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METATEC INTERNATIONAL INC
Form 10-Q
May 09, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2002

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 0-9220

METATEC INTERNATIONAL, INC.
(Exact name of Registrant as specified in its charter)

OHIO
(State of Incorporation)

31-1647405
(IRS Employer Identification No.)

7001 Metatec Boulevard
Dublin, Ohio
(Address of principal executive offices)

43017
(Zip code)

Registrant's telephone number, including area code: (614) 761-2000

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 X No
--- ---

Number of Common Shares outstanding as of April 23, 2002: 6,536,113

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METATEC INTERNATIONAL, INC.

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PART I - FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

METATEC INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS	At March 31,

	2002
	(Unaudited)

ASSETS	
Current assets:	
Cash and cash equivalents	\$ 595,551
Accounts receivable, net of allowance for doubtful accounts of \$400,000	10,125,523
Due from sale of assets	-
Inventory	1,916,482
Prepaid expenses	897,058
Refundable income taxes	875,000

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Total current assets	14,409,614
Property, plant and equipment - net	27,690,612
Other assets	163,649

TOTAL ASSETS	\$ 42,263,875
	=====
LIABILITIES & SHAREHOLDERS' DEFICIENCY	
Current liabilities:	
Accounts payable	\$ 3,828,612
Accrued expenses:	
Royalties	5,879,705
Personal property taxes	1,337,356
Payroll	520,445
Restructuring	754,776
Taxes, benefits and other	1,636,611
Unearned income	177,005
Current maturities of long-term real estate debt	157,399
Current maturities of other long-term debt and capital lease obligations	296,066

Total current liabilities	14,587,975
Long-term real estate debt	18,484,513
Other long-term debt and capital lease obligations, less current maturities	17,328,378
Other long-term liabilities	658,042

Total liabilities	51,058,908

Shareholders' deficiency:	
Common stock - no par value; authorized 10,000,000 shares; issued 2002 - 7,217,855, 2001 - 7,217,855 shares	33,008,138
Accumulated deficit	(37,340,638)
Accumulated other comprehensive loss	(741,246)
Treasury stock, at cost; 681,742 and 1,081,742 shares	(3,670,537)
Unamortized restricted stock	(50,750)

Total shareholders' deficiency	(8,795,033)

TOTAL LIABILITIES & SHAREHOLDERS' DEFICIENCY	\$ 42,263,875
	=====

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months ----- 2002 -----
NET SALES	\$ 15,245,6
Cost of sales	10,506,9 -----
Gross profit	4,738,7
Selling, general and administrative expenses	4,659,2
Restructuring expenses	-----
OPERATING EARNINGS (LOSS)	79,5
Other income and (expense):	
Investment income	4,0
Interest expense	(751,9 -----)
LOSS BEFORE INCOME TAXES	(668,4
Income tax benefit	875,0 -----
NET INCOME (LOSS)	\$ 206,5 =====
NET INCOME (LOSS) PER COMMON SHARE	
Basic and diluted	\$ 0. =====
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	
Basic and diluted	6,453,8 =====

See notes to condensed consolidated financial statements.

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METATEC INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIENCY (UNAUDITED)

	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock
-----	-----	-----	-----	-----
BALANCE AT DECEMBER 31, 2001	\$35,031,138	\$ (37,547,201)	\$ (786,480)	\$ (5,822,53

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Comprehensive Income:				
Net income		206,563		
Foreign currency translation adjustments			55,529	
Accretion of gain on termination of forward contracts			(10,295)	
Comprehensive income				
Issuance of treasury stock	(2,062,000)			2,152,000
Issuance of restricted shares	39,000			
Amortization of restricted stock				
BALANCE AT MARCH 31, 2002	\$33,008,138	\$ (37,340,638)	\$ (741,246)	\$ (3,670,533)

See notes to consolidated financial statements.

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METATEC INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the three months ended March 31,	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 206,563	\$ (1,926,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,519,412	2,778,000
Deferred income taxes	0	18,000
Net gain on sales of property, plant and equipment	0	(1,000)
Changes in assets and liabilities:		
Accounts receivable	1,847,271	2,415,000
Inventory	154,141	40,000
Prepaid expenses and other assets	(1,013,044)	(418,000)
Accounts payable and accrued expenses	(2,680,712)	(930,000)
Unearned income	(14,434)	(46,000)
Net cash provided by operating activities	19,197	1,929,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(22,058)	(551,000)
Proceeds from the sales of property, plant and equipment	1,185,234	3,000
Net cash provided by (used in) investing activities	1,163,176	(548,000)

