QRS MUSIC TECHNOLOGIES INC
Form 10QSB
February 18, 2005

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 December 31, 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	**36-3683315**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2011 Seward Avenue, Naples, Florida 34109
(Address of principal executive offices)

(239) 597-5888
(Issuer s telephone number)

(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 ý No o

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

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 o No ý

QRS MUSIC TECHNOLOGIES, INC.

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For the Quarter Ended December 31, 2004

QRS Music Technologies, Inc.

Consolidated Balance Sheets

	December 31, 2004 (Unaudited)	June 30, 2004
Assets		
Current assets		
Cash	$ 1,108,452	$ 1,602,571
Accounts receivable (net of allowance for doubtful accounts of $103,400, and $73,400 respectively)	1,147,476	803,909
Inventories	7,070,133	5,652,583
Income taxes refundable	83,000	79,000
Advances due from stockholder	0	18,000
Deferred income taxes	620,000	620,000
Prepaid expenses and other current assets	245,228	88,866
	10,274,289	8,864,929
Property, plant and equipment	1,255,455	1,050,246
Other assets	78,137	109,780
	$ 11,607,881	$ 10,024,955
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 165,012	$ 165,012
Accounts payable (including $25,782 and $24,487 due to related parties as of December 31, 2004 and June 30, 2004, respectively)	770,091	516,623
Accrued expenses	431,796	413,993
Liability for preferential payment	477,601	477,601
Loan payable to stockholder	500,000	0
	2,344,500	1,573,229
Long-term debt	41,056	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 $2,235,988 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	3,962,311	3,068,072
	9,222,325	8,328,086
	$ 11,607,881	$ 10,024,955

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Income

Three Months Ended December 31, 2004 and 2003

	December 31, 2004 (Unaudited)	December 31, 2003 (Unaudited)
Net sales	$ 6,800,026	$ 6,622,014
Cost of sales	4,541,775	4,252,849
Gross profit	2,258,251	2,369,165
Operating expenses		
Selling, general and administrative	1,110,486	571,428
Research and development	94,544	83,661
	1,205,030	655,089
Income from operations	1,053,221	1,714,076
Interest expense	11,752	4,073
Income before income taxes	1,041,469	1,710,003
Income tax expense		
Current	410,000	649,858
Deferred	0	0
	410,000	649,858
Net income	631,469	1,060,145
Less current period preferred stock dividends in arrears	(32,096)	(32,096)
Income available to common stockholders	$ 599,373	$ 1,028,049
Earnings per common share		
Basic	$ .06	$ .11
Assuming dilution	$ .06	$ .11
Weighted average number of common shares outstanding		
Basic	9,458,956	9,358,956
Assuming dilution	9,555,956	9,417,113

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Income

Six Months Ended December 31, 2004 and 2003

		December 31, 2004 (Unaudited)		December 31, 2003 (Unaudited)
Net sales	$	11,640,756	$	10,099,750
Cost of sales		7,993,914		6,768,041
Gross profit		3,646,842		3,331,709
Operating expenses				
Selling, general and administrative		1,969,419		1,243,677
Research and development		197,424		167,630
		2,166,843		1,411,307
Income from operations		1,479,999		1,920,402
Interest expense		14,760		13,511
Income before income taxes		1,465,239		1,906,891
Income tax expense				
Current		571,000		723,674
Deferred		0		0
		571,000		723,674
Net income		894,239		1,183,217
Less current period preferred stock dividends in arrears		(64,192)		(64,192)
Income available to common stockholders	$	830,047	$	1,119,025
Earnings per common share				
Basic	$	.09	$	.12
Assuming dilution	$	.09	$	.12
Weighted average number of common shares outstanding				
Basic		9,458,956		9,358,956
Assuming dilution		9,565,956		9,417,113

