QRS MUSIC TECHNOLOGIES INC
Form 10QSB
February 20, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended December 31, 2006

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 x 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 x

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes o No x

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: 9,658,956

Transitional Small Business Disclosure Format (Check One): Yes o No x

QRS MUSIC TECHNOLOGIES, INC.

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For the Quarter Ended December 31, 2006

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QRS Music Technologies, Inc.

Unaudited Consolidated Balance Sheets

	December 31, 2006	June 30, 2006
Assets		
Current assets		
Cash	$ 819,081	$ 56,466
Accounts receivable (net of allowance for doubtful accounts of $302,000, and $475,000 respectively)	1,191,849	1,538,860
Inventories	7,710,895	8,272,748
Income taxes refundable	87,000	0
Deferred income taxes	929,000	929,000
Prepaid expenses and other current assets	60,855	109,668
	10,798,680	10,906,742
Property, plant and equipment	1,173,807	1,206,569
Goodwill	60,000	60,000
Other intangible assets	807,924	844,893
Other assets	32,049	27,549
	$ 12,872,460	$ 13,045,753
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 88,124	$ 86,472
Accounts payable (including $160,747 and $123,296 due to related parties)	1,611,938	1,672,298
Accrued expenses	533,806	548,753
Note payable to stockholder	250,000	250,000
Income taxes payable	0	17,000
	2,483,868	2,574,523
Long-term debt	633,138	677,617
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 $2,492,754 and $2,428,562, respectively.	5,349	5,349
Common stock, voting, $.01 par value, 40,000,000 shares authorized, 9,658,956 shares issued and outstanding.	96,590	96,590
Additional paid-in capital	5,358,075	5,358,075
Retained earnings	4,295,440	4,333,599
	9,755,454	9,793,613
	$ 12,872,460	$ 13,045,753

See accompanying notes

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QRS Music Technologies, Inc.

Unaudited Consolidated Statements of Operations

Three Months Ended December 31, 2006 and 2005

	December 31, 2006	December 31, 2005
Net sales	$ 5,326,395	$ 5,730,270
Cost of sales	3,512,342	3,717,268
Gross profit	1,814,053	2,013,002
Operating expenses		
Selling, general and administrative	1,232,707	1,064,852
Research and development	159,001	209,638
	1,391,708	1,274,490
Income from operations	422,345	738,512
Interest expense	10,633	4,758
Income before income taxes	411,712	733,754
Income tax expense (benefit)		
Federal	133,000	279,000
State	23,000	0
	156,000	279,000
Net income	255,712	454,754
Less current period preferred stock dividends in arrears	(32,096)	(32,096)
Income available to common stockholders	$ 223,616	$ 422,658
Income per common share		
Basic	$ .02	$ .05
Assuming dilution	$ .02	$ .04
Weighted average number of common shares outstanding		
Basic	9,658,956	9,458,956
Assuming dilution	9,658,956	9,535,956

See accompanying notes

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QRS Music Technologies, Inc.

Unaudited Consolidated Statements of Operations

Six Months Ended December 31, 2006 and 2005

	December 31, 2006	December 31, 2005
Net sales	$ 8,611,122	$ 9,689,516
Cost of sales	6,228,497	6,546,883
Gross profit	2,382,625	3,142,633
Operating expenses		
Selling, general and administrative	2,197,065	1,988,303
Research and development	217,249	489,558
	2,414,314	2,477,861
Income (loss) from operations	(31,689)	664,772
Interest expense	21,470	10,102
Income (loss) before income taxes	(53,159)	654,670
Income tax expense (benefit)		
Federal	(13,000)	238,000
State	(2,000)	0
	(15,000)	238,000
Net income (loss)	(38,159)	416,670
Less current period preferred stock dividends in arrears	(64,192)	(64,192)
Income (loss) available to common stockholders	$ (102,351)	$ 352,478
Income (loss) per common share		
Basic	$ (.01)	$ .04
Assuming dilution	$ (.01)	$ .04
Weighted average number of common shares outstanding		
Basic	9,658,956	9,458,956
Assuming dilution	9,658,956	9,541,956

See accompanying notes

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QRS Music Technologies, Inc.

Unaudited Consolidated Statements of Cash Flows

Six months Ended December 31, 2006 and 2005

	2006 (Unaudited)	2005 (Unaudited)
Operating activities		
Net (loss)	$ (38,159)	$ 416,670
Depreciation and amortization	118,893	69,170
Provision for bad debt (recoveries)	(30,323)	211,102
Changes in		
Accounts receivable	377,334	(296,337)
Inventories	561,853	616,122
Income taxes refundable	(104,000)	88,000
Prepaid expenses and other current assets	48,813	72,487
Other assets	(19,564)	(6,407)
Accounts payable	(60,360)	28,485
Accrued expenses	(14,947)	(41,378)
Net cash provided by operating activities	839,540	1,100,944
Investing activities		
Acquisitions of property and equipment	(34,097)	(92,225)
Net cash (used in) investing activities	(34,097)	(92,225)
Financing activities		
Repayments of long term debt lending institution	(42,828)	(108,834)
Net cash (used in) financing activities	(42,828)	(108,834)
Increase in cash	762,615	899,885
Cash		
Beginning of period	56,466	603,004
End of period	$ 819,081	$ 1,502,889
Supplemental disclosure of cash flow information		
Interest paid	$ 21,470	$ 10,101
Income taxes paid	$ 89,000	$ 150,000

See accompanying notes

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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, 2006.