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CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in long-term debt	16,622,586	3,450
Payment of long-term debt and capital lease obligations	(19,261,343)	(2,066)
Net cash provided by (used in) financing activities	(2,638,757)	1,383
Effect of exchange rate on cash	70,751	(4)
Increase (decrease) in cash and cash equivalents	(1,385,633)	2,760
Cash and cash equivalents at beginning of period	1,981,184	2,086
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 595,551	\$ 4,846
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Interest paid	\$ 691,179	\$ 854
Income tax refunds received	\$ (5,700)	\$ (122)
Assets purchased by the assumption of a liability	\$ 38,962	\$ 123
Issuance of restricted stock	\$ 39,000	\$ 35
Payment of accrued restructuring expense by the issuance of treasury stock	\$ 90,000	\$

See notes to condensed consolidated financial statements.

METATEC INTERNATIONAL, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (unaudited)

1. BASIS OF PRESENTATION - The consolidated balance sheet as of March 31, 2002, the consolidated statements of operations for the three months ended March 31, 2002 and 2001, the consolidated statement of shareholders' equity for the three months ended March 31, 2002, and the consolidated statements of cash flows for the three month periods then ended have been prepared by the Company, without audit. In the opinion of management, all adjustments, which consist solely of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position, results of operations and changes in cash flows for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted

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in the United States of America have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's December 31, 2001 annual report on Form 10-K. The results of operations for the period ended March 31, 2002 are not necessarily indicative of the results for the full year.

Income taxes - In March 2002, the President signed the Job Creation and Worker Assistance Act of 2002 into law. This law extended the carry back period from two to five years for net operating losses arising in the 2001 and 2002 taxable years. The Company recorded an income tax benefit in the quarter ended March 31, 2002 related to this law.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, "Goodwill and Other Intangibles." SFAS 142 is effective for all fiscal years beginning after December 15, 2001, and requires changes in the amortization of certain goodwill and intangible assets, including an annual assessment of possible impairment. The adoption of this statement did not have a material impact on the Company's consolidated financial statements since the Company's goodwill and intangible assets were fully impaired at December 31, 2001 and written off.

In August 2001, the FASB issued SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." While this statement supercedes SFAS No. 121, "Accounting for Impairment of Long-Lived Assets to Be Disposed Of" it retains the fundamental provisions of SFAS No. 121 for recognition and impairments of assets to be held and used, and assets to be disposed of by sale. This statement was adopted in the first quarter of the year ended December 31, 2002. The adoption of this statement did not have a material effect on the Company's consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2002 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2001

CRITICAL ACCOUNTING POLICIES

The Company's Form 10-K for the year ended December 31, 2001 included a discussion of the Company's critical accounting policies, which discussion should be read in conjunction with the quarterly information contained in this Form 10-Q.

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BUSINESS OF THE COMPANY

The Company is transitioning from a disc manufacturing company to a supply chain solutions company that enables companies to streamline the process of delivering products and information to market by providing technology driven supply chain solutions that increase efficiencies and reduce costs. The Company assists its customers with a wide range of services from preparing their product for market to delivering their finished product into the distribution channel or directly to the end-users. The solution is built on a solid technology foundation that includes both customized system integration and a web-based reporting and tracking tool that makes real-time information easily accessible. Technologies include CD-ROM and DVD manufacturing services and secure Internet-based software distribution service. The Company's core CD-ROM manufacturing capabilities serve

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as a component of the supply chain. The Company maintains operations in Ohio and The Netherlands. Revenues attributed to product types are distinguished as CD-ROM sales and other sales. As its core business, a majority of the Company's revenue continues to come from its optical disc manufacturing business.

RESULTS OF OPERATIONS

Net sales for the three months ended March 31, 2002 were \$15,246,000, a decrease of \$5,803,000, or 28% over the same period of the prior year. This decrease resulted primarily from CD-ROM manufacturing sales decreasing \$5,809,000 to \$13,832,000 for the three months ended, or 30%. This decrease was due to several factors. First, the closing of the Company's Milpitas, California ("Silicon Valley") plant and the planned restructuring that reduced manufacturing capacity and eliminated certain low-margin customers. Second, the pricing for CD-ROM products and services continued to decline or remained at low levels industry-wide due to excess manufacturing capacity, a trend the Company anticipates will continue through 2002. Finally, the demand for the Company's CD-ROM products and services declined due to several factors, including a decline in general economic conditions, the continued increase in customers using on-line or electronic methods to distribute information, and the continued maturation of the CD-ROM market. DVD sales accounted for \$642,000 during the three months ended March 31, 2002, as compared to \$624,000 for the same period in the prior year.

Gross profit was 31% of net sales for the three months ended March 31, 2002 as compared to 27% of net sales for the same period of the prior year. This increase was due mainly to the closing of the Company's Silicon Valley plant and the elimination of certain low margin customers.

