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MAI SYSTEMS CORP
Form 10-Q
November 13, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

COMMISSION FILE NO. 1-9158

MAI SYSTEMS CORPORATION
(Exact name of Registrant as Specified in its Charter)

DELAWARE
(State or other jurisdiction
of incorporation or organization)

22-2554549
(I.R.S. Employer
Identification No.)

9601 Jeronimo Road
Irvine, California 92618
(Address of Principal Executive Office)

Registrant's telephone number, including area code: (949) 598-6000

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 and (2) has been subject to such filing
requirements for the past 90 days.

Yes No
 X

Indicate by check mark whether the registrant has filed all documents and
reports required to be filed by Sections 12, 13 or 15(d) of the Securities
Exchange Act of 1934 subsequent to the distribution of securities under a plan
confirmed by a court.

Yes No
 X

As of October 31, 2001, 13,691,085 shares of the registrant's Common Stock,
\$.01 par value, were outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MAI Systems Corporation
Condensed Consolidated Balance Sheets
(Unaudited)

	December 31, 2000 ----- (dollars)
ASSETS	
Current assets:	
Cash	\$ 1,019
Receivables, less allowance for doubtful accounts of \$2,154 in 2000 and \$1,636 in 2001	4,338
Inventories	325
Notes receivable	2,700
Investment in subsidiary held for sale	--
Prepays and other assets	807
Total current assets	9,189
Furniture, fixtures and equipment, net	1,882
Intangibles, net	5,308
Other assets	66
Total assets	\$ 16,445
LIABILITIES AND STOCKHOLDERS' DEFICIENCY	
Current liabilities:	
Bridge loan	\$ 220
Current portion of long-term debt	274
Accounts payable	7,395
Customer deposits	2,234
Accrued liabilities	4,182
Income taxes payable	272
Unearned revenue	5,423
Total current liabilities	20,000
Line of credit	2,579
Long-term debt	5,234
Other liabilities	742
Total liabilities	28,555
Stockholders' deficiency:	
Preferred Stock, par value \$0.01 per share; 1,000,000 shares authorized, none issued and outstanding	--
Common Stock, par value \$0.01 per share; authorized 24,000,000 shares; 11,006,658 and 13,691,085 shares issued and issuable at December 31, 2000 and September 30, 2001, respectively	113
Additional paid-in capital	220,622
Accumulated other comprehensive income	80

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Accumulated deficit	(232,925)

Total stockholders' deficiency	(12,110)

Total liabilities and stockholders' deficiency	\$ 16,445
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The accompanying notes are an integral part of these condensed consolidated financial statements.

-2-

MAI Systems Corporation
Condensed Consolidated Statements of Operations
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months September 30,	
	2000	2001	2000	2001
	(in thousands, except per share data)		(in thousands, except per share data)	
Revenue				
Software, networks and professional services:				
Software sales	\$ 2,503	\$ 1,258	\$ 5,867	\$ 2,811
Network and computer equipment	435	375	1,353	1,110
Professional services	5,708	4,952	17,057	15,110
	-----	-----	-----	-----
	8,646	6,585	24,277	23,031
Legacy revenue	1,148	860	4,406	3,110
	-----	-----	-----	-----
Total revenue	9,794	7,445	28,683	26,141
Direct costs	4,260	2,286	13,633	7,110
	-----	-----	-----	-----
Gross profit	5,534	5,159	15,050	19,031
Selling, general and administrative expenses	2,500	2,474	8,757	8,110
Research and development costs	906	1,213	3,104	3,104
Amortization of intangibles	649	664	1,946	1,946
Other operating (income) expense, net	53	(10)	111	(10)
	-----	-----	-----	-----
Operating income	1,426	818	1,132	3,871
Interest income	118	7	273	7
Interest expense	(377)	(413)	(1,125)	(1,125)
	-----	-----	-----	-----
Income before income taxes	1,167	412	280	2,753
Provision for income taxes	38	1	38	1
	-----	-----	-----	-----
Net income	\$ 1,129	\$ 411	\$ 242	\$ 2,752
	=====	=====	=====	=====

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Income per share:

Basic income per share	\$ 0.10	\$ 0.03	\$ 0.02	\$
	=====	=====	=====	=====
Diluted income per share	\$ 0.10	\$ 0.03	\$ 0.02	\$
	=====	=====	=====	=====
Weighted average common shares used in determining income per share:				
Basic	10,907	13,691	10,907	1
	=====	=====	=====	=====
Diluted	10,907	13,928	10,907	1
	=====	=====	=====	=====

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

-3-

MAI Systems Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	For the Nine Months Ended September 30,	
	2000	2001
	-----	-----
	(in thousands, except per share data)	
Net cash used in operating activities	\$ (293)	\$ (946)
	-----	-----
Cash flows from investing activities - capital expenditures	(216)	(282)
	-----	-----
Cash flows from financing activities:		
Net increase (decrease) in line of credit	(205)	18
Proceeds received from sale of subsidiary	--	1,000
Repayments of long-term debt	(285)	(240)
Repayments of bridge loan	(995)	(220)
	-----	-----
Net cash provided by (used in) financing activities	(1,485)	558
	-----	-----
Effect of exchange rate changes on cash and cash equivalents	52	8
	-----	-----
Net change in cash and cash equivalents	(1,942)	(662)

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Cash and cash equivalents at beginning of period	2,645	1,019
Cash and cash equivalents at end of period	\$ 703	\$ 357

Supplemental disclosure of non-cash investing and financing activities (See Notes 6 and 7)

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

-4-

MAI Systems Corporation
Notes to Condensed Consolidated Financial Statements
Nine Months ended September 30, 2001
(Unaudited)

1. BASIS OF PRESENTATION

Companies for which this report is filed are MAI Systems Corporation and its wholly-owned subsidiaries (the "Company"). The information contained herein is unaudited, but gives effect to all adjustments (which are normal recurring accruals) necessary, in the opinion of Company management, to present fairly the condensed consolidated financial statements for the interim period. All significant intercompany transactions and accounts have been eliminated in consolidation.

Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"), and these financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K as amended for the year ended December 31, 2000, which is on file with the SEC.

2. INVENTORIES

Inventories are summarized as follows:

	December 31, 2000 ----	September 30, 2001 ----
	(dollars in thousands)	
Finished goods	\$124	\$145
Replacement parts	201	67
	\$325	\$212

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3. PLAN OF REORGANIZATION

In 1993, the Company emerged from a voluntary proceeding under the bankruptcy protection laws. Notwithstanding the confirmation and effectiveness of its Plan of Reorganization (the "Plan"), the Bankruptcy Court continues to have jurisdiction to resolve disputed pre-petition claims against the Company to resolve matters related to the assumptions, assignment or rejection of executory contracts pursuant to the Plan and to resolve other matters that may arise in connection with the implementation of the Plan.

Shares of common stock may be distributed by the Company to its former creditors. As of October 31, 2001, 6,758,251 shares of Common Stock had been issued pursuant to the Plan and were outstanding.

4. BUSINESS ACQUISITIONS

HOTEL INFORMATION SYSTEMS, INC. ("HIS"):

During 1996, the Company entered into arbitration proceedings regarding the purchase price of HIS. The Company placed approximately 1,100,000 shares of Common Stock issued in connection with the acquisition of HIS in an escrow account to be released in whole, or in part, upon final resolution of post closing adjustments.

In November 1997, the purchase price for the acquisition of HIS was reduced by \$931,000 pursuant to arbitration proceedings. As a result, goodwill was reduced by \$931,000 and approximately 100,650 shares will be released from the escrow account and returned to the Company. In addition, further claims by the Company against HIS relating to legal costs and certain disbursements currently estimated at \$650,000 are presently pending. Resolution of such claims

-5-

may result in release of additional escrow shares to the Company. Upon settlement, the Company may, as needed, pursuant to the asset purchase agreement and related documents, issue additional shares of Common Stock in order that the recipients ultimately receive shares worth a fair value of \$9.25 per share. This adjustment applies to a maximum of 73,466 shares of Common Stock. As of September 30, 2001, the fair market value of the Company's common stock was \$0.35 per share, which would result in approximately 2,370,000 additional shares being issued. Also, included in the escrow account at September 30, 2001 is 200,000 shares of Common Stock which do not have a guarantee of value. The amount and number of shares will be determined based on the final resolution of such claims. Accordingly, as of September 30, 2001, the final purchase price has not been determined.

5. BUSINESS DIVESTITURES

On June 19, 1999, the Company sold GSI for an amount in excess of the book value of net assets sold. Assets sold of approximately \$3,749,000 consisted of accounts receivable of \$1,514,000, inventories of \$364,000, furniture, fixtures and equipment of \$218,000, intangible assets of \$1,573,000 and prepaid expenses of \$80,000. Liabilities assumed by the buyer consisted of accounts payable and accrued liabilities of \$197,000, deposits of \$100,000, unearned revenue of \$351,000 and long-term debt of

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446,000. The Company received three promissory notes totaling \$4,925,000 with face values of \$1,100,000, \$1,500,000 and \$2,325,000, respectively. Interest was paid monthly at the rate of 10% per annum on both the \$1,100,000 and \$1,500,000 notes, with the principal due and payable on June 19, 2001 and June 19, 2003, respectively. The \$1,100,000 promissory note was guaranteed by a third party. Principal payments and interest, at prime plus 1%, was to commence for the \$2,325,000 promissory note on October 1, 2002 in 48 monthly installments of approximately \$48,000 of principal, plus accrued interest.

Imputing interest at a rate of 10%, the present value of the \$2,325,000 promissory note at the date of sale was \$1,682,000 which resulted in a combined carrying value of \$4,282,000 for all three promissory notes. The gain on sale of \$1,227,000 had been deferred until collection of the proceeds representing the gain can be assured. As of December 31, 2000, the Notes were held for sale and were written down to an amount which approximated their estimated net realizable value of \$2,700,000.

