PACIFIC MAGTRON INTERNATIONAL CORP
Form 10-Q
November 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended September 30, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from __________ to __________

Commission file number 000-25277

PACIFIC MAGTRON INTERNATIONAL CORP.
(Exact Name of Registrant as Specified in Its Charter)

Nevada	88-0353141
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1600 California Circle, Milpitas, California 95035
(Address of Principal Executive Offices)

(408) 956-8888
(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 [X] No [ ]

Common Stock, $0.001 par value per share:

10,485,100 shares issued and outstanding at November 6, 2002

Part I. - Financial Information

PACIFIC MAGTRON INTERNATIONAL CORP.
CONSOLIDATED BALANCE SHEETS

	September 30, 2002	December 31, 2001
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,667,400	$ 3,110,000
Restricted cash	250,000	250,000
Accounts receivable, net of allowance for doubtful accounts of $400,000 as of September 30, 2002 and December 31, 2001	4,133,500	4,590,100
Inventories	3,843,900	2,952,000
Prepaid expenses and other current assets	338,300	387,300
Deferred income taxes	1,283,900	1,212,200
Total Current Assets	12,517,000	12,501,600
Property and Equipment, net	4,584,200	4,711,500
Deposits and Other Assets	122,900	110,200
	$ 17,224,100	$ 17,323,300

See accompanying notes to consolidated financial statements.

PACIFIC MAGTRON INTERNATIONAL CORP.

CONSOLIDATED BALANCE SHEETS

	September 30, 2002	December 31, 2001
	(Unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Current portion of notes payable	$ 60,000	$ 55,900
Floor plan inventory loans	1,002,400	1,545,000
Accounts payable	7,218,600	4,786,600
Accrued expenses	275,000	379,200
Total Current Liabilities	8,556,000	6,766,700
Notes Payable, less current portion	3,184,600	3,230,300
Deferred Tax Liabilities	26,400	34,200
Commitments and Contingencies		
Minority Interest - PMIGA	--	2,200
Preferred Stock, $0.001 par value; 5,000,000 Shares authorized; 4% Series A Redeemable Convertible Preferred Stock; 1,000 shares designated; 600 shares issued and outstanding (Liquidation value of $608,100 as of September 30, 2002)	436,200	--
Shareholders' Equity:		
Common stock, $0.001 par value; 25,000,000 shares authorized; 10,485,100 shares issued and outstanding	10,500	10,500
Additional paid-in capital	2,246,200	1,745,500
Retained earnings	2,764,200	5,533,900
Total Shareholders' Equity	5,020,900	7,289,900
	$ 17,224,100	$ 17,323,300

See accompanying notes to consolidated financial statements.

PACIFIC MAGTRON INTERNATIONAL CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)

Sales:				
Products	$ 18,036,500	$ 20,804,600	$ 50,462,400	$ 55,644,000
Services	194,600	35,600	778,800	114,100
Total Sales	18,231,100	20,840,200	51,241,200	55,758,100
Cost of Sales:				
Products	17,094,600	19,360,800	47,351,100	51,901,600
Services	84,400	14,200	382,500	31,600
Total Cost of Sales	17,179,000	19,375,000	47,733,600	51,933,200
Gross Margin	1,052,100	1,465,200	3,507,600	3,824,900
Research and development	--	46,800	--	68,500
Selling, General and Administrative Expenses	2,086,300	1,737,700	6,763,100	5,857,200
(Loss) from Operations	(1,034,200)	(319,300)	(3,255,500)	(2,100,800
Other (Expense) Income:				
Interest income	4,300	20,000	14,600	107,900
Interest expense	(45,800)	(60,200)	(138,900)	(201,900
Equity loss on investment	--	(4,600)	--	(14,500
Impairment loss on investment	--	--	--	(250,000
Other income (expense)	(7,600)	(14,100)	(39,700)	8,400
Total Other (Expense)	(49,100)	(58,900)	(164,000)	(350,100
(Loss) Before Income Tax Benefit and Minority Interest	(1,083,300)	(378,200)	(3,419,500)	(2,450,900
Income Tax Benefit	(341,400)	--	(1,107,000)	(365,500
(Loss) Before Minority Interest	(741,900)	(378,200)	(2,312,500)	(2,085,400
Minority Interest	--	8,200	2,200	30,000
Net (Loss)	(741,900)	(370,000)	(2,310,300)	(2,055,400
Accretion and deemed dividend related to beneficial conversion of 4% Series A Convertible Preferred Stock and value of warrant	(6,100)	--	(459,400)	--
Net (Loss) applicable to Common Shareholders	$ (748,000)	$ (370,000)	$ (2,769,700)	$ (2,055,400
Basic and diluted (loss) per share	$ (0.07)	$ (0.04)	$ (0.26)	$ (0.20
Basic and diluted weighted average common shares outstanding	10,485,100	10,420,700	10,485,100	10,228,800