Selling, general and administrative ("SG&A") expenses were \$4,659,000, or 31% of net sales, for the three months ended March 31, 2002 as compared to \$6,648,000, or 32% of net sales, for same period of the prior year. The reduction in SG&A expenses was primarily attributed to the restructuring and workforce reductions announced during the fourth quarter of 2001.

No restructuring expenses were incurred during the first quarter of 2002. Restructuring expenses of \$110,000 were incurred during the three months ended March 31, 2001. These 2001 restructuring expenses consisted primarily of severance and termination benefits related to the U.S. workforce reduction of approximately 6%.

Investment income was \$4,000 and \$35,000 for the three month periods ended March 31, 2002 and 2001, respectively.

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Interest expense for the three months ended March 31, 2002 was \$752,000 as compared to \$947,000 for the same period of the prior year. The decrease in interest expense was due to decreased borrowings under revolving loan and term loan facilities, as well as decreases in interest rates.

The Company recognized an income tax benefit of \$875,000 for the three months ended March 31, 2002. In March 2002, the President signed the Job Creation and Worker Assistance Act of 2002 into law. This law extended the carry back period from two years to five years for net operating losses arising in the 2001 and 2002 taxable years. For the same time period for the prior year, the Company did

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not record an income tax benefit due to the uncertainty of realizing the value of such benefit.

Based upon the foregoing, the net income for the three months ended March 31, 2002 was \$206,000, or net income per basic or diluted common share of \$.03, as compared to a net loss in the same period of the prior year of \$1,927,000, or net loss per basic or diluted common share of \$.31.

FINANCIAL CONDITION - LIQUIDITY AND CAPITAL RESOURCES

Source of Liquidity

The Company financed its business during the three months ended March 31, 2002 through cash generated from operations. Cash flow from operating activities was \$19,000 for the three months ended March 31, 2002, as compared to \$1,924,000 for the three months ended March 31, 2001. This decrease is primarily due to the payment of accrued restructuring charges. The Company had cash and cash equivalents of \$596,000 as of March 31, 2002.

Bank Financing Matters

As further described below, the Company has a term loan facility and a revolving loan facility (collectively, the "Credit Facilities") with its banks. The Company is required to comply with certain financial and other loan covenants set forth in the loan agreement for the Credit Facilities. The Company was in compliance with such covenants as of March 31, 2002. As of March 31, 2002, \$9,791,000 and \$6,549,000 were outstanding under the term loan facility and the revolving loan facility, respectively.

On February 8, 2002, the Company entered into an amended and restated loan agreement (the "Loan Agreement") with its banks which replaced the Company's prior agreement with its banks. Under the Loan Agreement, the Credit Facilities consist of three separate loans: (1) an asset based revolving loan facility with a borrowing base as described below; (2) a term loan facility in the principal amount of \$9,326,250; and (3) a second term loan facility in the original principal amount of \$509,238, which principal amount may be increased up to \$1,000,000 by advances made to the Company through December 31, 2002. The borrowing base of the revolving loan facility is limited to the lesser of (i) \$12,490,762, or (ii) the sum of (A) 80% of eligible domestic accounts receivable, plus (B) 30% of eligible domestic inventory, plus (C) 90% of domestic machinery and equipment. The borrowing base is further reduced by the aggregate amount of the Company's outstanding letters of credit and is permanently reduced by the amount of any additional advances made to the company under the second term loan facility.

The revolving loan and the term loans under the Credit Facilities mature on April 1, 2004. Quarterly principal payments are required for the term loans beginning in June 2002 if cash flows exceed certain specified targets over designated periods of time. The Credit Facilities are secured by a first lien on all non-real estate business assets of the Company and a pledge of the stock of the Company's subsidiaries. The Company is required to comply with the financial and other covenants contained in the Loan

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Agreement. The revolving loan and the term loans accrue interest at a rate equal to 3.5% in excess of the prime rate of the banks. Certain fees are required to be paid to the banks in connection with the Credit Facilities. The Company

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expects that it will be able to negotiate a new borrowing facility prior to April 1, 2004. However, there can be no assurance that the Company will be able to do so.

The Company has a \$19,000,000 term loan facility which was used to permanently finance the Company's Dublin, Ohio distribution center completed in 1999 and to pay down other bank debt. The loan facility has an outstanding principal balance of \$18,641,912 as of March 31, 2002. This term loan facility is payable in monthly principal and interest payments based upon a thirty year amortization schedule, bears interest at a fixed rate of 8.2%, and matures on September 1, 2009. This loan facility is secured by a first lien on all real property of the Company and letters of credit in favor of the lender, in an aggregate amount of \$1,650,000.