On April 6, 2001 the Company entered into an agreement with the maker of the Notes whereby the maker reconveyed 100% of the common stock of GSI to the Company for the purpose of selling GSI to a third party. In connection with the agreement, the Company canceled the Notes and entered into a new \$1.1 million secured promissory note with the same party. The maker will be paid a commission of 30% of the future sale price, which will be first applied to the \$1.1 million note and paid in cash to the maker thereafter. On July 27, 2001, the Company entered into an Asset Purchase Agreement ("Agreement") with the third party for approximately \$3.2 million whereby all of the assets of GSI were acquired and all of the liabilities assumed, except for approximately \$300,000 of obligations, which will remain with GSI. The payment terms under the Agreement require a \$1 million non-refundable cash payment to the Company, which was received on July 27, 2001, and a \$1.5 million payment to be paid the earlier of 120 days from the Agreement date or the date the buyer receives the requisite licenses and approvals in all gaming jurisdictions. Upon receipt of the \$1.5 million payment, the third party will also be required to pay \$500,000 in April 2002 and the remaining \$500,000 in January 2003 subject to a maximum of \$250,000 reduction pursuant to the resolution of certain uncertainties as of the date of the Agreement. As of July 27, 2001, current assets and current liabilities of GSI were approximately \$1.9 million and \$2.7 million, respectively. In the event that the buyer does not receive certain licenses or approvals from the respective gaming authorities, the buyer shall have the right to cancel the Agreement and return the GSI business to the Company, including its assets and employees to the Company with no further obligation. The Company has deferred any gain due to the contingent nature of this sales transaction. The Company believes that the \$1.7 million carrying value is recoverable and, accordingly, is classified as current in the accompanying consolidated balance sheets.

On October 9, 2001, the Company sold certain rights under customer contracts together with the related assets and liabilities of its domestic Legacy hardware maintenance division to the third party which currently provides the on-site repair and warranty service to the Company's Legacy hardware maintenance customers. Pursuant to the agreement, the Company retained the software maintenance component of the customer contracts and will continue to provide the software support services directly to the domestic Legacy customer base. Additionally, the third party will be required to pay the Company approximately 15% of the third party's hardware maintenance revenue stream relating to the hardware maintenance customer contracts subsequent to October 31, 2003. In connection with the sale, the Company received \$328,000 in cash and sold approximately \$119,000 of assets consisting of inventory, spare

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parts, fixed assets and certain accounts receivable. The third party also assumed approximately \$978,000 of liabilities consisting of

-6-

accrued liabilities of approximately \$366,000 and deferred revenue of approximately \$612,000. The sale resulted in a gain of approximately \$1,187,000 in October 2001.

6. LINE OF CREDIT, BRIDGE LOAN AND LONG-TERM DEBT

On July 28, 1999, the Company obtained a Bridge Loan from Coast Business Credit ("Coast") in the amount of \$2,000,000. The Bridge Loan originally bore interest at prime plus 5% (prime plus 8% when default interest rates apply) and was payable interest only on a monthly basis with all accrued and unpaid principal and interest due on the earlier of June 30, 2000 or the date the Company receives a debt or equity infusion of at least \$10,000,000. Loan origination fees of \$75,000 paid to Coast in connection with the Bridge Loan are included in prepaids and other assets and are being amortized to interest expense over the term of the loan. Due to a temporary event of default on the Bridge Loan and the secured revolving credit facility and pursuant to a forbearance agreement with Coast, the Company began making weekly principal payments of \$25,000 on the Bridge Loan commencing in September 1999. During the default period, the Company also paid \$40,000 in default fees to Coast in 1999 and \$30,000 in 2000.

In April 1998, the Company negotiated a \$5,000,000 secured revolving credit facility with Coast. The availability of this facility is based on a calculation using a rolling average of certain cash collections. The facility was amended on July 28, 1999 to allow for aggregate borrowings on an interest only basis under the credit facility and Bridge Loan not to exceed \$6,000,000. The facility is secured by all assets, including intellectual property of the Company, and bears interest at prime plus 2.25% (prime plus 5.25% when default interest rates apply) and expires on April 30, 2003. The facility was again amended on April 13, 2000 and September 12, 2000. In accordance with the amendments, the Bridge Loan and the credit facility bear interest at prime plus 4.5% and required \$35,000 weekly principal payments on the Bridge Loan, except for the period from September 12, 2000 through December 8, 2000, which required monthly payments of \$35,000, until it was paid in full. During the first quarter of 2001, the remaining balance of the Bridge Loan was repaid in full. Additionally, the credit facility was amended to allow for aggregate borrowings on an interest only basis under the credit facility not to exceed \$3,360,000. In connection with the amendment on April 13, 2000, Coast waived all existing defaults. Additionally, the Company agreed to pay Coast a fee of \$300,000 ("Loan Fee") in weekly installments of \$35,000 commencing after the Bridge Loan is paid in full. The Loan Fee was fully paid by April 23, 2001. The facility contains various restrictions and covenants, including a minimum consolidated net worth, debt coverage ratio and minimum quarterly profitability. The Company was in compliance with these covenants as of September 30, 2001.

At December 31, 2000 and September 30, 2001, approximately \$2,579,000 and \$2,597,000, respectively, was available and drawn down under the credit facility.

Loan restructuring fees of \$300,000 were incurred in connection with the line of credit and Bridge Loan, are classified in prepaids and other

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current assets and are being amortized to interest expense over the term of the facility.

In March 1997 the Company issued \$6,000,000 of 11% subordinated notes payable due in 2004 to an investment fund managed by Canyon Capital Management LP ("Canyon"). In September 1997 this indebtedness was reduced to \$5,250,000 through application of a portion of the proceeds realized from the exercise of warrants by Canyon. The notes call for semi-annual interest payments. On September 3, 1999, the Company failed to make the semi-annual interest payment due on that date in the amount of \$288,750.

