months of rent concessions and the lease was extended through January 1, 2026. The initial base rent for the lease agreement was \$18,711 per month, increasing to \$20,831 for the period from November 1, 2020 through October 31, 2021, \$21,409 for the period from November 1, 2021 through October 31, 2022, \$20,843 for the period November 1, 2022 through October 31, 2023, \$21,885 for the period from November 1, 2023 through October 31, 2024, \$22,979 for the period from November 1, 2023 through October 31, 2024 and \$24,128 for the period from November 1, 2025 through January 1, 2026. For the year ended June 30, 2022, total rent expense charged to operations was approximately \$188,000.

The table below presents certain information related the lease-related assets and liabilities recorded on the balance sheet as of June 30:

	<u>2022</u>
Weighted average remaining lease term (in years)	
Operating lease	3.58
Finance leases	3.36
Weighted average discount rate	
Operating lease	5 %
Finance leases	10 %
Operating cash flow from operating leases	\$ 254,599
Financing cash flow from finance leases	41,070

Future minimum lease payments under the above leases are as follows:

Year Ending June 30,	Operating lease obligations	Financial lease obligations
2023	\$ 193,627	\$ 32,913
2024	231,184	24,794
2025	256,228	17,466
2026	161,567	14,372
2027	--	6,027
	<u>\$ 842,606</u>	<u>\$ 95,572</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 9. SHAREHOLDERS' EQUITY

Preferred Stock: The Company is authorized to issue 1,863,354 shares of Series A convertible preferred stock with no par value. In 2022, 248,447 shares of Series A convertible preferred stock were issued to a private equity firm for \$1.61 per share. Preferred stock issuance costs for the year ending June 30, 2022 were \$20,000. In addition, the private equity firm converted \$1,000,000 of debt into 621,118 shares of Series A convertible preferred stock. These shares have a liquidation preference of 1.67 times the Series A convertible preferred stock issuance price. The holder of Series A convertible preferred stock has the option to convert the shares into shares of common stock at \$1.61 per share.

Common Stock: The Company is authorized to issue 50,000,000 shares of common stock with no par value. In 2022, the Company issued 6,147 shares, with an average share price of approximately of \$1.87, to a series of individuals as a result of a Regulation CF capital raise. In 2022, the Company issued 250,000 shares, with an average share price of approximately of \$2.00, to the selling company as part of acquisition of the Vooray brand. The Company has 14,072,131 shares outstanding as of June 30, 2022. Stock issuance costs for the year ending June 30, 2022 were \$81,126. At June 30, 2022, the Company has stock subscriptions receivable in conjunction with the sale of common stock of \$37,087.

Distributions: Holders of shares are entitled to receive distributions on a pro rata basis, and are payable when and if declared by the Company's Board of Directors. Such distributions are not cumulative. Series A convertible preferred stock holders receive distributions prior to common stock holders. Distributions of \$70 were paid during the year ended June 30, 2022.

Voting Rights: Holders of common stock and Series A convertible preferred stock each have the right to one vote per share.

Warrants: During the year ended June 30, 2020, the Company issued warrants to purchase 165,060 shares of common stock in conjunction with a note payable to a private equity firm. The warrants were exercised November 2020. The Company valued the warrants at approximately \$50,000, which is reported as a debt discount to the note payable and amortized to interest expense over the life of the loan. The unamortized amount of the warrants at June 30, 2022 is \$7,918.

During the year ended June 30, 2022, the Company issued additional warrants to purchase 187,814 shares of common stock in conjunction with a note payable to a private equity firm. The Company initially valued the warrants at approximately \$93,907. They are reported as a debt discount to the note payable, and are amortized to interest expense over the life of the loan. The unamortized amount of the warrants at June 30, 2022 is \$62,605. The amount amortized to interest expense during the year ended June 30, 2022 was \$31,302.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 9. SHAREHOLDERS EQUITY (CONTINUED)

Stock Options: During the year ended June 30, 2018, the Company adopted stock incentive plans covering an aggregate of 5,727,565 shares, of the Company's unissued common stock to be granted to employees, directors, and select contractors of the Company. During the year ended June 30, 2022, the Company granted 716,162 stock options, to officers, directors and employees at exercise price of \$2.00 per share.