See accompanying notes to consolidated financial statements.

PACIFIC MAGTRON INTERNATIONAL CORP.

CONSOLIDATED STATEMENT OF PREFERRED STOCK AND SHAREHOLDERS' EQUITY
(Unaudited)

	Shareholders' Equity				
	Preferred Stock		Common Stock		Additional Paid-in Capital
	Shares	Amount	Shares	Amount	
Balances, December 31, 2001	--	--	10,485,100	$ 10,500	$ 1,745,50
Issuance of 600 shares of Series A Convertible Preferred Stock and 300,000 common stock warrants (net of cash issuance costs of $80,500) (unaudited)	600	$ 477,500	--	--	-
Proceeds allocated to 300,000 common stock warrants issued to preferred stock investor (unaudited)	--	(148,300)	--	--	148,30
Deemed dividend associated with beneficial conversion feature of convertible preferred stock (unaudited)	--	--	--	--	303,00
Deemed dividend associated with 300,000 stock warrants issued in connection with the issuance of convertible preferred stock (unaudited)	--	148,300	--	--	-
Issuance of 100,000 common stock warrants as payment of stock issuance costs (unaudited)	--	(49,400)	--	--	49,40
Preferred stock accretion (unaudited)	--	8,100	--	--	-
Net Loss (unaudited)	--	--	--	--	-
Balances, September 30, 2002 (unaudited)	600	$ 436,200	10,485,100	$ 10,500	$ 2,246,20

See accompanying notes to consolidated financial statements.

PACIFIC MAGTRON INTERNATIONAL CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
	(Unaudited)	(Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)	$(2,310,300)	$(2,055,400)
Adjustments to reconcile net (loss) to net cash used in operating activities:		
Equity in loss in investment	--	14,500
Impairment loss on investment - TargetFirst	--	250,000
Depreciation and amortization	225,500	203,600
Provision for doubtful accounts	--	75,000
(Gain) or Loss on disposal of fixed assets	(8,600)	1,400
Minority interest losses	(2,200)	(30,000)
Changes in operating assets and liabilities:		
Accounts receivable	456,600	(214,100)
Inventories	(891,900)	(69,300)
Prepaid expenses and other current assets	49,000	51,400
Deferred income taxes	(79,500)	(234,600)
Accounts payable	2,432,000	104,300
Accrued expenses	(104,200)	(269,900)
NET CASH USED IN OPERATING ACTIVITIES	(233,600)	(2,173,100)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Notes and interest receivable from shareholders	--	91,400
Acquisition of property and equipment	(128,000)	(80,200)
Increase in deposits and other assets	(22,700)	(7,600)
Proceeds from sale of property and equipment	48,400	--
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(102,300)	3,600
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in floor plan inventory loans	(542,600)	326,400
Principal payments on notes payable	(41,600)	(38,300)
Restricted cash	--	(175,000)
Treasury stock purchases	--	(14,700)
Proceeds from sale of FNC and PMIGA stock to minority shareholders	--	35,000
Net proceeds from issuance of redeemable convertible preferred stock	477,500	--
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(106,700)	133,400
NET DECREASE IN CASH AND CASH EQUIVALENTS	(442,600)	(2,036,100)
CASH AND CASH EQUIVALENTS, beginning of period	3,110,000	4,874,200
CASH AND CASH EQUIVALENTS, end of period	$ 2,667,400	$ 2,838,100

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY

The consolidated financial statements of Pacific Magtron International Corp. (the Company or PMIC) include its subsidiaries, Pacific Magtron, Inc. (PMI), Pacific Magtron (GA) Inc. (PMIGA), Frontline Network Consulting, Inc. (FNC), Lea Publishing, Inc. (Lea), PMI Capital Corporation (PMICC), and LiveWarehouse, Inc. (LW).