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Cash Flows

Six months Ended December 31, 2004 and 2003

		2004 (Unaudited)		2003 (Unaudited)
Operating activities				
Net income	$	894,239	$	1,183,217
Depreciation and amortization		70,000		61,000
Provision for bad debt, net		20,987		(36,914)
Changes in				
Accounts receivable		(364,554)		(257,078)
Inventories		(1,417,550)		109,203
Income taxes refundable		(4,000)		185,000
Prepaid expenses and other assets		(156,362)		102,261
Other assets		31,643		0
Accounts payable		253,468		203,549
Accrued expenses		17,803		90,588
Income taxes payable		0		491,674
Net cash provided by (used in) operating activities		(654,326)		2,132,500
Investing activities				
Acquisitions of property and equipment		(275,209)		(10,369)
Proceeds from repayment of advances due from stockholder		18,000		0
Net cash (used in) investing activities		(257,209)		(10,369)
Financing activities				
Payment of preferred stock dividends		0		(254,985)
Proceeds from note payable- stockholder		500,000		0
Repayments of long term debt lending institution		(82,584)		(96.358)
Net cash provided by (used in) financing activities		417,416		(351,343)
Increase (Decrease) in cash		(494,119)		1,770,778
Cash				
Beginning of period		1,602,571		966,935
End of period	$	1,108,452	$	2,737,723
Supplemental disclosure of cash flow information				
Interest paid	$	14,760	$	13,511
Income taxes paid	$	575,000	$	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 December 31, 2004 and June 30, 2004 consisted of:

	December 31, 2004 (Unaudited)	**June 30, 2004**
Raw materials	$ 5,451,921	$ 3,771,127
Finished goods	2,094,596	2,368,196
	7,546,517	6,139,323
Valuation reserve	(476,384)	(486,740)
	$ 7,070,133	$ 5,652,583

Note 3 Dividends in arrears

Dividends in arrears on the Series A preferred stock amounted to $96,288 at December 31, 2004.

Note 4 Earnings Per Share

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 for the three months ended December 31, 2004 was as follows:

	December 31, 2004	December 31, 2003
Numerator		
Net income	$ 631,469	$ 1,060,145
Preferred stock dividends in arrears	(32,096)	(32,096)
Income available to common stockholders	$ 599,373	$ 1,028,049
Denominator		
Basic weighted average shares outstanding	9,458,956	9,358,956
Weighted average shares outstanding for options	97,000	58,157
Diluted weighted average shares outstanding	9,555,956	9,417,113
Basic net income per share	$ .06	$ 0.11
Diluted net income per share	$ .06	$ 0.11

The computation of basic and diluted EPS for the six months ended December 31, 2004 was as follows:

		December 31, 2004		December 31, 2003
Numerator				
Net income	$	894,239	$	1,183,217
Preferred stock dividends in arrears		(64,192)		(64,192)
Income available to common stockholders	$	830,047	$	1,119,025
Denominator				
Basic weighted average shares outstanding		9,458,956		9,358,956
Weighted average shares outstanding for options		107,000		58,157
Diluted weighted average shares outstanding		9,565,956		9,417,113
Basic net income per share	$	.09	$	0.12
Diluted net income per share	$	.09	$	0.12

In 2005 and 2004, 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 Stockholder

On September 15, 2004, the Company s majority stockholder advanced the Company $500,000. Such advance was evidenced by an unsecured demand note bearing interest at 6% per annum. For the six month period ended December 31, 2004, the interest expense related to the loan was $8,795.

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 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 several defenses available to it under the Bankruptcy Code. On January 3, 2005 the United States Bankruptcy Court, Southern District of Ohio, Western Division, approved a negotiated settlement agreement between the Company and Dwight s Piano Co. The negotiated settlement agreement reduced the Company s preference liability to $61,395. Upon the consummation of the settlement, the United States Bankruptcy Court immediately entered an Order vacating the default judgment entered, and subsequently dismissed the litigation initiated by Dwight s Piano Co. against the Company, with prejudice. As a result of the negotiated settlement, for the quarter ending March 31, 2005 the Company will recognize a gain of approximately $259,000, (net of income taxes) or $.03 per share.

