

QRS MUSIC TECHNOLOGIES INC
Form 10QSB
November 15, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-QSB

ý **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2004

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from to

Commission file number 0-31955

QRS Music Technologies, Inc.

(Exact name of small business issuer as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

36-3683315

(IRS Employer Identification No.)

2011 Seward Avenue, Naples, Florida 34109

(Address of principal executive offices)

(239) 597-5888

(Issuer's telephone number)

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(Former name, former address and former fiscal year, if changed since last report)

Check whether issuer (1) Filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 9,458,956

Transitional Small Business Disclosure Format (Check One): Yes ☐ No ☒

QRS MUSIC TECHNOLOGIES, INC.

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SIGNATURES

QRS Music Technologies, Inc.**Consolidated Balance Sheets**

	September 30, 2004 (Unaudited)	June 30, 2004
Assets		
Current assets		
Cash	\$ 796,414	\$ 1,602,571
Accounts receivable (net of allowance for doubtful accounts of \$83,400, and \$73,400 respectively)	1,159,347	803,909
Inventories	6,925,916	5,652,583
Income taxes refundable	0	79,000
Advances due from stockholder	0	18,000
Deferred income taxes	620,000	620,000
Prepaid expenses and other current assets	208,014	88,866
	9,709,691	8,864,929
Property, plant and equipment	1,120,376	1,050,246
Other assets	79,854	109,780
	\$ 10,909,921	\$ 10,024,955
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 165,012	\$ 165,012
Accounts payable (including \$24,487 due to related parties as of September 30, 2004 and June 30, 2004)	646,203	516,623
Accrued expenses	389,940	413,993
Liability for preferential payment	477,601	477,601
Loan payable to shareholder	476,000	0
Income taxes payable	82,000	0
	2,236,756	1,573,229
Long-term debt	82,309	123,640
Commitments and contingencies		
Stockholders' equity		
Series A preferred stock, voting, \$.01 par value, 2,000,000 shares authorized, 534,925 shares issued and outstanding, liquidation value of \$2,203,892 and \$2,171,796, respectively.	5,349	5,349
Common stock, voting, \$.01 par value, 40,000,000 shares authorized, 9,458,956 shares, issued and outstanding.	94,590	94,590
Additional paid-in capital	5,160,075	5,160,075
Retained earnings	3,330,842	3,068,072
	8,590,856	8,328,086
	\$ 10,909,921	\$ 10,024,955

See accompanying notes

QRS Music Technologies, Inc.**Consolidated Statements of Income****Three Months Ended September 30, 2004 and 2003**

	September 30, 2004 (Unaudited)	September 30, 2003 (Unaudited)
Net sales	\$ 4,840,730	\$ 3,477,736
Cost of sales	3,452,139	2,515,192
Gross profit	1,388,591	962,544
Operating expenses		
Selling, general and administrative	858,933	672,249
Research and development	102,880	83,969
	961,813	756,218
Income from operations	426,778	206,326
Interest expense	3,008	9,438
Income before income taxes	423,770	196,888
Income tax expense		
Current	161,000	73,816
Deferred	0	0
	161,000	73,816
Net income	262,770	123,072
Less current period preferred stock dividends in arrears	(32,096)	(32,096)
Income available to common stockholders	\$ 230,674	\$ 90,976
Earnings per common share		
Basic	\$.02	\$.01
Assuming dilution	\$.02	\$.01
Weighted average number of common shares outstanding		
Basic	9,458,956	9,358,956
Assuming dilution	9,574,956	9,417,113

See accompanying notes

QRS Music Technologies, Inc.**Consolidated Statements of Cash Flows****Three months Ended September 30, 2004 and 2003**