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, 2006 and June 30, 2006 consisted of:

	December 31, 2006 (Unaudited)	June 30, 2006
Raw materials	$ 4,971,377	$ 5,138,868
Finished goods	3,484,518	3,904,261
	8,455,895	9,043,129
Valuation reserve	(745,000)	(770,381)
	$ 7,710,895	$ 8,272,748

Note 3 Dividends in arrears

Cumulative dividends in arrears on the Series A preferred stock amounted to $353,054 at December 31, 2006.

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, 2006	December 31, 2005
Numerator		
Net income	$ 255,712	$ 454,754
Preferred stock dividends in arrears	(32,096)	(32,096)
Income available to common stockholders	$ 223,616	$ 422,658
Denominator		
Basic weighted average shares outstanding	9,658,956	9,458,956
Weighted average shares outstanding for options	0	77,000
Diluted weighted average shares outstanding	9,658,956	9,535,956
Basic net income per share	$ .02	$ .05
Diluted net income per share	$ .02	$ .04

In 2006 and 2005, 534,925 weighted average common shares from the conversion of convertible preferred stock were not included in the computation because they were antidilutive.

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

	December 31, 2006	December 31, 2005
Numerator		
Net income (loss)	$ (38,159)	$ 416,670
Preferred stock dividends in arrears	(64,192)	(64,192)
Income (loss) available to common stockholders	$ (102,351)	$ 352,478
Denominator		
Basic weighted average shares outstanding	9,658,956	9,458,956
Weighted average shares outstanding for options	0	83,000
Diluted weighted average shares outstanding	9,658,956	9,541,956
Basic net income (loss) per share	$ (.01)	$ .04
Diluted net income (loss) per share	$ (.01)	$ .04

In 2006 and 2005, 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). During the period ended December 31, 2006, there were no equity instruments granted for employee services.

Note 5 Note Payable

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, 2006, a payment of $250,000 was made, leaving a balance due of $250,000. Interest in the amount of $3,780 has been accrued for each of the quarters ended December 31, 2006 and 2005.

During the third quarter of Fiscal 2006, the Company acquired software and intellectual assets from and unrelated party for $855,403. Payment for the assets and software was issued in the form of a note payable. The note, payable in quarterly installments equal to $28,571 including accrued interest at a rate of 3.8% is due no later than January 1, 2014 and is secured by assets of the company equal to the outstanding balance of the loan. During the quarter ended December, 2006 the Company did not make any interest payments to the note holder. The remaining balance on December 31, 2006 was $721,262.

Subsequent to December 31, 2006 the major stockholder advanced the Company $154,000. Such advance was evidenced by an unsecured demand note bearing interest at 6 per cent per annum.

Note 6 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 7 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 acquisition.

Item 2. Management s Discussion and Analysis or Plan of Operation

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; 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, 2007, June 30, 2006 are referred to as fiscal 2007 , 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 player pianos. The Company has two wholly owned subsidiaries, one in Hong Kong and one in Australia. All statements made encompass the main Company and its two 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 leases space in Balmain, Australia and Hong Kong.

THREE MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2005.

SALES. Total sales decreased 7.0% from $5.73 million in the second three months of fiscal 2006 to $5.33 million in the second three months of fiscal 2007. The Company believes decreased sales were the result of a general decline in purchases of pianos by the marketplace. In an effort to increase sales, the Company has introduced a sales initiative to its dealer base to assist them in promoting and selling the Company product line to consumers. Those dealers who have adopted the sales concept are enthusiastic and the Company hopes for additional sales as a result of the sell through of the product.

COSTS AND EXPENSES. Total cost of sales decreased 5.5% from $3.72 million in the second three months of fiscal 2006 to $3.51 million in the second three months of fiscal 2007. As a percentage of sales, cost of sales increased 1.1% as a result of the mix of products that were sold.

Selling, general and administrative expenses increased 15.8% from $1.06 million in fiscal 2006 to $1.23 million in fiscal 2007. The increase is a result of an increase in marketing expenses related to sales initiatives and additional expenses related to the annual tradeshow.

Research and development costs decreased 24.2% for the quarter from $210,000 in the quarter ended December 2005 to $159,000 for the quarter ended December 2006. The decrease is a result of the timing of several projects nearing completion. Two products are nearing completion, and are now undergoing testing and final development.

INTEREST EXPENSE, NET. Net interest expense increased 123.5% from $4,800 in the second three months of fiscal 2006 to $10,600 in the second three months of fiscal 2007. The increase is due to the additional interest expense from the note payable entered into during fiscal 2006.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 38% for both fiscal 2007 and fiscal 2006.

NET INCOME. Net income decreased 43.8% from $455,000 for the three month period ended December 31, 2005 to $256,000 for the three month period ended December 31, 2006 as a result of the above mentioned variances.

