



RECONDITIONED SYSTEMS, INC

ANNUAL REPORT 2016

Dear Fellow Shareholders,

I am very pleased to report that this was the best year for your company since I became Chairman in 1995. Dirk Anderson has done a wonderful job managing us through a very difficult period. We have had a nice increase in our sales during a period when our competitors have been struggling. We have finally executed our business plan to be a wholesale manufacturer operating out of a building that we own. We have a strong financial position and we have good control of our costs going forward.

For this fiscal year ending March 31, 2016, we made \$923 thousand on sales of \$13.95 million. This compares to a profit \$584 thousand on sales of \$12.15 million for the previous year, ending March 31, 2015. This truly is an excellent performance.

The US economy continues to grow at a very subdued rate. However, domestic business conditions are excellent. Interest rates, inflation and energy costs remain historically low. The global economic situation also continues to be anemic and China's growth is lower than the last few years. I expect domestic employment growth will slow, which does not bode well for our industry. We are due for a recession, and I suspect that fiscal 2017 will be very challenging; if we just equal this year's sales results, I will be very pleased.

The Board of Directors decided to pay our eleventh annual cash dividend. This year it is \$.25 per share; that is a 25% increase over last year. The dividend is payable August 29, 2016, to shareholders of record July 8. As in the past, any future dividends will depend on our performance and financial condition.

Although we are a non-reporting public company, I will continue to write a quarterly letter and post it on our Internet Website at <http://www.rsisystems furniture.com>. Please keep track of our quarterly progress and filings by checking there under "About Us". Thank you for your continued support of our efforts.

Scott W. Ryan
Chairman of the Board

Reconditioned Systems, Inc.

Financial Statements

For the Years Ended
March 31, 2016 and 2015

RECONDITIONED SYSTEMS, INC.
BALANCE SHEETS
March 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$1,433,971	\$1,196,702
Accounts receivable	1,166,868	1,250,342
Income tax receivable – deferred	37,800	33,500
Inventory	2,029,336	1,739,333
Prepaid expenses and other current assets	<u>61,186</u>	<u>77,214</u>
Total current assets	4,729,161	4,297,091
Property and Equipment, net:	4,690,586	4,702,335
Other Assets:		
Refundable deposits and other	<u>36,681</u>	<u>49,593</u>
Total Assets	<u>\$9,456,428</u>	<u>\$9,049,019</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$531,224	\$556,651
Customer deposits	45,247	133,190
Accrued compensation and benefits	482,335	400,577
Income tax payable – current	197,515	187,878
Notes payable – current	<u>257,734</u>	<u>241,450</u>
Total current liabilities	<u>1,514,055</u>	<u>1,519,746</u>
Long-term Liabilities:		
Notes payable – long term	2,163,658	2,422,692
Income tax payable – deferred	<u>159,400</u>	<u>160,300</u>
	<u>2,323,058</u>	<u>2,582,992</u>
Stockholders' Equity:		
Common stock, no par value; 100,000,000 shares authorized, 1,734,652 shares issued, 960,978 and 974,630 shares outstanding, respectively	4,774,411	4,774,411
Retained earnings	<u>2,679,067</u>	<u>1,948,639</u>
	7,453,478	6,723,050
Less: treasury stock, 773,674 and 760,022 shares respectively, at cost	<u>(1,834,163)</u>	<u>(1,776,769)</u>
	<u>5,619,315</u>	<u>4,946,281</u>
Total Liabilities and Stockholders' Equity	<u>\$9,456,428</u>	<u>\$9,049,019</u>

The Accompanying Notes are an Integral Part
of the Financial Statements

RECONDITIONED SYSTEMS, INC.
STATEMENTS OF OPERATIONS
For the Years Ended March 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Sales	\$13,950,871	\$12,151,177
Cost of sales	<u>10,744,511</u>	<u>9,725,469</u>
Gross profit	3,206,360	2,425,708
Selling & administrative expenses	<u>1,658,793</u>	<u>1,504,916</u>
Income from operations	1,547,567	920,792
Other income (expense):		
Section 1256 gains (losses)	(12,039)	28,016
Interest income	1,711	7,654
Interest expense	(165,917)	(199,327)
Other	<u>8,631</u>	<u>118,619</u>
Net income before income taxes	1,379,953	875,754
Provision for income tax expense	<u>(457,313)</u>	<u>(291,377)</u>
Net income	<u>\$922,640</u>	<u>\$584,377</u>
Earnings per share : Basic and Diluted	<u>\$0.96</u>	<u>\$0.60</u>
Weighted average number of shares outstanding:		
Basic and Diluted	<u>962,092</u>	<u>978,558</u>