	2004 (Unaudited)	2003 (Unaudited)
Operating activities		
Net income	\$ 262,770	\$ 123,072
Depreciation and amortization	35,000	30,500
Provision for bad debt, net	11,434	39,680
Changes in :		
Accounts receivable	(366,873)	195,685
Inventories	(1,273,332)	(496,782)
Income taxes refundable	79,000	26,816
Prepaid expenses and other assets	(119,148)	0
Other assets	29,926	13,228
Accounts payable	129,580	20,157
Accrued expenses	(24,053)	(51,088)
Income taxes payable	82,000	0
Net cash (used in) operating activities	(1,153,696)	(98,732)
Investing activities		
Acquisitions of property and equipment	(105,130)	(2,751)
Proceeds from repayment of advances from stockholder	18,000	0
Net cash (used in) investing activities	(87,130)	(2,751)
Financing activities		
Payment of preferred stock dividends	0	(254,985)
Proceeds from note receivable - stockholder	500,000	0
Repayments on note payable stockholder	(24,000)	0
Repayments of long term debt lending institution	(41,331)	(55,005)
Net cash provided by (used in) financing activities	434,669	(309,990)
(Decrease) in cash	(806,157)	(411,473)
Cash		
Beginning of period	1,602,571	966,935
End of period	\$ 796,414	\$ 555,462
Supplemental disclosure of cash flow information		
Interest paid	\$ 3,008	\$ 9,438
Income taxes paid	\$ 0	\$ 47,000

Supplemental disclosure of Noncash Investing Activities:

On December 11, 2002, the Company, through a newly-formed, wholly-owned subsidiary, acquired certain assets of Gulbransen, Inc. As part of the acquisition, the Company issued 100,000 shares of its common stock upon the completion of certain documentation. This common stock was issued in December, 2003.

See accompanying notes

QRS Music Technologies, Inc.

Notes to Condensed Financial Statements

(Unaudited)

Note 1 Unaudited Interim Financial Statements

Interim condensed financial statements are prepared pursuant to the requirements for reporting on Form 10-QSB. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with US generally accepted accounting principles are omitted. For additional disclosures, see Notes to Consolidated Financial Statements contained in QRS Music Technologies, Inc. Annual Report on Form 10-KSB for the year ended June 30, 2004.

In the opinion of management of the Company, all adjustments, consisting solely of normal recurring adjustments, necessary for the fair presentation of the consolidated financial statements for these interim periods have been included. The current period's results of operations are not necessarily indicative of results which ultimately may be achieved for the year.

Note 2 Inventories

Inventories at September 30, 2004 and June 30, 2004 consisted of:

	September 30, 2004 (Unaudited)	June 30, 2004
Raw materials	\$ 5,525,916	\$ 3,771,127
Finished goods	1,887,441	2,368,196
	7,413,357	6,139,323
Valuation reserve	(487,441)	(486,740)
	\$ 6,925,916	\$ 5,652,583

Note 3 Dividends in arrears

Dividends in arrears on the Series A preferred stock amounted to \$64,192 at September 30, 2004.

Note 4 Earnings Per Share

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The Company computes earnings per share (EPS) under Statement of Financial Accounting Standard (SFAS) No. 128, Earnings per Share. Basic net earnings less preferred dividends are divided by the weighted average number of common shares outstanding during the year to calculate basic net earnings per common share. Diluted net earnings per common share are calculated to give effect to the potential dilution that could occur if convertible preferred stock, warrants, options or other contracts to issue common stock were exercised and resulted in the issuance of additional common shares.

The computation of basic and diluted EPS was as follows:

	September 30, 2004		September 30, 2003	
Numerator				
Net income	\$	262,770	\$	123,072
Preferred stock dividends in arrears		(32,096)		(32,096)
Income available to common stockholders	\$	230,674	\$	90,976
Denominator				
Basic weighted average shares outstanding		9,458,956		9,358,956
Weighted average shares outstanding for options		116,000		58,157
Diluted weighted average shares outstanding		9,574,956		9,417,113
Basic net income per share	\$	0.02	\$	0.01
Diluted net income per share	\$	0.02	\$	0.01

In 2004 and 2003, 534,925 weighted average common shares from the conversion of convertible preferred stock were not included in the computation because they were antidilutive.

Note 5 Note Payable Shareholder

On September 15, 2004, the Company's majority shareholder advanced the company \$500,000. Such advance was evidenced by an unsecured demand note bearing interest at 6% per annum. As of September 30, 2004 a partial payment had been made against the note.

Note 6 Commitments and Contingencies

The Company is a party to various other claims, legal actions and complaints arising in the ordinary course of business. In the opinion of management, all such matters are adequately covered by insurance, or if not so covered, are without merit or are of such kind or involve such amounts that unfavorable disposition would not have a material effect on the Company's financial position, results of operation or liquidity.