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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, 2004, June 30, 2005 are referred to as fiscal 2004 , fiscal 2005 , 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 Regristrant began renting space in Sydney, Australia with the purpose of opening a sales office to begin distribution of products to Australia. Registrant also began leasing space in China for the purpose of distributing product, and certain administrative duties.

THREE MONTHS ENDED DECEMBER 31, 2004 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2003.

SALES. Total sales increased 2.7% from $6.62 million in the second three months of fiscal 2004 to $6.8 million in the second three months of fiscal 2005. Increased sales of technology related products which included the Pianomation player systems, accounted for the increase.

COSTS AND EXPENSES. Total cost of sales increased 7.0% from $4.3 million in the second three months of fiscal 2004 to 4.5 million in the second three months of fiscal 2005. As a percentage of sales, cost of sales increased 2.6

percentage point as a result of the mix of products that were sold.

Selling, general and administrative expenses increased 94.3% from $571,000 in fiscal 2004 to $1.11 million in fiscal 2005. The increase is a result of the funding of a profit sharing plan for the benefit of the employees, increased legal and accounting expenses, an increase in accrued tax expense, and increased office expenses related to establishing new offices in Hong Kong and Australia.

INTEREST EXPENSE, NET. Net interest expense increased 188% from $4,000 in the second three months of fiscal 2004 to $11,800 in the second three months of fiscal 2005. The increase is due to the additional interest being paid on a loan to the the majority shareholder.

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 decreased 40.4% from $1.06 million for the three month period ended December 31, 2003 to 631,000 for the three month period ended December 31, 2004 as a result of the above mentioned variances.

SIX MONTHS MONTHS ENDED DECEMBER 31, 2004 COMPARED TO THE SIX MONTHS ENDED DECEMBER 31, 2003.

SALES. Total sales increased 15.3% from $10.1 million in the first six months of fiscal 2004 to $11.6 million in the first six months of fiscal 2005. Increased sales of technology related products which included the Pianomation player systems, accounted for the increase.

COSTS AND EXPENSES. Total cost of sales increased 18.1 % from $6.8 million in the first six months of fiscal 2004 to 8 million in the first six months of fiscal 2005. As a percentage of sales, cost of sales increased 1.7 percentage points as a result of the mix of products that were sold.

Selling, general and administrative expenses increased 58.3% from 1.24 million in fiscal 2004 to $1.97 million 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, the funding of a profit share plan on behalf of the company employees, and an increase in accrued tax expense.

INTEREST EXPENSE, NET. Net interest expense increased 9.2% from $13,000 in the first six months of fiscal 2004 to $15,000 in the first six months of fiscal 2005. The increase is due to the interest being paid on a loan from the majority shareholder.

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 decreased 24.4% from $1.18 million for the six month period ended December 31, 2003 to $894,000 for the six month period ended December 31, 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 $1.1 million and $1.6 million at December 31, 2004 and June 30, 2004, respectively. Cash decreased from June 30, 2004 to December 31, 2004 primarily as a result of an increase in inventory and accounts receivable, offset by 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 December 31, 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

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 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 several defenses available to it under the Bankruptcy Code. On January 3, 2005 the United States Bankruptcy Court, Southern District of Ohio, Western Division, approved a negotiated settlement agreement between the Company and Dwight s Piano Co. The negotiated settlement agreement reduced the Company s preference liability to $61,395. Upon the consummation of the settlement, the United States Bankruptcy Court immediately entered an Order vacating the default judgment entered, and subsequently dismissed the litigation initiated by Dwight s Piano Co. against the Company, with prejudice. As a result of the negotiated settlement, for the quarter ending March 31, 2005 the Company will recognize a gain of approximately $259,000, (net of income taxes) or $.03 per share.

A lawsuit filed in Clark County Nevada District Court in October 2000 by Family Music against the Company , Richard Dolan and a former employee of the Company was settled on February 3, 2005 . The lawsuit was settled without any payment to the plaintiff by the Company.

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.

On January 19, 2005, the Company filed a Form 8-K, which disclosed in Item 5 the settlement of the default judgment described in Legal Proceedings, Part II, Item 1 above.

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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 2/18/05

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