QRS MUSIC TECHNOLOGIES INC
Form 10QSB
February 14, 2006

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, 2005

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

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). 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, 2005

QRS Music Technologies, Inc.

Consolidated Balance Sheets

		December 31, 2005 (Unaudited)		June 30, 2005
Assets				
Current assets				
Cash	$	1,502,889	$	603,004
Accounts receivable (net of allowance for doubtful accounts of $466,954, and $214,400 respectively)		992,143		906,909
Inventories		7,295,729		7,911,851
Income taxes refundable		145,000		233,000
Deferred income taxes		620,000		620,000
Prepaid expenses and other current assets		109,083		181,570
		10,664,844		10,456,334
Property, plant and equipment		1,225,960		1,202,904
Other assets		130,236		123,829
	$	12,021,040	$	11,783,067
Liabilities and Stockholders Equity				
Current liabilities				
Current portion of long-term debt	$	0	$	108,834
Accounts payable (including $76,601 and $30,737 due to related parties)		1,433,782		1,462,267
Accrued expenses		494,688		536,066
Note payable to stockholder		250,000		250,000
		2,178,470		2,357,167
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 $2,364,372 and $2,300,180, 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		4,582,556		4,165,886
		9,842,570		9,425,900
	$	12,021,040	$	11,783,067

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Operations

Three Months Ended December 31, 2005 and 2004

	2005 (Unaudited)	2004 (Unaudited)
Net sales	$ 5,730,270	$ 6,800,026
Cost of sales	3,717,268	4,541,775
Gross profit	2,013,002	2,258,251
Operating expenses Selling, general and administrative	1,064,852	1,110,486
Research and development	209,638	94,544
	1,274,490	1,205,030
Income (loss) from operations	738,512	1,053,221
Interest expense	4,758	11,752
Income (loss) before income taxes	733,754	1,041,469
Income tax expense (benefit)		
Current	279,000	410,000
Deferred	0	0
	279,000	410,000
Net income (loss)	454,754	631,469
Less current period preferred stock dividends in arrears	(32,096)	(32,096)
Income (loss) available to common stockholders	$ 422,658	$ 599,373
Earnings (loss) per common share		
Basic	$ .05	$ .06
Assuming dilution	$ 04	$ .06
Weighted average number of common shares outstanding		
Basic	9,458,956	9,458,956
Assuming dilution	9,535,956	9,555,956

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Operations

Six Months Ended December 31, 2005 and 2004

		2005 (Unaudited)		2004 (Unaudited)
Net sales	$	9,689,516	$	11,640,756
Cost of sales		6,546,883		7,993,914
Gross profit		3,142,633		3,646,842
Operating expenses Selling, general and administrative		1,988,303		1,969,419
Research and development		489,558		197,424
		2,477,861		2,166,843
Income from operations		664,772		1,479,999
Interest expense		10,102		14,760
Income before income taxes		654,670		1,465,239
Income tax expense (benefit)				
Current		238,000		571,000
Deferred		0		0
		238,000		571,000
Net income		416,670		894,239
Less current period preferred stock dividends in arrears		(64,192)		(64,192)
Income available to common stockholders	$	352,478	$	830,047
Earnings per common share				
Basic	$	.04	$	.09
Assuming dilution	$	.04	$	.09
Weighted average number of common shares outstanding				
Basic		9,458,956		9,458,956
Assuming dilution		9,541,956		9,565,956

See accompanying notes

QRS Music Technologies, Inc.

Consolidated Statements of Cash Flows

Six months Ended December 31, 2005 and 2004

	2005 (Unaudited)	2004 (Unaudited)
Operating activities		
Net income	$ 416,670	$ 894,239
Depreciation and amortization	69,170	70,000
Provision for bad debt, net	211,102	20,987
Changes in		
Accounts receivable	(296,337)	(364,554)
Inventories	616,122	(1,417,550)
Income taxes refundable	88,000	(4,000)
Prepaid expenses and other current assets	72,487	(156,362)
Other assets	(6,407)	31,643
Accounts payable	28,485	253,468
Accrued expenses	(41,378)	17,803
Net cash provided by (used in) operating activities	1,100,944	(654,326)
Investing activities		
Acquisitions of property and equipment	(92,225)	(275,209)
Proceeds from repayment of advances from stockholder	0	18,000
Net cash (used in) investing activities	(92,225)	(257,209)
Financing activities		
Proceeds from note payable - stockholder	0	500,000
Repayments of long term debt lending institution	(108,834)	(82,584)
Net cash provided by (used in) financing activities	(108,834)	417,416
Increase (Decrease) in cash	899,885	(494,119)
Cash		
Beginning of period	603,004	1,602,571
End of period	$ 1,502,889	$ 1,108,452
Supplemental disclosure of cash flow information		
Interest paid	$ 10,101	$ 14,760
Income taxes paid	$ 150,000	$ 575,000

See accompanying notes

QRS Music Technologies, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 Unaudited Interim Financial Statements

Interim consolidated 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, 2005.

