

ADVANCED MARKETING SERVICES INC

Form 10-Q

November 12, 2002

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended September 28, 2002

Commission File Number: 0-16002

ADVANCED MARKETING SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-3768341
(I.R.S. Employer
Identification No.)

5880 Oberlin Drive
San Diego, California 92121
(Address of principal executive offices)
(Zip Code)

(858) 457-2500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (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

The number of shares of the Registrant's Common Stock outstanding as of November 1, 2002 was 18,965,054, net of treasury shares of 4,096,975.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS** (See Note 1 for Basis of Presentation)

ADVANCED MARKETING SERVICES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited Amounts in Thousands, Except Share Data)

| | Sept. 28, 2002 | March 31, 2002 | Sept. 29, 2001 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|-------------------|
| ASSETS | | | |
| Current Assets: | | | |
| Cash and Cash Equivalents | \$ 4,221 | \$ 21,115 | \$ 23,160 |
| Investments, Available-for-Sale (Note 3) | 1,411 | 2,010 | 2,271 |
| Accounts Receivable, Net of Allowances for Uncollectible Accounts and Sales Returns of \$8,837 at September 28, 2002, \$9,239 at March 31, 2002 and \$6,639 at September 29, 2001 | 178,111 | 156,193 | 119,819 |
| Vendor and Other Receivables | 5,696 | 6,485 | 2,597 |
| Inventories | 199,416 | 123,904 | 176,295 |
| Deferred Income Taxes | 7,737 | 7,242 | 8,151 |
| Prepaid Expenses | 3,585 | 3,439 | 1,912 |
| Total Current Assets | 400,177 | 320,388 | 334,205 |
| Goodwill (Note 3) | 38,189 | 37,444 | 8,880 |
| Property and Equipment, Net (Note 3) | 34,090 | 30,983 | 24,854 |
| Investments, Available-for-Sale (Note 3) | 2,547 | 3,631 | 2,617 |
| Other Assets | 10,319 | 10,406 | 6,701 |
| TOTAL ASSETS | \$485,322 | \$402,852 | \$377,257 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | | |
| Current Liabilities: | | | |
| Lines of Credit | \$ 45,000 | \$ 25,000 | \$ |
| Accounts Payable | 280,129 | 223,960 | 243,856 |
| Accrued Liabilities | 23,314 | 20,046 | 16,548 |
| Income Taxes Payable | 1,687 | 1,522 | 3,302 |
| Total Current Liabilities | 350,130 | 270,528 | 263,706 |
| Commitments and Contingencies (Note 7) | | | |
| Stockholders Equity: | | | |
| Common Stock, \$0.001 Par Value, Authorized 100,000,000 Shares, Issued 23,049,000 Shares at September 28, 2002, 23,009,000 Shares at March 31, 2002 and 22,824,000 Shares at September 29, 2001 | 23 | 23 | 23 |
| Additional Paid-In Capital | 37,715 | 37,551 | 34,165 |
| Deferred Compensation | (498) | (609) | (719) |
| Retained Earnings, net of common stock dividends | 120,341 | 113,503 | 97,978 |
| Cumulative Other Comprehensive Loss (Note 2) | (926) | (1,953) | (1,705) |
| Less: Treasury Stock, 4,097,000 Shares at September 28, 2002, 3,734,000 Shares at March 31, 2002 and September 29, 2001, at Cost | (21,463) | (16,191) | (16,191) |

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| | | | |
|--------------------------------------------------|------------------|------------------|------------------|
| Total Stockholders Equity | 135,192 | 132,324 | 113,551 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | <u>\$485,322</u> | <u>\$402,852</u> | <u>\$377,257</u> |

The accompanying notes are an integral part of these condensed consolidated statements.