The Company and Canyon subsequently entered into a forbearance agreement which provided that the Company pay Canyon weekly interest payments of \$12,500 effective January 1, 2000. In addition, the Company executed a security agreement, which provided Canyon with a lien on all of the Company's tangible and intangible property, which lien is junior to the lien granted to Coast.

On April 13, 2000, the Company entered into an agreement with Canyon which waived all existing events of default, accelerated the maturity date to March 3, 2003 and provided for continued weekly interest payments of \$12,500. On January 31, 2001, the Company entered into an agreement with Canyon whereby the specified accrued interest of \$431,000 was added to the principal balance of the subordinated notes payable. As part of this agreement, the Company also agreed to pay Canyon an additional \$79,000 loan fee, of which \$29,000 was added to principal.

7. COMMON STOCK

-7-

In January and February of 2001, the Company entered into agreements with several creditors to retire approximately \$2.1 million of obligations outstanding as of December 31, 2000 in exchange for 798,000 shares of Common Stock and \$470,000 of cash. This resulted in a gain of \$1,377,000 in the first quarter of 2001. To fulfill its performance under the agreement, the Company issued the 798,000 shares of its Common Stock and filed an S-3 Registration statement in March 2001 to cause them to become tradable with the effectiveness of the Registration Statement. The S-3 Registration Statement was declared effective by the Securities Exchange Commission on October 30, 2001. As of October 31, 2001 the Company has paid approximately \$362,000 pursuant to these agreements with the remainder to be paid over the next thirteen months.

In May 2001, the Company issued 35,000 shares of its Common Stock valued at \$12,000, its fair market value at the date of issuance, to a creditor to satisfy certain of its obligations.

8. INCOME (LOSS) PER SHARE OF COMMON STOCK

Basic and diluted income or loss per share is computed using the weighted average shares of common stock outstanding during the period. Consideration is also given in the diluted income per share calculation for the dilutive effect of stock options and warrants.

The following table illustrates the computation of basic and diluted earnings (loss) per share under the provisions of SFAS 128:

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	For The Three Months Ended September 30,		For The Nine Months September 30,	
	2000	2001	2000	2001
	(in thousands, except per share data)		(in thousands, except per share data)	
Numerator:				
Numerator for basic and diluted earnings per share - net income	\$ 1,129	\$ 411	\$ 242	\$ 242
Denominator:				
Denominator for basic earnings per Share-weighted average number of Common shares outstanding during the period	10,907	13,691	10,907	12,907
Incremental common shares attributable To exercise of outstanding options	--	237	--	--
Denominator for diluted earnings Per share	10,907	13,928	10,907	13,907
Basic earnings per share	\$ 0.10	\$ 0.03	\$ 0.02	\$ 0.02
Diluted earnings per share	\$ 0.10	\$ 0.03	\$ 0.02	\$ 0.02

9. ACCOUNTING PRONOUNCEMENTS

-8-

In July 2001, the FASB issued SFAS No. 141 "Business Combinations". This statement requires that all business initiated after June 30, 2001 be accounted for by a single method - the purchase method. It also sets forth criteria for the identification of intangible assets apart from goodwill. At the same time, the FASB also issued SFAS No. 142 "Goodwill and Other Intangible Assets". This statement addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in financial statements. Specifically, SFAS No. 142 requires that goodwill be tested for impairment annually and that amortization of goodwill cease. SFAS No. 142 is required to be implemented by the Company commencing on January 1, 2002. The Company is currently assessing the impact these new standards will have on the Company's results. Goodwill amortization was \$413,000 and \$142,000 for the three months ended September 30, 2001 and 2000 respectively, and \$1,240,000 and \$1,282,000 for the nine months ended September 30, 2001 and 2000 respectively.

On October 3, 2001, the Financial Accounting Standards Board issued FASB Statement No. 144, Accounting for the Impairment or Disposal of Long

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-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While Statement No. 144 supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets for Be Disposed Of, it retains many of the fundamental provisions of that Statement.

Statement No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business. However, it retains the requirement in Opinion 30 to report separately discounted operations and extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to owners) or is classified as held for sale. By broadening the presentation of discounted operations to include more disposal transactions, the FASB has enhanced managements ability to provide information that helps financial statement users to assess the effects of a disposal transaction on the ongoing operations of an entity.

Statement No. 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Early application is encouraged.

10. LEGAL PROCEEDINGS

Chapter 11 Bankruptcy Proceedings

At September 30, 2001, there was only one material claim to be settled before the Company's Chapter 11 proceeding could be formally closed, a tax claim with the United States Internal Revenue Service (the "Service"). The amount of this claim is in dispute. The Company has reserved \$712,000 for settlement of this claim, which it is anticipated would be payable to the Service in equal monthly installments over a period of six (6) years from the settlement date at an interest rate of 6%.