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, 2005 and June 30, 2005 consisted of:

	December 31, 2005 (Unaudited)	June 30, 2005
Raw materials	$ 4,848,582	$ 5,746,815
Finished goods	3,159,472	2,936,315
	8,008,054	8,683,130
Valuation reserve	(712,325)	(771,279)
	$ 7,295,729	$ 7,911,851

Note 3 Dividends in arrears

Cumulative dividends in arrears on the Series A preferred stock amounted to $224,672 at December 31, 2005.

Note 4 Earnings Per Share

The Company computes earnings per share (EPS) under Statement of Financial Accounting Standards (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 three month computation of basic and diluted EPS was as follows:

		December 31, 2005		December 31, 2004
Numerator				
Net income	$	454,754	$	631,469
Preferred stock dividends in arrears		(32,096)		(32,096)
Income available to common stockholders	$	422,658	$	599,373
Denominator				
Basic weighted average shares outstanding		9,458,956		9,458,956
Weighted average shares outstanding for options		77,000		97,000
Diluted weighted average shares outstanding		9,535,956		9,555,956
Basic net income per share	$	0.05	$	0.06
Diluted net income per share	$	0.04	$	0.06

The six month computation of basic and diluted EPS was as follows:

		December 31, 2005		December 31, 2004
Numerator				
Net income	$	416,670	$	894,239
Preferred stock dividends in arrears		(64,192)		(64,192)
Income available to common stockholders	$	352,478	$	830,047
Denominator				
Basic weighted average shares outstanding		9,458,956		9,458,956
Weighted average shares outstanding for options		83,000		107,000
Diluted weighted average shares outstanding		9,541,956		9,565,956
Basic net income per share	$	0.04	$	0.09
Diluted net income per share	$	0.04	$	0.09

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.

Effective July 1, 2005, the Company adopted the Statement of Financial Accounting Standards Board (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R requires entities to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). To date, the Company has not granted any equity instruments for employee services.

Note 5 Note Payable - Lending Institution

As of May 15, 2002 the Company owed approximately $919,000 to a lending institution pursuant to a note due May 2002. The Company 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 and due in May 2007, required the Company to satisfy certain financial covenants concerning tangible capital funds and debt coverage ratio. During the period ended December 31, 2005, the Company repaid the amount due in full and the lending institution released its security interest in the assets of the Company.

Note 6 Note Payable Stockholder

During the year ended June 30, 2005 the Company was advanced $500,000 from its major stockholder. Such advance was evidenced by an unsecured demand note bearing interest at 6 per cent per annum. During the year ended June 30, 2005, a payment of $250,000 was made, leaving a balance due of $250,000. The Company recognized $8,790 and $7,560 in interest expense during the six months ended December 31, 2005 and 2004, respectively, related to this note payable. Interest in the amount of $3,780 has been accrued for the quarter ended December 31, 2005 as compared to $8,790 accrued for the quarter ended December 31, 2004.

Note 7 Commitments and Contingencies

The Company is a party to various 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.

Note 8 Future Commitments and Contingencies

As reported in a Form 8K filed on February 13, 2006, the Company signed a letter of intent on February 10, 2006 to pursue discussions with another company regarding a possible purchase.

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 the Company 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 the Company.

GENERAL.

The Company s fiscal year ends each June 30, and the fiscal years ended June 30, 2005, June 30, 2006 are referred to as fiscal 2005 , fiscal 2006 , respectively.

The Company is a Delaware Corporation and is a manufacturer and distributor of pianos, Pianomation units, and music for electronic player systems (in a variety of forms) and music rolls for use in pneumatic player pianos. The Company has three wholly owned subsidiaries, one in Hong Kong one in Australia, and the third was formed in the US for purposes of the Gulbransen asset acquisition. All statements made encompass the main Company and its three subsidiaries. The Company sells its products to dealers and end-users, predominately in the United States and has offices in New York, Pennsylvania, Florida and Nevada. In addition, the Company recently started leasing space in Balmain, Australia and Hong Kong.

THREE MONTHS ENDED DECEMBER 31, 2005 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2004.

SALES. Total sales decreased 15.7% from $6.8 million in the second quarter of fiscal 2004 to $5.73 million in the second quarter of fiscal 2005. Decreased sales were the result of a delay in the release of a new controller product, which lead some buyers to postpone their purchases and slower than expected summer sales season for some dealers, delaying their inventory reorders.