PMI's principal activity consists of the importation and wholesale distribution of electronics products, computer components, and computer peripheral equipment throughout the United States.

In May 1998, PMI formed its Frontline Network Consulting (Frontline) division, a corporate information systems group that serves the networking and personal computer requirements of corporate customers. In July 2000, the Company formed Frontline Network Consulting, Inc., a California corporation. Effective October 1, 2000, PMI transferred the assets and liabilities of the Frontline division to FNC. Concurrently, FNC issued 20,000,000 shares to the Company and became a wholly-owned subsidiary. On January 1, 2001, FNC issued 3,000,000 shares of its common stock to three key FNC employees for past services rendered pursuant to certain Employee Stock Purchase Agreements. As a result of this transaction, the Company's ownership interest in FNC was reduced to 87%. In August 2001 and in March 2002, FNC repurchased and retired a total of 2,000,000 of its shares from former employees at $0.01 per share, resulting in an increase in the Company's ownership of FNC from 87% to 96%.

In May 1999, the Company entered into a Management Operating Agreement which provided for a 50% ownership interest in Lea Publishing, LLC, a California limited liability company formed in January 1999 to develop, sell and license software designed to provide internet users, resellers and providers with advanced solutions and applications. On June 13, 2000, the Company increased its direct and indirect interest in Lea to 62.5% by completing its investment in 25% of the outstanding common stock of Rising Edge Technologies, Ltd., the other 50% owner of Lea, which was a development stage company. In December 2001, the Company entered into an agreement with Rising Edge Technology (Rising Edge) and its principal owners to exchange the 50% Rising Edge ownership interest in Lea for its 25% ownership interest in Rising Edge. As a consequence, PMIC owns 100% of Lea and no longer has an ownership interest in Rising Edge. No amounts were recorded for the 50% Rising Edge ownership interest in Lea received in this exchange because of the write-down of the Rising Edge investment to zero in the fourth quarter of 2001. On May 28, 2002, the Company formed Lea Publishing, Inc, a California corporation. Effective June 1, 2002, Lea Publishing, LLC transferred all of its assets and liabilities to Lea Publishing, Inc.

In August 2000, PMI formed Pacific Magtron (GA), Inc., a Georgia corporation whose principal activity is the wholesale distribution of PMI's products in the eastern United States market. During 2001, PMIGA sold 15,000 shares of its common stock to an employee for $15,000. On June 19, 2002, PMIGA repurchased 15,000 shares of its common stock for $15,000. As a result, PMIGA is 100% owned by PMI.

On October 15, 2001, the Company formed an investment holding company, PMI Capital Corporation (PMICC), a wholly owned subsidiary of the Company, for the purpose of acquiring companies or assets deemed suitable for PMIC's organization. In October 2001, the Company acquired through PMICC certain assets and assumed the accrued vacation of certain employees of Live Market, Inc. in exchange for a cash payment of $85,000. These LiveMarket assets were then transferred to Lea.

In December 2001, the Company incorporated LiveWarehouse, Inc. (LW), a wholly-owned subsidiary of the Company, to provide consumers a convenient way to purchase computer products via the internet.

2. CONSOLIDATION AND UNCONSOLIDATED INVESTEES

The accompanying consolidated financial statements include the accounts of Pacific Magtron International Corp. and its wholly-owned subsidiaries, PMI, PMIGA, Lea, PMICC and LW and majority-owned subsidiary, FNC. All inter-company accounts and transactions have been eliminated in the consolidated financial statements. Investments in companies in which financial ownership is at least 20%, but less than a majority of the voting stock, are accounted for using the equity method. Equity investments with ownership of less than 20% are accounted for on the cost method.