On August 20, 2003 a default judgment in the amount of approximately \$478,000 was entered against the Company in the United States Bankruptcy Court, Southern District of Ohio, Western Division. The default judgment was granted to Dwight's Piano Co (formerly known as Baldwin Piano & Organ Company and subsidiaries, a former customer of the Company) and was based upon claims that preferential transfers were made to the Company during the 90 day period prior to Baldwin's bankruptcy filing on May 31, 2001. Because a judgment was entered into against the Company by the Court, the entire amount of the judgment was accrued as of June 30, 2003. The Company filed a motion seeking vacation of the judgment and raised various defenses under the Bankruptcy Code. The Company is currently involved in negotiations for the settlement of the judgment.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS.

Certain statements in this Form 10-QSB constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Registrant to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: the effects of the changes in Homeland Security policies, specifically relating to the effects on international and domestic transportation of goods, the state of the economy; the financial condition of major OEM's such as Baldwin Piano Co. and Young Chang Pianos; competition; seasonality; success of operating initiatives; new product development and introduction schedules; acceptance of new product offerings; advertising and promotional efforts; adverse publicity; changes in business strategy or development plans; availability and terms of capital; labor and employee benefit costs; changes in government regulations; uncertainty regarding economic recovery of the United States and international economies in general and consumer spending in particular, and other factors particular to Registrant.

GENERAL.

The Registrant's fiscal year ends each June 30, and the fiscal years ended June 30, 2003, June 30, 2004 are referred to as fiscal 2003, fiscal 2004, respectively.

Registrant is a Delaware Corporation and is a manufacturer and distributor of pianos, pianomation units, and compact discs and music rolls for use in player pianos. Registrant sells its products to dealers and end-users, predominately in the United States and has divisions in New York, Pennsylvania, Florida and Nevada.

Recently the Registrant began renting space in Sydney, Australia with the purpose of opening a sales office to begin distribution of products to Australia. Registrant also began pursuing the lease of space in China for the purpose of distributing product, and certain administrative duties.

THREE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2003.

SALES. Total sales increased 39.2% from \$3.48 million in the first three months of fiscal 2004 to \$4.84 million in the first three months of fiscal 2005. Increased sales of technology which included the Pianomation player systems, accounted for the increase.

COSTS AND EXPENSES. Total cost of sales increased 37.3 % from \$2.5 million in the first three months of fiscal 2004 to \$3.5 million in the first three months of fiscal 2005. As a percentage of sales, cost of sales increased one percentage point as a result of the mix of products that were sold.

Selling, general and administrative expenses increased 27.8% from \$672,000 in fiscal 2004 to \$859,000 in fiscal 2005. The increase is a result of additional advertising expenses, increased commissions and selling expenses due to increased sales, an increase in shipping and delivery costs as a result of the rising transportation costs, increased legal and accounting expenses, and increased office expenses related to establishing new offices in Hong Kong and Australia.

INTEREST EXPENSE, NET. Net interest expense decreased 68.1% from \$9,400 in the first three months of fiscal 2004 to \$3,000 in the first three months of fiscal 2005. The decrease is due to a reduction in the outstanding balance during the period.

PROVISION FOR INCOME TAXES. Registrant accrued a provision for federal and state income taxes at an effective rate of 38% for both periods.

NET INCOME. Net income increased 113.5% from \$123,000 for the three month period ended September 30, 2003 to \$263,000 for the three month period ended September 30, 2004 as a result of the above mentioned variances.

LIQUIDITY AND CAPITAL RESOURCES.

The primary sources of Registrant's cash are net cash flows from operating activities and short-term vendor financing. Currently, Registrant does not have available any established lines of credit with banking facilities.

Registrant's cash was \$796,000 and \$1.6 million at September 30, 2004 and June 30, 2004, respectively. Cash decreased from June 30, 2004 to September 30, 2004 primarily as a result of an increase in inventory and accounts receivable, offset by the increase in net income, and proceeds received from a note payable to a stockholder.

As of May 15, 2002 the Registrant owed approximately \$919,000 to a lending institution pursuant to a note due May 2002. Registrant refinanced the debt prior to the due date. The new note, payable in monthly installments of \$13,751, plus accrued interest at the prime rate (4.75% at September 30, 2004) and due in May 2007, requires the Registrant to satisfy certain financial covenants concerning tangible capital funds and debt coverage ratio. As of the date hereof, the

Registrant is in compliance with these covenants.