The Accompanying Notes are an Integral Part
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RECONDITIONED SYSTEMS, INC.
STATEMENTS OF STOCKHOLDERS' EQUITY
For the Years Ended March 31, 2016 and 2015

	Common Stock Shares	Common Stock Amount	Retained Earnings	Treasury Stock	Total
Balance at March 31, 2014	985,397	\$4,775,981	\$1,511,307	\$(1,723,238)	\$4,564,050
Cash Dividend			(147,045)		(147,045)
Treasury stock purchases	(11,428)			(55,103)	(55,103)
ESP shares sold	661	(1,570)		1,572	2
Net income			584,377		584,377
Balance at March 31, 2015	974,630	\$4,774,411	\$1,948,639	\$(1,776,769)	\$4,946,281
Cash Dividend			(192,212)		(192,212)
Treasury stock purchases	(13,652)			(57,394)	(57,394)
Net income			922,640		922,640
Balance at March 31, 2016	960,978	\$4,774,411	\$2,679,067	\$(1,834,163)	\$5,619,315

The Accompanying Notes are an Integral Part
of the Financial Statements

RECONDITIONED SYSTEMS, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended March 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Cash received from customers	\$14,042,976	\$12,434,362
Cash paid to suppliers and employees	(12,502,559)	(10,900,003)
Income taxes	(452,876)	(76,542)
Interest received and Section 1256	(10,328)	7,654
Interest paid	<u>(165,917)</u>	<u>(200,793)</u>
Net cash provided by operating activities	<u>911,296</u>	<u>1,264,678</u>
Cash Flows from Investing Activities:		
Change in note receivable	-	74,365
Sale of fixed assets	-	6,000
Purchase of property, equipment and amortizable assets	(186,707)	(41,504)
Other	<u>(6,166)</u>	<u>(8,466)</u>
Net cash received (used) by investing activities	<u>(192,873)</u>	<u>30,395</u>
Cash Flows from Financing Activities:		
Repayment of debt principal	(231,548)	(517,514)
Payment of cash dividend	(192,212)	(147,047)
Transfers to/from ESP Plan	-	2
Purchase of treasury stock	<u>(57,394)</u>	<u>(55,103)</u>
Net cash used by financing activities	<u>(481,154)</u>	<u>(719,662)</u>
Increase in cash and cash equivalents	237,269	575,411
Cash and cash equivalents at beginning of period	<u>1,196,702</u>	<u>621,291</u>
Cash and cash equivalents at end of period	<u>\$1,433,971</u>	<u>\$1,196,702</u>

The Accompanying Notes are an Integral Part
of the Financial Statements

RECONDITIONED SYSTEMS, INC.
STATEMENTS OF CASH FLOWS (Continued)
For the Years Ended March 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Reconciliation of Net Income to Net Cash Provided by Operating Activities:		
Net Income	922,640	584,377
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	205,033	201,661
Provision for doubtful accounts	-	(16,500)
Changes in assets and liabilities:		
Accounts receivable	83,474	136,550
Inventory	(290,003)	64,707
Prepaid expenses and other assets	17,327	4,077
Current and Deferred income taxes	4,437	214,835
Accounts payable	(25,427)	21,369
Customer deposits	(87,943)	(29, 334)
Accrued compensation	81,758	84,402
Other accrued expenses	<u>-</u>	<u>(1,466)</u>
Net cash provided by operating activities	<u>\$911,296</u>	<u>\$1,264,678</u>

The Accompanying Notes are an Integral Part
of the Financial Statements

RECONDITIONED SYSTEMS, INC.
Notes to the Financial Statements

Note 1.