3. FINANCIAL STATEMENT PRESENTATION

The accompanying consolidated financial statements at September 30, 2002 and for the three and nine month periods ended September 30, 2002 and 2001 are unaudited. However, they have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of consolidated financial position and results of operations for the periods presented. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles have been omitted. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes presented in the Company's Form 10-K for the year ended December 31, 2001. Interim operating results are not necessarily indicative of operating results expected for the entire year.

Certain reclassifications have been made to prior period balances in order to conform to the current period presentation. In the current quarter, $148,300 has been reclassified from Additional Paid-in Capital to Preferred Stock on the balance sheet.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2000, the EITF reached a consensus on Issue 00-14, "Accounting for Certain Sales Incentives." This issue addresses the recognition, measurement and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or are exercisable by a customer as a result of, a single exchange transaction. In April 2001, the EITF reached a consensus on Issue 00-25, "Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services." This issue addresses the recognition, measurement and income statement classification of consideration, other than that directly addressed by Issue 00-14, from a vendor to a retailer or wholesaler. Issue 00-25 is effective for the Company's 2002 fiscal year. Both Issue 00-14 and 00-25 have been codified under Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products." The adoption of Issue 01-09 during the first quarter of 2002 did not have a material impact on the Company's financial position or results of operations.

In June 2001, the Financial Accounting Standards Board finalized SFAS No. 141, BUSINESS COMBINATIONS, and No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS No. 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS No. 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS No. 142 that the Company reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS No. 141. The Company recorded its acquisition of Technical Insights and LiveMarket in September and October 2001 in accordance with SFAS No. 141 and did not recognize any goodwill relating to these transactions. However, certain intangibles totaling $59,400, including intellectual property and vendor reseller agreements, were identified and recorded in the consolidated financial statements in deposits and other assets.

SFAS No. 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS No. 142 requires that the Company identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS No. 142. SFAS No. 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS No. 142 requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS No. 142. The adoption of SFAS No. 142 did not have a material effect on the Company's financial position, results of operations or cash flows since the value of intangibles recorded is relatively insignificant and no goodwill has been recognized.

In August 2001, the FASB issued SFAS No. 143 Accounting for Obligations associated with the Retirement of Long-Lived Assets. SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. SFAS No. 143 states that companies should recognize the asset retirement cost, at its fair value, as part of the cost asset and classify the accrued amount as a liability in the balance sheet. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the ability would be subsequently updated for revised estimates of the discounted cash outflows. SFAS No. 143 will be effective for fiscal years beginning after June 15, 2002. The Company does not expect the adoption of SFAS No. 143 to have a material effect on its financial position, results of operations, or cash flows.

In October 2001, the FASB issued SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes the SFAS No. 121 by requiring that one accounting model to be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by broadening the presentation of discontinued operation to include more disposal transactions. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The adoption of SFAS No. 144 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Statement of Financial Accounting Standards No. 145, "Rescission of SFAS Statements No. 4, 44, and 64, Amendment of SFAS Statement No. 13, and Technical Corrections" ("SFAS 145"), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt." SFAS 145 amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No. 4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. The Company does not expect the adoption of SFAS No. 145 to have a material effect on its financial position, results of operations, or cash flows.

Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 replaces Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of SFAS 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS No. 146 to have a material effect on its financial position, results of operations, or cash flows.

5. STATEMENTS OF CASH FLOWS

Cash was paid during the nine months ended September 30, 2002 and 2001 for:

	NINE MONTHS ENDING SEPTEMBER 30,	
	2002	2001
Income taxes	$ 7,400	$ 1,500
Interest	$138,900	$201,900

6. RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2002, the Company made short-term salary advances to a shareholder/officer totaling $30,000, without interest. These advances were recorded as a bonus paid to the shareholder/officer during the second quarter ended June 30, 2002.

The Company sells computer products to a company owned by a member of our Board of Directors. Management believes that the terms of these sales transactions are no more favorable than given to unrelated customers. For the three and nine months ended September 30, 2002, and 2001, the Company recognized the following sales revenues from this customer:

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	NINE MONTHS ENDING SEPTEMBER 30	THREE MONTHS ENDING SEPTEMBER 30
Year 2002	$494,400	$123,000
Year 2001	$476,200	$ --

Included in accounts receivable as of September 30, 2002 is $96,300 due from this related customer.