Registrant believes its current available cash position, coupled with its cash forecast for the year and periods beyond, is sufficient to meet its cash needs on both a short-term and long-term basis. There are no major capital expenditures planned in the foreseeable future, nor any payments planned for off-balance sheet obligations. Registrant's management is not aware of any known trends or demands, commitments, events, or uncertainties, as they relate to liquidity which could negatively affect Registrant's ability to operate and grow as planned.

Item 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting

During the third quarter of the fiscal year ending June 30, 2004 the Company's chief executive officer and chief financial officer learned of instances of insufficiencies in certain disclosure controls and procedures and internal controls during the fiscal year ending June 30, 2003 and for the first three quarters of fiscal 2004. As a result, an evaluation was performed of the involved disclosure controls and procedures and internal controls and there was found to be a significant deficiency, and necessary improvements needed to be made to ensure these deficiencies would not be repeated. The matter was discussed with the audit committee, the independent auditors, corporate counsel and the Board of Directors. The correction of the deficiency was assigned the highest priority, and action has been taken to correct it.

As a result of the evaluation the following conclusions were reached:

There was no fraud affecting the Company's financial statements.

Corrective action is being taken to address and remedy the deficiency.

Discussed below is specific information regarding the disclosure controls and procedures deficiency and the internal control deficiencies and the corresponding corrective actions as implemented through May 19, 2004.

In the 3rd quarter of the fiscal year ending June 30, 2004, the Company discovered that a default judgment in the amount of approximately \$478,000 plus interest had been entered against it in United States Bankruptcy Court, Southern District of Ohio, Western Division. Due to a gap in the disclosure controls and procedures system the receipt of process was not handled in an appropriate manner, and did not come to the attention of management or counsel within the appropriate time to be properly reviewed and assessed for effect on the Company's financial statements and action necessary for proper disclosure. Management has reviewed its procedures and taken appropriate actions to ensure these matters will be handled in the appropriate manner. The company has appointed its current registered agent in the State of Delaware to act as registered agent in all states where the Company has offices. The Company intends to instruct the registered agent that copies of all

receipts of process are to be sent to the chief executive officer, chief financial officer, corporate counsel and chairman of the board. Such matters that materially affect the Company's financial position will be immediately brought to the attention of the audit committee, who will in turn prepare a separate analysis of the impact on the Company's financial reporting. It has also been determined that the audit committee will meet on a more frequent basis. As a regular course of business at all Board meetings the audit committee will review with the Board of Directors any outstanding issues. If the audit committee believes an item of a significant nature has arisen, it will immediately request a special Board Meeting to review the circumstances.

Company policies regarding the deficient disclosure controls and procedures have been communicated to all employees in writing.

The Company intends to form a disclosure committee that will meet no less frequently than quarterly to review and discuss any outstanding or potential issues.

Management intends to engage in additional training and continuing education regarding best practices for disclosure and control procedures and internal controls.

The Company is committed to ongoing periodic reviews of its controls and their effectiveness. Controls have improved and management has no reason to believe that the financial statements included in this report are not fairly stated in all material respects. Management believes its practices and procedures, although not as mature or as formal as management intends them

to be in the future, are adequate under the circumstances, and that there are no material inaccuracies or omissions in this Form

PART II- OTHER INFORMATION

Item 1. Legal Proceedings

In the 3rd quarter of the fiscal year ending June 30, 2004, the Company discovered that a default judgment in the amount of approximately \$478,000 plus interest had been entered against it in United States Bankruptcy Court, Southern District of Ohio, Western Division. The default judgment was granted to Dwight's Piano Co, fka Baldwin Piano & Organ Company and subsidiaries and was based upon Plaintiff's claims that preferential transfers were made during the 90 period prior to Baldwin's bankruptcy filing on May 31, 2001. The Company filed a motion seeking vacation of the judgment under Fed.R.Bankr.P. 9024 and 7055, raising various defenses under 11 USC 547(c) of the Bankruptcy Code. The company is currently involved in negotiations for the settlement of the judgment.

Item 6. Exhibits and Reports on Form 8-K.

a. Exhibit Index

31.1 Certifications (of Chief Financial Officer)

31.2 Certifications (of Chief Executive Officer)

32.1 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

32.2 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350

b) Reports on Form 8-K.

On May 18, 2004, the Company filed a Form 8-K, which disclosed in Item 5 the default judgment described in Legal Proceedings, Part II, Item 1 above.

SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

QRS Music Technologies, Inc.

Date 11/15/04

/s/ Ann A. Jones
Ann A. Jones, Chief Financial Officer