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ADVANCED MARKETING SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited Amounts in Thousands, Except Per Share Data)

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | Sept. 28, 2002 | Sept. 29, 2001 | Sept. 28, 2002 | Sept. 29, 2001 |
| Net Sales | \$ 219,157 | \$ 164,203 | \$ 411,033 | \$ 311,181 |
| Cost of Goods Sold | 182,764 | 138,887 | 345,248 | 264,567 |
| Gross Profit | 36,393 | 25,316 | 65,785 | 46,614 |
| Distribution and Administrative Expenses | 29,359 | 19,665 | 55,165 | 36,065 |
| Income From Operations | 7,034 | 5,651 | 10,620 | 10,549 |
| Interest Income | 194 | 280 | 415 | 742 |
| Equity in Net Income (Loss) of Affiliates | 128 | 195 | (8) | (46) |
| Interest Expense and Other, Net | (31) | (13) | 229 | (52) |
| Income Before Provision For Income Taxes | 7,325 | 6,113 | 11,256 | 11,193 |
| Provision for Income Taxes | 2,875 | 2,399 | 4,418 | 4,393 |
| Net Income | \$ 4,450 | \$ 3,714 | \$ 6,838 | \$ 6,800 |
| Net Income Per Share: | | | | |
| Basic | \$ 0.23 | \$ 0.19 | \$ 0.36 | \$ 0.36 |
| Diluted | \$ 0.23 | \$ 0.19 | \$ 0.34 | \$ 0.34 |
| Weighted Average Shares Used in Calculation: | | | | |
| Basic | 19,110 | 19,111 | 19,197 | 19,082 |
| Diluted | 19,602 | 19,836 | 19,927 | 19,833 |

The accompanying notes are an integral part of these condensed consolidated statements.

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ADVANCED MARKETING SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited Amounts in Thousands)

| | Six Months Ended | |
|---------------------------------------------------------------------------------------------|-------------------|-------------------|
| | Sept. 28, 2002 | Sept. 29, 2001 |
| Net income | \$ 6,838 | \$ 6,800 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Equity in net loss of affiliates | 8 | 46 |
| Depreciation and amortization | 3,069 | 2,028 |
| Loss on sale of equipment | 71 | |
| Provision for uncollectible accounts and sales returns | (402) | 1,361 |
| Markdown of inventories | 656 | 998 |
| Deferred income taxes | (495) | (954) |
| Amortization of deferred compensation | 111 | 111 |
| Changes in working capital components: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (20,458) | (18,156) |
| Inventories | (75,612) | (57,448) |
| Other assets | (1,575) | 25 |
| Increase in: | | |
| Accounts payable | 56,140 | 68,471 |
| Accrued liabilities | 3,007 | 2,340 |
| Income taxes payable | 146 | 165 |
| Net cash (used in) provided by operating activities | (28,496) | 5,787 |
| | | |
| Purchase of property and equipment | (6,677) | (8,878) |
| Investment in equity of affiliate | | (1,383) |
| Purchase of investments, available-for-sale | (1,457) | (4,364) |
| Sale and redemption of investments, available-for-sale | 3,184 | 3,875 |
| Net cash used in investing activities | (4,950) | (10,750) |
| | | |
| Borrowings on lines of credit | 20,000 | |
| Proceeds from exercise of options | 164 | 173 |
| Purchase of treasury stock | (5,272) | (988) |
| Net cash provided by (used in) financing activities | 14,892 | (815) |
| Effect of exchange rate changes on Cash and Cash Equivalents | 1,660 | (836) |
| Net Decrease in Cash and Cash Equivalents | (16,894) | (6,614) |
| CASH AND CASH EQUIVALENTS, Beginning of period | 21,115 | 29,774 |
| CASH AND CASH EQUIVALENTS, End of period | \$ 4,221 | \$ 23,160 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash Paid For: | | |
| Income Taxes | \$ 4,873 | \$ 4,946 |

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| | | | |
|----------|----|-----|----|
| Interest | \$ | 381 | \$ |
|----------|----|-----|----|

The accompanying notes are an integral part of these condensed consolidated statements.