Summary of Significant Accounting Policies, Nature of Operations, and Use of Estimates

Nature of Business:

Reconditioned Systems, Inc. (“RSI” or the “Company”), is a corporation that was incorporated in the State of Arizona in March 1987. The principal business purpose of the Company is the manufacturing and sale of office workstations comprised of panel systems to customers located throughout the United States and Canada. The Company markets its products primarily in the continental United States.

Pervasiveness of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Revenue Recognition:

The Company recognizes a sale when its earnings process is complete. In connection with projects that are to be installed by a customer or an agent of the customer, the sale is recognized when the product is shipped to or possession is taken by the customer.

Cash and Cash Equivalents:

The Company considers all highly liquid debt instruments and money market funds purchased with an initial maturity of three (3) months or less to be cash equivalents.

Accounts Receivable – Trade:

Accounts receivable are reported at the customers’ outstanding balances less any allowance for doubtful accounts. The allowance is based upon a review of the individual accounts outstanding and the Company’s prior history of uncollectible receivables. Based on management’s assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. At March 31, 2016 and 2015, the Company has established an allowance for doubtful accounts in the amount of \$15,000 and \$15,000, respectively.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 1.
Summary of Significant Accounting Policies, Nature of Operations, and Use of Estimates
(Continued)

Inventory:

Inventory, which is primarily composed of used office workstations raw materials and manufacturing supplies, is stated at the lower of average cost or market. The Company reviews its inventory monthly and makes provisions for damaged and obsolete items. The Company contemplates its ability to alter the size of panels and other workstation components and designs projects so that the workstations are comprised of products currently in inventory in establishing its obsolescence reserve. At March 31, 2016 and 2015, the Company had established a reserve for damaged and obsolete inventory in the amount of \$53,023 and \$53,023, respectively.

Property and Equipment:

Property and equipment are recorded at cost. Major renewals and improvements are charged to the asset accounts while replacements, maintenance and repairs, which do not improve or extend the lives of respective assets, are expensed. At the time property and equipment are retired or otherwise disposed of, the assets and related depreciation accounts are relieved of applicable amounts. Gains or losses from retirements or sales are credited or charged to income. Depreciation is generally provided for on the straight-line basis over the following estimated useful lives of the assets:

	<u>Years</u>
Building & improvements	15-40
Office furniture and equipment	5 – 7
Machinery and equipment	5 – 7
Leasehold improvements	3 – 5
Vehicles	3 – 5
Showroom furniture	1 – 3

Long-Lived Assets:

The Company evaluates long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When undiscounted future cash flows are not expected to be sufficient to recover an asset's carrying amount, the asset is written down to its fair value.

Long-lived assets to be disposed of other than by sale are classified as held and used until they are disposed of. Long-lived assets to be disposed of by sale are classified as held for sale and are reported at the lower of carrying amount or fair value less cost to sell, and depreciation is ceased.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 1.
Summary of Significant Accounting Policies, Nature of Operations, and Use of Estimates
(Continued)

Deferred Income Taxes:

Deferred income taxes are provided on an asset and liability method, whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, there is uncertainty of using the operating losses in future periods. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Stock-Based Plans:

The Company adopted an Employee Stock Purchase Plan (the "Plan") effective April 1, 2005, which offers the Company's common stock to employees at a purchase price of 90% of book value. The Plan is consider non-compensatory. As of March 31, 2016, there were a total of 0 outstanding shares issued under the Plan. As of May 29, 2015 this plan was discontinued and the company purchased all of the outstanding shares from the employees.

Earnings Per Common and Common Equivalent Share:

Basic earnings per share include no dilution and are computed by dividing income available to common stockholders by the weighted average number of shares outstanding for the period.

Diluted earnings per share amounts are computed based on the weighted average number of shares actually outstanding plus the shares that would be outstanding assuming the exercise of dilutive stock options, all of which are considered to be common stock equivalents. The number of shares that would be issued from the exercise of stock options has been reduced by the number of shares that could have been purchased from the proceeds at the average market price of the Company's stock. In addition, certain outstanding options are not included in the computation of diluted earnings per share because their effect would be antidilutive.