CSA Private Limited

CSA is a MAI shareholder. On August 9, 1996, MAI acquired from Hotel Information Systems, Inc. ("HIS") substantially all their assets and certain of their liabilities (the "HIS Acquisition"). At the time of MAI's acquisition of HIS in 1996, CSA was a shareholder of HIS and, in connection with the purchase, MAI agreed to issue to CSA shares of its common stock worth approximately \$4.8 million in August 1996, which amount had increased to approximately \$6.8 million as of December 31, 2000, pursuant to the agreement. MAI also granted CSA demand registration rights with respect to such stock. CSA requested registration of their shares, but MAI delayed registration based upon its good faith exercise of its rights under its agreement with CSA. On October 5, 1998, CSA filed a lawsuit against MAI in the U.S. District Court for the Central District of California. Pursuant to a settlement agreement entered into as of May 13, 1999 MAI agreed by November 1, 1999 to file, or at a minimum to commence the process to file, a registration statement with the Securities and Exchange Commission ("SEC") for the purpose of registering CSA's shares. CSA initiated another lawsuit in December 1999 in the above-referenced court (a) seeking damages in excess of \$5 million; (b) enforcement of the settlement agreement; and (c) and injunctive relief through court order to cause MAI to file with the SEC. On March 6, 2000, the Company answered the complaint. Because the Company did not conclude the registration statement filing by November 1, 1999, CSA initiated a second lawsuit in January 2000 to

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enforce the settlement agreement and secure injunctive relief through court order to cause the Company to file a registration statement.

-9-

The Company entered into a second settlement agreement with CSA in February 2001, whereby it agreed to take the following steps on or before March 1, 2001: (i) issue CSA additional shares of its Common Stock to bring CSA's total share ownership to 2,433,333 shares; (ii) immediately file a registration statement for all of CSA's shares of our common stock; and (iii) execute a secured debt instrument in favor of CSA in the principal sum of \$2,800,000 which is subordinate only to our present group of three (3) senior secured leaders and requires cash installment payments to commence June 1, 2002. The number of shares which may be sold by the selling shareholder includes: (i) CSA's current ownership of 517,319 shares, and (ii) 1,916,014 additional shares which were issued to CSA pursuant to the settlement agreement. On October 30, 2001 the Securities and Exchange Commission declared the registration statement effective and as of that date CSA's shares freely tradable.

In connection with the second settlement agreement with CSA, the Company recorded the \$2.8 million debt issuance as a reduction in paid in capital and the 1,916,014 additional shares as an addition to common stock and a reduction to additional paid in capital. The \$2.8 million of debt accrues interest at 10% per annum and requires payments of \$37,500 commencing on March 1, 2002 through September 1, 2002 and monthly payments of \$107,500 commencing on October 1, 2002 until all outstanding principal and accrued interest is paid in full. In any event, payment of any unpaid principal and accrued interest is due by October 1, 2003.

Other Litigation

The Company is also involved in various other legal proceedings that are incident to its business. Management believes the ultimate outcome of these matters will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

11. COMPREHENSIVE INCOME

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and disclosure of comprehensive income and its components (revenue, expenses, gains and losses) in a full set of general purpose financial statements. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997 and requires reclassification of financial statements for earlier periods to be provided for comparative purposes. The Company has presented the information required by SFAS No. 130 as follows (in thousands):

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2000	2001	2000	2001
	----	----	----	----
Net income	\$ 1,129	\$411	\$242	\$2,099

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Change in cumulative translation adjustments	(194)	46	40	56
	-----	----	----	-----
Comprehensive income	\$ 935	\$457	\$282	\$2,155
	=====	=====	=====	=====

Accumulated other comprehensive (loss) income in the accompanying consolidated balance sheets consists of cumulative translation adjustments.

-10-

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2001, working capital improved from a working capital deficiency of \$10,811,000 at December 31, 2000 to a working capital deficiency of \$5,391,000. Excluding unearned revenue of \$3,841,000, the Company's working capital deficiency at September 30, 2001 would be \$1,550,000 or a ratio of current assets to current liabilities of 0.82 to 1.0. Excluding unearned revenue, working capital deficiency at December 31, 2000 was \$5,388,000, with a current ratio of 0.63 to 1.0. Excluding unearned revenue, the decrease in the working capital deficiency of \$3,838,000 was primarily attributable to decreases in the Coast Bridge Loan of \$220,000, accounts payable of \$4,064,000 (mainly due to vendor settlements described in Note 7 to the consolidated financials statements), deposits of \$894,000, accrued liabilities of \$650,000 and unearned revenue of \$1,582,000 offset by decreases in cash of \$662,000, receivables of \$964,000 and notes receivable/investment in subsidiary held for sale of \$1,000,000 (which represents a non refundable deposit received from the sale of GSI on July 27, 2001).

Cash was \$357,000 at September 30, 2001, as compared to \$1,019,000 at December 31, 2000. Availability under the Company's secured revolving credit facility is based on a calculation using a rolling average of certain cash collections. At September 30, 2001, approximately \$2,597,000 was available and drawn down under this facility. The facility expires on April 30, 2003.

Net cash used in investing activities for the nine months ended September 30, 2001, totaled \$282,000, which represented capital expenditures.

Net cash provided by financing activities for the nine months ended September 30, 2001 totaled \$558,000, which is comprised of a \$1 million non-refundable cash deposit received in connection with the sale of GSI on July 27, 2001 and an \$18,000 increase in the secured revolving credit facility offset by \$240,000 and \$220,000 in repayments of long-term debt and Bridge Loan, respectively. The revolving credit facility requires monthly interest only payments on the average outstanding balance for the period. The Company is required to make weekly payments of \$12,500 on the subordinated debt. The facility, and subordinated debt pursuant to an intercreditor agreement between Canyon Capital and Coast Business Credit, contains various restrictions and covenants, including an adjusted minimum consolidated net worth of (\$4,466,000) as of September 30, 2001, minimum quarterly debt coverage ratio of 1.1:1 and minimum quarterly profitability of \$250,000. We were in compliance with these covenants as of September 30, 2001. In the event that we are not in compliance with the various restrictions and covenants and were unable to receive waivers for

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non-compliance, the facility and subordinated debt would become immediately due and payable. The restrictions and covenants are assessed quarterly.