7. INCOME TAXES

On March 9, 2002, legislation was enacted to extend the general Federal net operating loss carryback period from two years to five years for net operating losses incurred in 2001 and 2002. As a result of Management's analysis of estimated future operating results and other tax planning strategies, the Company did not record a valuation allowance on the portion of the deferred tax assets of $1,107,000 and $1,034,700 relating to Federal net operating loss carryforward at September 30, 2002 and December 31, 2001, respectively, as the Company believed that it was more likely than not that this deferred tax asset would be realized. On June 12, 2002, the Company received a Federal income tax refund of $1,034,700.

8. FLOOR PLAN INVENTORY LOANS AND LETTER OF CREDIT

On July 13, 2001, PMI and PMIGA (the Companies) obtained a $4 million (subject to credit and borrowing base limitations) accounts receivable and inventory financing facility from Transamerica Commercial Finance Corporation (Transamerica). This credit facility has a term of two years, subject to automatic renewal from year to year thereafter. The credit facility can be terminated by Transamerica under certain conditions and the termination is subject to a fee of 1% of the credit limit. The facility includes up to a $3 million inventory line (subject to a borrowing base of up to 85% of eligible accounts receivable plus up to $1,500,000 of eligible inventories), that includes a sub-limit of $600,000 working capital line and a $1 million letter of credit facility used as security for inventory purchased on terms from vendors in Taiwan. Borrowing under the inventory loans are subject to 30 to 45 days repayment, at which time interest begins to accrue at the prime rate, which was 4.75% at September 30, 2002. Draws on the working capital line also accrue interest at the prime rate. The credit facility is guaranteed by both PMIC and FNC. As of September 30, 2002, the Companies had an outstanding balance of $990,800 due under this credit facility.

Under the accounts receivable and inventory financing facility from Transamerica, the Companies are required to maintain certain financial covenants. As of December 31, 2001, the Companies were in violation of the minimum tangible net worth covenant. On March 6, 2002, Transamerica issued a waiver of the default and revised the covenants under the credit agreement retroactively to September 30, 2001. The revised covenants require the Companies to maintain certain financial ratios and to achieve certain levels of profitability. As of December 31, 2001 and March 31, 2002, the Companies were in compliance with these revised covenants. As of June 30, 2002, the Companies did not meet the revised minimum tangible net worth and profitability covenants, giving Transamerica, among other things, the right to call the loan and immediately terminate the credit facility.

On October 23, 2002, Transamerica issued a waiver of the default occurring on June 30, 2002 and revised the terms and covenants under the credit agreement. Under the revised terms, the credit facility includes FNC as an additional borrower and PMIC continues as a guarantor. Effective October 2002, the new credit limit is $3 million in aggregate for inventory loans and the letter of credit facility. The letter of credit facility is limited to $1 million. The credit limits for PMI and FNC are $1,750,000 and $250,000, respectively. As of September 30, 2002, the Companies did not meet the covenants as revised on October 23, 2002 relating to profitability and tangible net worth. This constitutes a technical default and gives Transamerica, among other things, the right to call the loan and immediately terminate the credit facility.

In March 2001, FNC obtained a $2 million discretionary credit facility from Deutsche Financial Services Corporation (Deutsche) to purchase inventory. To secure payment, Deutsche obtained a security interest in all of FNC's inventory, equipment, fixtures, accounts, reserves, documents, general intangible assets and all judgments, claims, insurance policies, and payments owed or made to FNC. Under the loan agreement, all draws matured in 30 days. Thereafter, interest accrued at the lesser of 16% per annum or at the maximum lawful contract rate of interest permitted under applicable law (16% as of September 30, 2002).