Advertising:

All direct advertising costs are expensed as incurred. The Company charged to operations \$5,637 and \$12,189 in advertising costs for the years ended March 31, 2016 and 2015, respectively.

Shipping costs:

Shipping costs include freight and mailing charges associated with delivery of goods from the company's warehouse to customer's designated locations. The company's policy is to classify shipping costs as part of cost of goods sold in the statement of operations.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 2.
Concentrations

The Company maintains cash balances at various financial institutions. Deposits not to exceed \$250,000 at the financial institutions are insured by the Federal Deposit Insurance Corporation. As of March 31, 2016, the Company had approximately \$681,000 of uninsured cash.

In addition, the Company specializes in remanufacturing one particular original equipment manufacturers (OEM) line of office workstations. The business is dependent upon a readily available supply of new parts, as well as used product.

Note 3.
Fair Value of Financial Instruments

The Company estimates that the fair value of all financial instruments at March 31, 2016 and 2015 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying balance sheets. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value, and accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

Estimated fair values of the Company's financial instruments (all of which are held for non-trading purposes), are as follows:

	March 31, 2016		March 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$1,433,971	\$1,433,971	\$1,196,702	\$1,196,702
Accounts receivable	\$1,166,868	\$1,166,868	\$1,250,342	\$1,250,342
Accounts payable	\$531,224	\$531,224	\$556,651	\$556,651
Notes payable	\$2,421,392	\$2,421,392	\$2,664,142	\$2,664,142

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 4.
Property and Equipment

Property and equipment by major classifications are as follows:

	<u>March 31, 2016</u>	<u>March 31, 2015</u>
Land	\$1,547,830	\$1,547,830
Building & improvements	3,170,429	3,170,429
Office furniture and equipment	244,906	234,550
Machinery and equipment	814,400	675,919
Vehicles	<u>33,650</u>	<u>33,650</u>
	5,811,215	5,662,374
Accumulated depreciation	<u>(1,120,629)</u>	<u>(960,040)</u>
	<u>\$4,690,586</u>	<u>\$4,702,335</u>

Depreciation expense for the years ended March 31, 2016 and 2015 totaled \$160,589 and \$161,208 respectively.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 5.
Pledged Assets and Line of Credit

As of March 31, 2016, the Company had a \$500,000 line of credit agreement with National Bank of Arizona. Under this agreement, interest is payable at the bank's Prime rate plus 1%. The line of credit is collateralized by accounts receivable, inventory, property and equipment, and intangibles, which total \$5,625,573. As of March 31, 2016, the Company had no outstanding borrowings on the line of credit and was in compliance with all of the covenants of the agreement. The line of credit matures on August 30, 2016.

Note 6.
Notes Payable

On May 26, 2011, the Company closed escrow on the purchase of a 105,000 square foot commercial building located on an 8.62 acre parcel in Chandler, Arizona for a purchase price of \$4,375,000. The Company made a cash payment of \$1,000,000 and entered into a \$3,375,000 promissory note payable to the seller. Under the terms of the original promissory agreement, the Company was scheduled to make another payment of \$1,375,000 on September 1, 2013. The remaining principal balance of \$2,000,000 was to be amortized over ten years at a 6.5% interest rate, payable in monthly installments of \$22,709.59. On December 28, 2012, the Company terminated the original promissory agreement and entered into a revised note payable. Under the new promissory agreement, the Company made an additional cash payment of \$355,000 and entered into a \$3,000,000 promissory note payable to the seller to be amortized over ten years at a 6.5% interest rate, payable in monthly installments of \$34,064 beginning September 1, 2013. As a result of the modification in terms, the carrying value of the note was discounted by an additional \$20,000 for early payment.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 7.
Operating Lease Commitments

The Company leases warehouse, and office space in Georgia. The lease agreement requires the Company to pay property taxes, insurance and maintenance costs.