Activity as to aggregate stock options outstanding is as follows:

	Number of stock options	Exercise price range per share	Weighted average exercise price
Options outstanding at June 30, 2021	4,359,935	\$0.52 - \$2.00	\$1.08
Options granted	716,162	\$2.00	\$2.00
Options exercised	--	--	\$--
Options canceled or expired	(1,525,353)	\$1.30 - \$2.00	\$1.31
Options outstanding at June 30, 2022	3,550,744	\$0.52 - \$2.00	\$1.17

The weighted average fair value of options granted during the year ended June 30, 2022 was \$2. The aggregate intrinsic value of options outstanding at June 30, 2022 was \$0.

The number of non-vested stock options as of June 30, 2022 included in the table above is as follows:

	Number of shares	Weighted average grant date fair value
Non-vested shares at June 30, 2021	2,295,267	\$1.28
Granted	716,162	\$2.00
Forfeited	(1,525,353)	\$1.31
Vested	(254,711)	\$1.18
Non-vested shares at June 30, 2022	1,231,365	\$1.66

At June 30, 2022, the total compensation cost related to non-vested stock option awards not yet recognized totaled approximately \$32,000. The weighted average period over which this amount was expected to be recognized at June 30, 2022 is 3.7 years. The weighted average remaining contractual term of options that are exercisable at June 30, 2022 is 3.2 years.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 9. SHAREHOLDERS EQUITY (CONTINUED)

The following summarizes information about the Company's stock options outstanding at June 30, 2022:

Range of exercise prices	Number outstanding at June 30, 2022	Weighted average contractual life in years	Weighted average exercise price	Number exercisable at June 30, 2022
\$0.52 - \$0.72	1,466,500	0.3	\$0.62	1,389,220
\$1.30 - \$1.43	1,359,986	2.7	\$1.32	873,074
\$2.00	724,258	4.6	\$2.00	57,085

NOTE 10. REVENUE RECOGNITION

Revenue from contracts with customers based on timing of revenue recognition consists of the following, as of June 30:

	<u>2022</u>
Performance obligations transferred at a point in time	\$ 28,399,420
Performance obligations transferred over time	--
Less: discounts	<u>(5,030,418)</u>
	<u>\$ 23,369,002</u>

NOTE 11. INCOME TAXES

Deferred income taxes are provided for temporary differences in recognizing certain income and expense items for financial and tax reporting purposes. A valuation allowance has been recorded to fully offset the deferred tax asset as it is more likely than not that the asset will not be realized. The valuation allowance increased by \$327,737 during the year ended June 30, 2022.

At June 30, 2022, the Company had U.S federal and California state tax net operating loss (NOL) carryforwards of approximately \$3,675,000 and \$4,653,000, respectively, which begin to expire in 2040.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 11. INCOME TAXES (CONTINUED)

Significant components of the Company's deferred tax assets are shown below.

Year ended June 30,	<u>2022</u>
Deferred tax assets:	
Net operating loss carry-forwards	\$ 1,183,000
Lease liability	251,450
Accrued vacation	50,200
Other timing differences	<u>21,600</u>
Total deferred tax assets	<u>1,506,250</u>
Deferred tax liabilities	
Depreciation and amortization on PPE and Intangibles	(97,000)
Right-of-use asset	(250,500)
Prepaid expenses	<u>(131,000)</u>
Total deferred tax liabilities	<u>(478,500)</u>
Less valuation allowance	<u>(1,027,750)</u>
Net deferred tax asset	<u>\$ --</u>

A reconciliation of the expected tax computed at the U.S statutory federal income tax rate to the total provision for income taxes is as follows:

Year ended June 30,	<u>2022</u>
Expected federal income tax at 21%	\$ (277,712)
Expected state income tax, net of federal tax benefit	(117,072)
Non-deductible expenses	16,047
PPP loan - tax exempt income	(172,000)
Valuation allowance increase	327,737
Wage expense disallowance for ERTC tax credit	<u>223,000</u>
Provision for income taxes	<u>\$ --</u>

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 12. RELATED PARTY TRANSACTIONS

Shareholder Note Receivable: As a result of a common stock purchase, the Company has a long-term note receivable due from a shareholder with a maturity date of January 1, 2085 or earlier. The note is secured by the shareholder's grant of security interest in shares of the Company. The note accrues annual interest at approximately 0.95% and payments of \$500 are received monthly. Interest income is capitalized into the note balance. Interest income of \$3,928 was recognized during the year ended June 30, 2022. Principal payments of \$5,000 was received during the year ended June 30, 2022. The outstanding balance of the shareholder note receivable was \$412,811 at June 30, 2022, and has been recorded as contra equity within the consolidated statements of shareholders' equity due to the relative uncertainty surrounding repayment.