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**ADVANCED MARKETING SERVICES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

1. BASIS OF PRESENTATION

The accompanying interim Condensed Consolidated Financial Statements as of and for the three and six month periods ended September 28, 2002 and September 29, 2001 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with instructions to Form 10-Q, without an audit by our independent public accountants, and therefore, do not include all the information and footnotes necessary for a fair presentation of consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America. Reference should be made to the annual financial statements, including footnotes thereto, included in the Advanced Marketing Services, Inc. (AMS, we, us and our) Annual Report on Form 10-K, for the fiscal year ended March 31, 2002. The accompanying unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments, which, in our management's opinion, are necessary for a fair presentation. Our management believes that the disclosures included in the accompanying Condensed Consolidated Financial Statements and footnotes are adequate so that the information is not misleading.

Operating results for interim periods are not necessarily indicative of operating results to be expected for our fiscal year ending March 31, 2003. Our net sales in the third fiscal quarter have historically been, and we expect them to continue to be, significantly greater than in any other quarter of our fiscal year due to increased demand during the holiday season.

Consistent with wholesale distribution industry practice, our net sales and cost of goods sold for interim periods are cut off on the Saturday nearest to the end of the calendar month. The cut-off for the fourth fiscal quarter is always March 31. This practice may result in differences in the number of business days for which our sales and cost of goods sold are recorded both as to quarter-to-quarter comparisons, and as to comparisons of quarters between years.

Financial statements prepared in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect amounts reported as assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and amounts reported as revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior period amounts have been reclassified to conform to the current period presentation.

The accompanying Condensed Consolidated Financial Statements include our accounts and those of our wholly owned subsidiaries. Our policy is to include the operating results of our foreign subsidiaries in our Condensed Consolidated Statements of Income one-month in arrears. We have eliminated all significant intercompany accounts and transactions.

Table of Contents**2. COMPREHENSIVE INCOME**

Comprehensive income is summarized as follows (in thousands):

| | Three Months Ended | | Six Months Ended | |
|------------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | Sept. 28, 2002 | Sept. 29, 2001 | Sept. 28, 2002 | Sept. 29, 2001 |
| Net Income | \$4,450 | \$3,714 | \$6,838 | \$6,800 |
| Foreign Currency Translation Adjustment | 1,409 | (718) | 985 | (836) |
| Unrealized Gains/(Losses) on Investments | 27 | 2 | 42 | (27) |
| Comprehensive Income | \$5,886 | \$2,998 | \$7,865 | \$5,937 |

We do not provide for US income taxes on foreign currency translation adjustments because such amounts are considered to be invested indefinitely.

3. COMPONENTS OF CERTAIN BALANCE SHEET CAPTIONS***Investments, Available-for-Sale***

Investments, available-for-sale consist principally of debt securities issued by the federal government of the United States of America and state and local municipalities. Available-for-sale securities are stated at fair market value as determined by the most recently traded price of each security at the balance sheet date. The cost and estimated fair market value of investments are as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| September 28, 2002 | \$3,923 | \$ 35 | \$ | \$3,958 |
| March 31, 2002 | \$5,648 | \$ | \$ (7) | \$5,641 |
| September 29, 2001 | \$4,932 | \$ | \$ (44) | \$4,888 |

As of September 28, 2002, we had investments in debt securities amounting to approximately \$1.4 million that were scheduled to mature within one year and approximately \$2.5 million that were scheduled to mature within two years. For each of the periods presented, we sold no investment prior to its maturity date. We use the specific identification method in determining cost on these investments.

Table of Contents**3. COMPONENTS OF CERTAIN BALANCE SHEET CAPTIONS (continued)*****Property and Equipment***

A summary of property and equipment is as follows (in thousands):

| | As of | | |
|------------------------------------------|----------------|----------------|----------------|
| | Sept. 28, 2002 | March 31, 2002 | Sept. 29, 2001 |
| Leasehold improvements | \$ 5,235 | \$ 5,869 | \$ 2,237 |
| Office furniture, equipment and software | 33,583 | | |