Future minimum lease payments were as follows at March 31, 2016:

<u>March 31,</u>	<u>Amount</u>
2017	\$28,886
2018	30,594
2019	31,517
2020	<u>10,610</u>
	<u>\$101,607</u>

Rent expense under the operating lease agreement for the year ended March 31, 2016 was \$31,851.

Note 8.
Cash Dividends

On May 13, 2016 and May 7, 2015, the Board of Directors approved cash dividends of \$0.25 and \$0.20, respectively per share payable on August 29, 2016 and August 27, 2015, respectively. Cash dividends paid for the years ending March 31, 2015 and 2014 totaled \$192,212 and \$147,045, respectively and have been charged to retained earnings.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 9.
Income Taxes

The income tax expense is comprised of the following:

	For the Year Ended	
	<u>March 31, 2016</u>	<u>March 31, 2015</u>
Current Tax Expense:		
Federal	\$ 389,403	\$227,697
State	<u>73,110</u>	<u>47,880</u>
	<u>462,513</u>	<u>275,577</u>
Deferred Tax Expense:		
Federal	(4,200)	12,600
State	<u>(1,000)</u>	<u>3,200</u>
	<u>(5,200)</u>	<u>15,800</u>
Total Income Tax Expense	<u>\$457,313</u>	<u>\$291,377</u>

The Company's income tax provision differs from the amounts computed by applying the federal statutory income tax rate to income before income taxes. Reconciliation to the statutory federal income tax rate is as follows:

	For the Year Ended	
	<u>March 31, 2016</u>	<u>March 31, 2015</u>
Income tax at statutory effective rate	\$469,183	\$297,756
State income taxes, net of federal benefit	24,857	15,895
Domestic production credit	(38,658)	(22,520)
Other nondeductible/nontaxable items	<u>1,931</u>	<u>246</u>
Income Tax Expense	<u>\$457,313</u>	<u>\$291,377</u>

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 10.
Income Taxes (Continued)

Significant components of the Company's deferred tax assets and liabilities are as follows:

	For the Year Ended	
	<u>March 31, 2016</u>	<u>March 31, 2015</u>
Deferred tax assets:		
Reserves, allowances and accruals	55,600	52,800
Deferred interest	<u>(17,800)</u>	<u>(19,300)</u>
Deferred tax asset	<u>\$37,800</u>	<u>\$33,500</u>
Deferred tax liability:		
Property and equipment related	\$95,000	\$65,350
Deferred interest	64,400	82,200
Deferred gain on installment sale	<u>-</u>	<u>12,750</u>
Deferred tax liability	<u>\$159,400</u>	<u>\$160,300</u>

Summary of valuation allowance:

Balance at April 1, 2015	\$ -
Addition for the year ended March 31, 2016	<u>-</u>
Balance at March 31, 2016	<u><u>-</u></u>

Realization of the net deferred tax assets is dependent on future reversals of existing taxable temporary differences and adequate future taxable income, exclusive of reversing temporary differences and carryforwards. Although realization is not assured, management believes that it is more likely than not that the net deferred tax assets will be realizable. The amount of the net deferred tax asset considered realizable could be reduced in the near term if actual future taxable income is lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable temporary differences.

RECONDITIONED SYSTEMS, INC.
Notes to Financial Statements (Continued)

Note 11.
Earnings Per Share

For the years ended March 31, 2016 and 2015 the following data shows amounts used in computing earnings per share and the effect on income and the weighted average number of shares of dilutive potential common stock.

	March 31,	
	<u>2016</u>	<u>2015</u>
Basic and Diluted EPS		
Income before extraordinary item	\$922,640	\$584,377
Extraordinary item	-	-
Net income	<u>\$922,640</u>	<u>\$584,377</u>
Weighted average number of shares outstanding	962,092	978,558
Effect of dilutive securities	-	-
Total common shares + assumed conversions	<u>962,092</u>	<u>978,558</u>
Basic and Diluted earnings per share	<u>\$0.96</u>	<u>\$0.60</u>

Corporate Information

COMMON STOCK LISTING AND TRADING

Reconditioned Systems, Inc. common stock is trading on the Pink Sheets under the ticker symbol RESY.

CORPORATE HEADQUARTERS

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David M Ryan
Director