Other Liquidity Matters

The Company completed the sale of certain of its manufacturing assets associated with its Silicon Valley facility on January 15, 2002 for approximately \$1.0 million. The sale transaction was effective as of December 31, 2001.

The Company and the landlord of its Silicon Valley facility agreed to terminate the lease for this facility on January 15, 2002. The lease termination agreement was effective as of December 31, 2001. The lease termination relieved the Company of paying approximately \$12.2 million in lease payments due over the next seven years. In exchange for its agreement to terminate the lease, the landlord received a \$1.5 million unsecured, non-interest bearing promissory note (discounted to \$1,228,349 at 8.5%) due in four equal installments beginning in January 2003, approximately \$1.1 million in cash, and 300,000 shares of the Company's common stock.

Plan to Improve Liquidity and Financial Condition

The Company currently has a shareholders' deficiency of \$8,795,000 as of March 31, 2002, as compared to a shareholders' deficiency of \$9,145,000 as of December 31, 2001. These financial conditions present both short-term and long-term liquidity issues for the Company.

Management is addressing, and has addressed, the short-term liquidity situation. In response to declining pricing and reduced demand for CD-ROM products, management is transitioning the Company from a disc manufacturing company to a supply chain solutions company. In addition, management is also focusing on higher-margin customers in certain industries and reducing the number of the Company's low-margin disc customers. Finally, the maturity date of the Company's Credit Facilities was extended until April 2004.

The Company has generated positive cash flow from operations in each of the last three fiscal years, as well as in the first quarter 2002. Management believes that the Company's current focus on its core business customers and continued cost saving measures will allow it to generate sufficient cash flows to meet operational needs in 2002. However, there can be no assurance that such measures will allow the Company to generate sufficient cash flows for the remainder 2002. Furthermore, additional actions will need to be taken to address the Company's long-term liquidity issues as a result of the Company's shareholders' deficiency.

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The Amended Loan Agreement with the banks includes financial covenants which require the Company to meet specified cash flow thresholds over designated periods of time. There can be no assurance that the Company will be able to meet these cash flow thresholds over such periods of time.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Statements contained in this Form 10-Q or any other reports or documents prepared by the Company or made by management of the Company may be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause the Company's actual results to differ materially from those projected. Such risks and uncertainties that might cause such a difference include, but are not limited to: changes in general business and economic conditions; changes in demand for CD-ROM products or supply chain services; excess capacity levels in the CD-ROM industry; the introduction of new products or services by competitors; increased competition (including pricing pressures); changes in manufacturing efficiencies, changes in supply chain services techniques; changes in technology; the Company's ability to meet the cash flow thresholds and other financial covenants in its loan agreement with its banks, the failure of which could result in the banks' exercising their legal remedies against the Company or its assets; the Company's shareholders' deficiency, which means that shareholders may not realize any value upon a sale or liquidation of the Company or its assets; and other risks discussed in the Company's filings with the Securities and Exchange Commission, including those risks discussed under the caption "Forward Looking Statements; Risk Factors Affecting Future Results" and elsewhere in the Form 10-K for Metatec's year ended December 31, 2001.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

There is no change in the quantitative and qualitative disclosures about the Company' market risk from the disclosures contained in the Company's Form 10-K for its fiscal year ended December 31, 2001.

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PART II - OTHER INFORMATION

Items 1-4. Inapplicable.

Item 5. Other Information.

As of April 26, 2002, the Company's shares began trading on the Over The Counter Bulletin Board (OTCBB). The stock ticker symbol remains as "META." The Company had previously announced the anticipated move to the OTCBB from the NASDAQ National Market, as described in its Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

Item 6. Exhibits and Reports on Form 8-K

(a) none

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- (b) Reports on Form 8-K.
 - (i) The Company filed a Form 8-K dated January 3, 2002, under Item 5 to report that the Company had entered into an extension to a standstill agreement between the Company and its banks with respect to a default by the Company under its then-existing credit facilities.
 - (ii) The Company filed a Form 8-K dated February 14, 2002, under Item 5 to report the sale of certain of its manufacturing plant assets associated with its Milpitas, California facility, the entering into of an amended and restated loan agreement with its banks, and the hiring of its new Chief Financial Officer.

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.

Metatec International, Inc.

/s/ Gary W. Qualmann

Date: May 9, 2002

BY: Gary W. Qualmann
Chief Financial Officer
(authorized signatory-
principal financial officer)

/s/ Julia A. Pollner

BY: Julie A. Pollner
Senior Vice President - Finance
(authorized signatory-
principal accounting officer)

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Exhibit Index

Exhibit Number -----	Description of Exhibit -----
None.	