SIX MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THE SIX MONTHS ENDED DECEMBER 31, 2005.

SALES. Total sales decreased 11.1% from $9.69 million in the first six months of fiscal 2006 to $8.61 million in the first six months of fiscal 2007. The Company believes decreased sales were the result of a general decline in purchases of pianos by the marketplace. In an effort to increase sales, the Company has introduced several sales initiatives to its dealer base to assist them in promoting and selling the Company product line to consumers. The offering of these initiatives began late during fiscal year 2006, and has continued for the first six months of fiscal 2007. The largest of the initiatives requires the dealer to make several commitments to the product line, some initially and some on an ongoing basis The effects of the initial commitments adopted by the dealer base have been experienced during the first six months of fiscal 2007. The Company also has firm pledges from other dealers for adoption of the sales initiatives. as the dealers are able to transition resources.

COSTS AND EXPENSES. Total cost of sales decreased 4.9% from $6.55 million in the first six months of fiscal 2006 to $6.23 million in the first six months of fiscal 2007. As a percentage of sales, cost of sales increased 4.8% as a result of the mix of products that were sold. In an effort to increase sales, several promotions were offered leading into the second quarter, lowering the price of pianos, and decreasing the gross margin on those sales.

Selling, general and administrative expenses increased 10.5% from $1.99 million in fiscal 2006 to $2.2 million in fiscal 2007. The increase is a result of an increase in legal and accounting fees and an increase in sales, marketing and delivery expenses. Sales, marketing and delivery expenses increased as a result of several promotions offered during the six months as incentives to increase sales. The Company also increased its presence at the annual tradeshow, and there were additional expenses related to the larger booth space.

Research and development costs decreased 55.6% for the period from $490,000 in the period ended December 2005 to $217,000 for the period ended December 2006. The decrease is a result of the timing of several projects nearing completion. Two products are nearing completion, and are now undergoing testing and final development.

INTEREST EXPENSE, NET. Net interest expense increased 112.6% from $10,100 in the first six months of fiscal 2006 to $21,500 in the first six months of fiscal 2007. The increase is due to the additional interest expense from the note payable entered into during fiscal 2006.

PROVISION FOR INCOME TAXES. The Company accrued a provision (benefit) for federal and state income taxes at an effective rate of 28% for fiscal 2007 and 36% for fiscal 2006.

NET INCOME. Net income decreased109.2% from a $417,000 for the six month period ended December 31, 2005 to a loss of $38,000 for the six month period ended December 31, 2006 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 $819,000 and $56,000 at December 31, 2006 and June 30, 2006, respectively. Cash increased from June 30, 2006 to December 31, 2006 primarily as a result of a decreases in inventory and accounts receivable.

The Company had a note payable to a lending institution due May 2002 which required a balloon payment of approximately $919,000. The Company retired that loan in fiscal 2006.

During the fiscal year ended June 2005, the Company entered into a demand note payable to its majority shareholder for $500,000 bearing an interest rate of 6% per annum. The Company has since made a partial payment of principal against the note of $250,000, and continues to accrue interest for the note.

Subsequent to December 31, 2006 the major stockholder advanced the Company $154,000. Such advance was evidenced by an unsecured demand note bearing interest at 6 per cent per annum.

During the fiscal year ended June 2006, the Company entered into a note payable with an individual in exchange for the purchase of intellectual property (technology and copyrights). That note is payable in quarterly payments of $28,571 plus accrued interest at 3.8%, due in full by January 1, 2014 and secured by assets of the Company equal to the remaining balance of the loan.

The Company is considering short-term financing to meet short-term obligations. As the Company disclosed in its Form 8K filed on February 14, 2006 it is currently investigating an acquisition of National Educational Music Company (NEMC). Should that acquisition occur, the Company anticipates that it would be, in part, financed through debt. At this time the Company has not identified the source or possible terms of that debt. There are no other major capital expenditures planned for in the foreseeable future, nor any payments planned for off-balance sheet obligations. Except as stated above, 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

The Company is currently in the process of updating and refining its internal communication and computer system in order to continue to address ongoing changing regulations and past deficiencies. With the deployment of the new communication and computer system new procedures and process flows are also being deployed and refined to further insure the accuracy and timeliness of financial reporting.

In addition to internal improvements, the Company took steps to increase the size of its Board of Directors by adding independent directors, knowledgeable in the industry and financial matters. Such changes took effect in fiscal 2006. The Company added three new independent board members, two of whom serve on the Audit Committee.

During the year end audit process for fiscal year 2006, the Company s independent auditors noted a material weakness involving the Company s internal controls and operations, primarily relating to the year end close procedure. The Company has increased the frequency of its internal financial reviews, and has changed some closing procedures to a monthly rather than quarterly basis. The Company continues to address this issue and is committed to further improving its quarterly and year end close procedure. The Company is in the process of reorganizing the responsibilities in the accounting department to further ensure timely recording of all entries

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 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: February 19, 2007	By:	/s/ Ann A. Jones Ann A. Jones, Chief Financial Officer
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