COSTS AND EXPENSES. Total cost of sales decreased 18.2% from $4.54 million in the second quarter of fiscal 2004 to $3.72 million in the second quarter of fiscal 2005. As a percentage of sales, cost of decreased almost two percentage points as a result of positive cost reducing activities taken earlier in the year.

Selling, general and administrative expenses decreased 4.1% from $1.11 million in fiscal 2004 to $1.06 million in fiscal 2005. The decrease in sales related expenses, due to the lower sales, and the decrease in marketing expenses were offset by an increase in delivery expenses due to the rising fuel costs, and an increase in telephone and informational technology costs.

Research and development costs also increased 122% for the quarter from $95,000 in the quarter ended December 2004 to $210,000 for the quarter ended December 2005. The increase is a result of the additional spending necessary to successfully bring several new products to market to meet dealer and consumer demand during the peak selling season.

INTEREST EXPENSE, NET. Net interest expense decreased 59.5% from $12,000 in the second quarter of fiscal 2005 to $5,000 in the second quarter of fiscal 2006. The decrease is due to the declining balance due to a financial institution.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 38% for both periods.

NET INCOME. Net income decreased 28% from $631,000 for the three month period ended December 31, 2004 to $454,000 for the three month period ended December 31, 2005 as a result of the above mentioned variances.

SIX MONTHS ENDED DECEMBER 31, 2005 COMPARED TO THE SIX MONTHS ENDED DECEMBER 31, 2004.

SALES. Total sales decreased 16.8% from $11.64 million in the six months ended December 2004 to $9.69 million for the six months ended December 2005. Decreased sales were the result of a delay in the release of a new controller product, which lead some buyers to postpone their purchases and slower than expected summer sales season for some dealers, delaying their inventory reorders.

COSTS AND EXPENSES. Total cost of sales decreased 18.1% from $7.99 million in the six months ended December 2004 to $6.55 million in the six months ended December 2005. As a percentage of sales, cost of sales decreased slightly over 1 percentage point as a result of the mix of products sold and positive cost reduction initiatives undertaken earlier in the year.

Selling, general and administrative expenses increased 1% from $1.97 million in fiscal 2004 to $1.99 million in fiscal 2005. The increase is a result of additional legal and accounting expenses related to new products and opportunities, and increased office expenses related to establishing new offices in Hong Kong and Australia offset by a decrease in sales related expenses due to the lower sales, and a decrease in marketing expenses.

Research and development costs also increased 148% for the six months from $197,000 in the six months ended December 2004 to $490,000 for the six months ended December 2005. The increase is a result of the additional spending necessary to launch several new products before the peak selling season and the annual industry trade show in January, 2006.

INTEREST EXPENSE, NET. Net interest expense decreased 31.6% from $15,000 in the second quarter of fiscal 2005 to $10,000 in the second quarter of fiscal 2006. The decrease is due to the declining balance due to a financial institution.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 38% for both periods.

NET INCOME. Net income decreased 53.4% from $894,000 for the six month period ended December 31, 2004 to $417,000 for the six month period ended December 31, 2005 as a result of the above mentioned variances.

LIQUIDITY AND CAPITAL RESOURCES.

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

The Company s cash was $1.5 million and $603,000 at December 31, 2005 and June 30, 2005, respectively. Cash increased from June 30, 2005 to December 31, 2005 primarily as a result of the decrease in inventory.

As of May 15, 2002 the Company owed approximately $919,000 to a lending institution pursuant to a note due May 2002. The Company 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 and due in May 2007, required the Company to satisfy certain financial covenants concerning tangible capital funds and debt coverage ratio. During the period ended December 31, 2005, the Company repaid the amount due in full and the lending institution released its security interest in the assets of the Company.

The Company 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, including if necessary retiring its outstanding loan. There are no major capital expenditures planned in the foreseeable future, nor any payments planned for off-balance sheet obligations. The Company s management is not aware of any known trends or demands, commitments, events, or uncertainties, as they relate to liquidity which could negatively affect the Company 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 a previous year s evaluation of the Disclosure Controls and Procedures the Company s chief executive officer and chief financial officer learned of instances of insufficiencies in certain disclosure controls and procedures and internal controls, Those insufficiencies were addressed and improvements were made in various procedures and functional operations, including the establishment of a Disclosure Committee, and the election of members to that Committee.

The Company is committed to ongoing periodic reviews of its disclosure controls and procedures and their effectiveness. The disclosure controls and procedures have improved and management intends to continue to enhance and formalize those controls and procedures. The Company s Chief Executive Office and the Chief Financial Officer believe the Company s practices and procedures, although not as mature or as formal as management intends them to be in the future, are effective .

PART II- OTHER INFORMATION

Item 6. Exhibits

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

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 2/14/06

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