Stockholders' deficiency increased from \$12,110,000 at December 31, 2000 to \$12,516,000 at September 30, 2001, mainly as a result of a reduction to additional paid in capital relating to final resolution of the settlement with CSA. Principal and interest payments on \$2.8 million of CSA debt commence on March 1, 2002. The decrease was offset by net income for the period of \$2,099,000 and approximately \$240,000 of common stock issued during the first six months of 2001.

Net cash used in operating activities for the nine months ended September 30, 2001 totaled \$946,000 and mainly related to decreases in accounts payable and customer deposits of \$3,392,000, accrued liabilities of \$125,000, income taxes payable of \$79,000, unearned revenue of \$1,582,000 and a gain recorded in the first half of 2001 on the issuance of common stock for settlement of vendor obligations of \$1,377,000 offset by net income for the period of \$2,099,000, non-cash charges for depreciation and amortization of tangible and intangible assets, of \$2,817,000 and a provision for doubtful accounts receivable of \$411,000. The Company expects that it will generate cash from its operating activities during the next twelve months.

Although the Company has a net stockholders' deficiency of \$12,516,000 at September 30, 2001, the Company believes it will generate sufficient funds from operations and obtain additional financing, as needed, in 2001 to meet its operating and capital requirements. The Company expects to generate positive cashflow during 2001 from shipping out products and services from its \$15 million backlog as of September 30, 2001 as well as new orders. Also, the Company entered into an agreement for the sale of its investment in GSI for approximately \$3.2 million, subject to adjustment, and has received a \$1 million non-refundable cash deposit on July 27, 2001. Subject to certain contingencies being resolved, the Company will receive \$1,500,000 by December 2001, \$500,000 in April 2002 and the balance in January 2003.

Lastly, the Company has historically been successful in securing additional capital, when needed, to meet operating and capital requirements.

-11-

RESULTS OF OPERATIONS

Three Months Ended September 30, 2000
Compared to Three Months Ended September 30, 2001

	Three Months Ended September 30, 2000	Percentage of Revenue	Three Months Ended September 30, 2001	Per of
	-----	-----	-----	-----
	(in thousands)		(in thousands)	
Revenues:				
Hospitality	\$7,750	79.1%	\$ 6,103	
Process Manufacturing	849	8.7%	482	
Legacy	1,195	12.2%	860	
Total revenue	9,794	100.0%	7,445	1
Gross profit	5,534	56.5%	5,159	
Selling, general &				
Administrative expenses	2,500	25.5%	2,474	
Research and development				

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costs	906	9.3%	1,213
Amortization of intangibles	649	6.6%	664
Other operating (income)/expense	53	0.5%	(10)

Revenue for the quarter ended September 30, 2001 was \$7,445,000 compared to \$9,794,000 in 2000, a decrease of \$2,349,000 or a 24.0% decrease. We continue to transition from our legacy business to the sale of enterprise solutions as 88.4% of our 2001 revenue resulted from our enterprise solutions business as compared to 87.8% in 2000. Our revenue from our sales of enterprise solutions in industries in which we compete (hospitality and process manufacturing), decreased 23.4% compared to the prior quarter of 2000. Hospitality revenue decreased 21.3% from \$7,750,000 in 2000 to \$6,103,000 in 2001, as a result of decreased software sales and professional services mainly due to decreased market spending on information technology in 2001 due to economic uncertainties in the industry. Process Manufacturing decreased from \$849,000 in 2000 to \$482,000 in 2001, a decrease of \$367,000 or a 43.2% decrease, as the process business unit transitioned from a direct selling model to a reseller model and completed development of new products. During 2000, we focused on developing enhancements to our CIMPRO V and CIMPRO classic process manufacturing products which were released in the first quarter of 2001. Consistent with our strategy to focus on providing software and services to our vertical markets, our legacy revenue (traditional hardware contract service revenues and proprietary add-on sales) declined 28.0% quarter over quarter, largely due to expected decreased volume and customers replacing their legacy systems due to Year 2000 compliance.

The decrease in revenue for our hospitality, process manufacturing and legacy business units from 2000 to 2001 were mainly attributable to a decrease in the volume of sales. Our respective business units continue to generate sufficient cash from operations to adequately fund the respective ongoing operating activities.

Revenue in our Asian hospitality operations decreased from \$1,402,000 in 2000 to \$835,000 in 2001. The deterioration of revenue from 2000 to 2001 is mainly due to the continued generally depressed condition of the Asian economies resulting in a decrease in sales in the region.

Gross profit increased to 69.3% in 2001 from 56.5% in 2000 due to a decrease of professional and software support costs which generated gross margins of 42% and 93% respectively in 2001 and 25% and 68% respectively in 2000.

Selling, general and administrative expenses ("SG&A") decreased 1.04% from \$2,500,000 in 2000 to \$2,474,000 in 2001. The decrease is mainly due to decreased payroll and facilities costs and the reduction in the use of third party service providers for the Company's hospitality division. As a result, SG&A for the Company's hospitality division decreased from \$1,937,000 in 2000 to \$1,817,000 in 2001.