Note Payable to Majority Shareholder: The Company has a payable due to a shareholder with a balance due of \$113,826 at June 30, 2022. The original amount of the note was \$201,040 with interest accruing at a rate of 5% per annum.

Note Payable to Shareholder: The Company has a payable due to a shareholder with a balance due of \$32,506 at June 30, 2022. The original amount of the note was \$50,260 with interest accruing at a rate of 5% per annum.

NOTE 13. CONCENTRATIONS

Credit Risk: The Company provides unsecured credit in the normal course of business to customers throughout the United States and in foreign markets.

Major Customers: For the year ended June 30, 2022, the Company had six distribution agreements that represent approximately 60% of revenue. If the financial condition or operations of these customers deteriorates, the risks associated with selling on credit could increase substantially.

Major Suppliers: For the year ended June 30, 2022, the Company had 3 vendors that accounted for 62% of inventory purchases. At June 30, 2022, these vendors accounted for 37% of accounts payable.

Cash Concentration: The Company's cash and cash equivalents consist of cash held at financial institutions. U.S. cash balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. At times balances may exceed federally insured limits. At June 30, 2022, the Company had approximately \$1,028,000 of uninsured cash. The Company has not experienced any losses in such accounts and Management believes that the Company is not exposed to any significant credit risk with respect to its cash and cash equivalents.

Geographic Concentration: Operations outside the United States include the subsidiary in Switzerland. Foreign operations are subject to risks inherent in operating under different legal systems and various political and economic environments. Among the risks are changes in existing tax laws, possible limitations on foreign investment and income repatriation, government price or foreign exchange controls, and restrictions on currency exchange.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 13. CONCENTRATIONS (CONTINUED)

Geographic Concentration (Continued): Results of operations for the Company's Swiss subsidiary are translated from the local (functional) currency to the U.S. dollar using average exchange rates during the period, while assets and liabilities are translated at the exchange rate in effect at the reporting date. Resulting gains or losses from translating foreign currency financial statements are recorded as other comprehensive income (loss). Foreign currency transaction gains (losses) resulting from exchange rate fluctuations on transactions denominated in a currency other than Euros are included in earnings.

As of June 30, 2022 all of the Company's inventory is located in a third-party warehouse in Tijuana, Mexico. Geographic information regarding net revenues is approximately as follows:

Year ending June 30,	<u>2022</u>
Approximate net revenues:	
US & Canada	\$ 20,253,845
Asia-Pacific	2,187,862
Europe, Middle East, and Africa	791,222
Latin America	<u>136,073</u>
	<u>\$ 23,369,002</u>

NOTE 14. CONTINGENCIES

Commission and royalty agreements: The Company has certain commission and royalty agreements through which it has obtained rights to manufacture and market products solely for sale to various purchasers and their franchisees, primarily consisting of studio fitness locations and other retailers. Commission and royalty expense of approximately \$4,708,000 related to these agreements, was included in selling, general, and administrative expenses for the year ended June 30, 2022. Product sales related to these agreements comprised approximately 50% of total net revenues for the years ended June 30, 2022. The Company may enter into other royalty and license agreements in the future as it deems necessary for conducting business.

Regulations and industry: The apparel industry is subject to laws and regulations of federal, state, and local governments. As a manufacturer of consumer products, the Company has exposure to California Proposition 65 which regulates substances officially listed by California as causing cancer, birth defects, or other reproductive harm. The regulatory arm of Proposition 65 that relates to the Company prohibits businesses from knowingly exposing individuals to listed substances without providing a clear and reasonable warning. All companies in California are subject to potential claims based on the content of their products sold. Management believes that the Company is in compliance with these laws. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future review and interpretation, as well as regulatory actions unknown or asserted at this time.

THIRTY THREE THREADS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
June 30, 2022

NOTE 15. RETIREMENT PLAN

The Company has established an employee benefit plan as provided under §401(k) of the Internal Revenue Code (the "Plan"). The Plan is open to all eligible employees as defined in the Plan documents. The Company may make matching and discretionary contributions to the Plan in such amounts as provided by the plan provisions and determined by the shareholders. The Company made contributions of approximately \$58,000 for the year ended June 30, 2022.

NOTE 16. SUBSEQUENT EVENTS

On July 1, 2022, the Company signed an Event Sponsorship Agreement with a promoter. The agreement is for the period through February 28, 2023. The agreement includes future cash and merchandise obligation up to \$30,000.

On August 23, 2022, the Company signed an amendment to a supply agreement. The amendment supersedes any prior agreement and will continue until December 31, 2024. Annually, the Company will pay the customer a combined domestic and foreign commission of \$3,250,000.