FNC was required to maintain certain financial covenants to qualify for the Deutsche bank credit line, and was not in compliance with certain of these covenants as of June 30, 2002 and December 31, 2001, which constituted a technical default under the credit line. This gave Deutsche the right to call the loan and terminate the credit line. The credit facility was guaranteed by PMIC and could be terminated by Deutsche immediately given the default. On April 30, 2002, Deutsche elected to terminate the credit facility effective July 1, 2002. As of September 30, 2002, FNC had a remaining outstanding balance of $11,600 under the normal terms of this credit facility. On October 9, 2002, the balance was repaid in full.

9. NOTES PAYABLE

In 1997, the Company obtained financing of $3,498,000 for the purchase of its office and warehouse facility. Of the amount financed, $2,500,000 was in the form of a 10-year bank loan utilizing a 30-year amortization period. This loan bears interest at the bank's 90-day LIBOR rate (1.81% as of September 30, 2002) plus 2.5%, and is secured by a deed of trust on the property. The balance of the financing was obtained through a $998,000 Small Business Administration (SBA) loan due in monthly installments through April 2017. The SBA loan bears interest at 7.569%, and is secured by the underlying property.

Under the bank loan for the purchase of the Company's office and warehouse facility, the Company is required, among other things, to maintain a minimum debt service coverage, a maximum debt to tangible net worth ratio, no consecutive quarterly losses, and net income on an annual basis. During 2001, the Company was in violation of two of these covenants which is an event of default under the loan agreement and gives the bank the right to call the loan. A waiver of these loan covenant violations was obtained from the bank in March 2002, retroactive to September 30, 2001, and through December 31, 2002. As a condition for this waiver, we transferred $250,000 to a restricted account as a reserve for debt servicing. This amount has been reflected as restricted cash in the accompanying consolidated financial statements.

10. SEGMENT INFORMATION

The Company has five reportable segments: PMI, PMIGA, FNC, Lea and LW. PMI imports and distributes electronic products, computer components, and computer peripheral equipment to various distributors and retailers throughout the United States, with PMIGA focusing on the east coast area. LW sells similar products as PMI to the end-users through a website. FNC serves the networking and personal computer requirements of corporate customers. Lea designs and installs advanced solutions and applications for internet users, resellers and providers. The accounting policies of the segments are the same as those described in the summary of significant accounting policies presented in the Company's Form 10-K. The Company evaluates performance based on income or loss before income taxes and minority interest, not including nonrecurring gains or losses. Inter-segment transfers between reportable segments have been insignificant. The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. PMI and PMIGA are comparable businesses with different locations of operations and customers.

The following table presents information about reported segment profit or loss for the nine months ended September 30, 2002:

	Revenues External Customers	Segment (loss) before income taxes and Minority Interest (4)
PMI	$40,674,600	$(1,214,700)

PMIGA	7,563,400	(520,500)
FNC	2,131,200(1)	(890,000)
LEA	412,000(3)	(611,900)
LW	460,000	(182,400)
TOTAL	$51,241,200	$(3,419,500)

The following table presents information about reported segment profit or loss for the nine months ended September 30, 2001:

	Revenues External Customers	Segment (loss) before income taxes and Minority Interest
PMI	$44,993,700	$ (943,100)
PMIGA	8,580,100	(509,200)
FNC	2,184,300(1)	(664,200)
LEA	--	(71,500)
LW	--	--
TOTAL	$55,758,100	(2,188,000)

The following table presents information about reported segment profit or loss for the three months ended September 30, 2002:

	Revenues External Customers	Segment (loss) before income taxes and Minority Interest (5)
PMI	$15,283,900	$ (492,800)
PMIGA	1,895,800	(149,200)
FNC	650,100(2)	(252,700)
LEA	79,000(3)	(161,900)
LW	322,300	(26,700)
TOTAL	$18,231,100	$(1,083,300)

The following table presents information about reported segment profit or loss for the three months ended September 30, 2001:

	Revenues External Customers	Segment (loss) before income taxes and Minority Interest
PMI	$16,993,600	$ (72,900)
PMIGA	3,208,200	(86,400)
FNC	638,400(2)	(155,500)
LEA	--	(41,400)
LW	--	--
TOTAL	$20,840,200	$ (356,200)

(1) Includes service revenues of $366,800 and $114,100 in 2002 and 2001,

respectively.