Research and development costs increased 34% over the comparable period in 2000. This is primarily a result of increased headcount in the Company's hospitality division and an increase in the use of contracted research and development personnel in 2001. Research and development costs for the hospitality division increased from \$653,000 in 2000 to \$1,114,000 in 2001 as a result of the Company's efforts and focus on new product development as well as enhancements to its current products.

The 2.3% increase in amortization of intangibles versus the comparable period of 2000 is due to the increased amortization expense associated with capitalized

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software development costs at the Company's Process Manufacturing division.

Nine Months Ended September 30, 2000
Compared to Nine Months Ended September 30, 2001

	Nine Months Ended September 30, 2000 ----- (in thousands)	Percentage of Revenue -----	Nine Months Ended September 30, 2001 ----- (in thousands)	Perce of Re -----
Revenues:				
Hospitality	\$20,403	71.1%	\$ 18,873	8
Process Manufacturing	3,382	11.8%	1,566	10
Legacy	4,898	17.1%	2,885	1
Total revenue	28,683	100.0%	23,324	100
Gross profit	15,050	52.5%	15,001	6
Selling, general & Administrative expenses	8,757	30.5%	7,318	3
Research and development Costs	3,104	10.8%	3,703	1
Amortization of intangibles	1,946	6.8%	1,993	1
Other operating (income) expense	111	0.4%	(1,406)	(

Revenue for 2000 was \$28,683,000 compared to \$23,324,000 in 2001 or a 18.7% decrease. We continue to transition from our legacy business to the sale of enterprise solutions as 87.6% of our 2001 revenue resulted from our enterprise solutions business as compared to 82.9% in 2000. Process Manufacturing decreased from \$3,382,000 in 2000 to \$1,566,000 in 2001 as the process business unit transitioned from a direct selling model to a reseller model and completed development of new products. During 2000, we focused on developing enhancements to our CIMPRO V and CIMPRO classic process manufacturing products which were released in the first quarter of 2001. Consistent with our strategy to focus on providing software and services to our vertical markets, our legacy revenue (traditional hardware contract service revenues and proprietary add-on sales) declined 41.1% year over year, largely due to expected decreased volume and customers replacing their legacy systems due to Year 2000 compliance.

The decrease in revenue for our process manufacturing and legacy business units from 2000 to 2001 were mainly attributable to a decrease in the volume of sales. Our respective business units continue to generate sufficient cash from operations to adequately fund the respective ongoing operating activities.

Revenue in our Asian hospitality operations decreased from \$3,077,000 in 2000 to \$1,907,000 in 2001. The deterioration of revenue from 2000 to 2001 is mainly due to the continued generally depressed condition of the Asian economies resulting in a decrease in sales in the region.

Gross profit increased to 64.3% in 2001 from 52.5% in 2000 due to a decrease of professional and software support services costs which generated gross margins of 33% and 91% respectively in 2001 and 19% and 70% respectively in 2000.

Selling, general and administrative expenses ("SG&A") decreased 16.4% from \$8,757,000 in 2000 to \$7,318,000 in 2001. The decrease is mainly due to decreased payroll and facilities costs and the reduction in the use of third party service providers for the Company's hospitality division. As a result, SG&A for the Company's hospitality division decreased from \$6,726,000 in 2000 to \$5,308,000 in 2001.

Research and development costs increased 19.3% over the comparable period in

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2000. This is primarily a result of increased headcount in the Company's hospitality division and an increase in the use of contracted research and development personnel in 2001. Research and development costs for the hospitality division increased from \$2,345,000 in 2000 to \$3,289,000 in 2001 as a result of the Company's efforts and focus on new product development as well as enhancements to its current products.

The 2.5% increase in amortization of intangibles versus the comparable period of 2000 is due to the increased amortization expense associated with capitalized software development costs at the Company's Process Manufacturing division.

-13-

Other operating income was \$1,406,000 in 2001 mainly as a result of the Company issuing common stock to certain creditors to satisfy its obligations which resulted in a gain of \$1,377,000 in the first quarter of 2001. There were no such transactions in 2000.

ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued SFAS No. 141 "Business Combinations". This statement requires that all business initiated after June 30, 2001 be accounted for by a single method - the purchase method. It also sets forth criteria for the identification of intangible assets apart from goodwill. At the same time, the FASB also issued SFAS No. 142 "Goodwill and Other Intangible Assets". This statement addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in financial statements. Specifically, SFAS No. 142 requires that goodwill be tested for impairment annually and that amortization of goodwill cease. SFAS No. 142 is required to be implemented by the Company commencing on January 1, 2002. The Company is currently assessing the impact these new standards will have on the Company's results. Goodwill amortization was \$413,000 and \$142,000 for the three months ended September 30, 2001 and 2000 respectively, and \$1,240,000 and \$1,282,000 for the nine months ended September 30, 2001 and 2000 respectively.

On October 3, 2001, the Financial Accounting Standards Board issued FASB Statement No. 144, Accounting for the Impairment or Disposal of Long -Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While Statement No. 144 supersedes FASB Statement No. 121, Accounting for the Impairment of Long -Lived Assets and for Long-Lived Assets for Be Disposed Of, it retains many of the fundamental provisions of that Statement.

Statement No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business. However, it retains the requirement in Opinion 30 to report separately discounted operations and extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to owners) or is classified as held for sale. By broadening the presentation of discounted operations to include more disposal transactions, the FASB has enhanced managements ability to provide information that helps financial statement users to assess the effects of a disposal transaction on the ongoing operations of an entity.

Statement No. 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Early application is encouraged.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK DISCLOSURES

The following discussion about the Company's market risk disclosures contains forward-looking statements. Forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those discussed in the forward-looking statements. The Company is exposed to market risk related to changes in interest rates and foreign currency exchange rates. The Company does not have derivative financial instruments for hedging, speculative, or trading purposes.

INTEREST RATE SENSITIVITY

Of the Company's \$11.6 million principal amount of indebtedness at September 30, 2001, \$2.6 million bears interest at a rate that fluctuates based on changes in prime rate. A one percentage point change in the underlying prime rate would result in a \$26,000 change in the annual amount of interest payable on such debt. Of the remaining amount of \$9.0 million, \$5.7 million bears interest at a fixed rate of 11%, \$2.9 million bears interest at a fixed rate of 10% and \$436,000 bears fixed interest rates ranging from 6% to 17.5%.

FOREIGN CURRENCY RISK

The Company believes that its exposure to currency exchange fluctuation risk is insignificant because the Company's transactions with international vendors are generally denominated in US dollars. The currency exchange impact on intercompany transactions was immaterial for the quarter ended September 30, 2001.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Chapter 11 Bankruptcy Proceedings

At September 30, 2001, there was only one material claim to be settled before the Company's Chapter 11 proceeding could be formally closed, a tax claim with the United States Internal Revenue Service (the "Service"). The amount of this claim is in dispute. The Company has reserved \$712,000 for settlement of this claim, which it is anticipated would be payable to the Service in equal monthly installments over a period of six (6) years from the settlement date at an interest rate of 6%.

CSA Private Limited

CSA is a MAI shareholder. On August 9, 1996, MAI acquired from Hotel Information Systems, Inc. ("HIS") substantially all their assets and certain of their liabilities (the "HIS Acquisition"). At the time of MAI's acquisition of HIS in 1996, CSA was a shareholder of HIS and, in connection with the purchase, MAI agreed to issue to CSA shares of its common stock worth approximately \$4.8 million in August 1996, which amount had increased to approximately \$6.8 million as of December 31, 2000, pursuant to the agreement. MAI also granted CSA demand registration rights with respect to such stock. CSA requested

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registration of their shares, but MAI delayed registration based upon its good faith exercise of its rights under its agreement with CSA. On October 5, 1998, CSA filed a lawsuit against MAI in the U.S. District Court for the Central District of California. Pursuant to a settlement agreement entered into as of May 13, 1999 MAI agreed by November 1, 1999 to file, or at a minimum to commence the process to file, a registration statement with the Securities and Exchange Commission ("SEC") for the purpose of registering CSA's shares. CSA initiated another lawsuit in December 1999 in the above-referenced court (a) seeking damages in excess of \$5 million; (b) enforcement of the settlement agreement; and (c) and injunctive relief through court order to cause MAI to file with the SEC. On March 6, 2000, the Company answered the complaint. Because the Company did not conclude the registration statement filing by November 1, 1999, CSA initiated a second lawsuit in January 2000 to enforce the settlement agreement and secure injunctive relief through court order to cause us to file a registration statement.

The Company entered into a second settlement agreement with CSA in February, 2001 whereby we agreed to take the

-15-

following steps on or before March 1, 2001: (i) issue CSA additional shares of our common stock to bring CSA's total share ownership to 2,433,333 shares; (ii) immediately file a registration statement for all of CSA's shares of our common stock; and (iii) execute a secured debt instrument in favor of CSA in the principal sum of \$2,800,000 which is subordinate only to our present group of three (3) senior secured lenders and requires cash installment payments to commence June 1, 2002. The number of shares which may be sold by the selling shareholder includes: (i) CSA's current ownership of 517,319 shares, and (ii) 1,916,014 additional shares which were issued to CSA pursuant to the settlement agreement. On October 30, 2001 the Securities and Exchange Commission declared the registration statement effective and as of that date CSA's shares freely tradable.

In connection with the second settlement agreement with CSA, the Company recorded the \$2.8 million debt issuance as a reduction in paid in capital and the 1,916,014 additional shares at par as an addition to common stock and a reduction to additional paid in capital. The \$2.8 million of debt accrues interest at 10% per annum and requires payments of \$37,500 commencing on March 1, 2002 through September 1, 2002 and monthly payments of \$107,500 commencing on October 1, 2002 until all outstanding principal and accrued interest is paid in full. In any event, payment of any unpaid principal and accrued interest is due by October 1, 2003.

Other Litigation

The Company is also involved in various other legal proceedings that are incident to its business. Management believes the ultimate outcome of these matters will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

- (a) None.
- (b) None.

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(c) None

(d) None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) None

(b) None

(c) None

(d) None

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) None

-16-

(b) Reports on Form 8-K.

None.

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.

MAI SYSTEMS CORPORATION
(Registrant)

Date: November 13, 2001

/s/James W. Dolan

James W. Dolan
Chief Financial and Operating Officer
(Chief Financial and Accounting Officer)

-17-