(2) Includes service revenues of $115,600 and $35,600 in 2002 and 2001, respectively.

(3) Total amount was derived from service revenues.

(4) Includes $1,591,500, $252,600, $141,200, $69,900, and $151,700, of PMIC corporate expenses allocated to PMI, PMIGA, FNC, Lea and LW, respectively.

(5) Includes $505,800, $54,200, $38,000, $14,200, and $39,700, of PMIC corporate expenses allocated to PMI, PMIGA, FNC, Lea and LW, respectively.

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The following is a reconciliation of reportable segment (loss) before income tax benefit and minority interest to the Company's consolidated total:

	Three months Ended September 30, 2001	Nine months Ended September 30, 2001
Total loss before income taxes and minority interest for reportable segments	$ (356,200)	$ (2,188,000)
Inter-company transactions	(17,400)	1,600
Equity in loss in investment in Rising Edge	(4,600)	(14,500)
Impairment loss on investment	--	(250,000)
Consolidated loss before income taxes and Minority interest	$ (378,200)	$ (2,450,900)

The reportable segment loss before income tax benefit and minority interest for the three months and nine months ended September 30, 2002 was equal to the Company's consolidated amounts presented in the consolidated statements of operations.

11. ACCOUNTS RECEIVABLE FACTORING AGREEMENT

Pursuant to a non-notification accounts receivable factoring agreement, the Company factors certain of its accounts receivable with a financial institution (the Factor) on a pre-approved non-recourse basis. The factoring commission charge is 0.375% and 2.375% of specific approved domestic and foreign receivables (Approved Accounts), respectively. The agreement, which expires February 28, 2003, is subject to automatic annual renewal provisions, and provides for the Company to pay a minimum of $200,000 in annual commission to the Factor. The Company is required to maintain the receivable records and to make reasonable collection efforts on the Approved Accounts. Approved Accounts are transferred to the Factor as assigned accounts (Assigned Accounts) when the receivables are not collected within 120 days from the due date or the customers become insolvent. The title of the receivable is transferred to the Factor when it becomes an Assigned Account. As a purchaser of the Assigned Accounts, the Factor has the title to the Assigned Accounts and has the unilateral right, such as to demand and collect payments from customers on the Assigned Accounts, compromise, sue for, and foreclose. The Company has no further obligations and control over the receivable when it becomes an Assigned Account. The Factor is obligated to pay the Company for the Assigned Accounts within 15 days after the receivable becomes an Assigned Account. Security interests in those Assigned Accounts are granted to the Factor upon the accounts become Assigned Accounts. In accordance with SFAS 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the Company accounts for the factored receivables as sales of financial assets when they become Assigned

Accounts. The total amount of receivables approved by the Factor as Approved Accounts was $16,535,500 and $8,359,700 for the nine months and three months ended September 30, 2002, respectively. The amount of receivables assigned to the Factor during the year and the quarter ended September 30, 2002 was $101,800 and $77,800, respectively There were no receivables assigned to the Factor prior to the quarter ended June 30, 2002. As of September 30, 2002, Assigned Accounts of $11,800 were included in accounts receivable.

12. DEPOSITS AND OTHER ASSETS

Included in deposits and other assets at September 30, 2002 are intangible assets relating to intellectual property and reseller agreements acquired during the fourth quarter of 2001 with a cost basis of $59,400 and accumulated amortization of $19,500. The Company is amortizing the intangible assets over a three-year period. Amortization expense for the nine months ended September 30, 2002 was approximately $19,000.

13. SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK

The Company is authorized to issue up to 5,000,000 shares of its $0.001 par value preferred stock that may be issued in one or more series and with such stated value and terms as may be determined by the Board of Directors. The Company has designated 1,000 shares as 4% Series A Redeemable Convertible Preferred Stock (the "Series A Preferred Stock") with a stated value per share of $1,000 plus all accrued and unpaid dividends.

On May 31, 2002 the Company entered into a Preferred Stock Purchase Agreement with an investor (Investor). Under the agreement, the Company agreed to issue 1,000 shares of its Series A Preferred Stock at $1,000 per share. On May 31, 2002, the Company issued 600 shares of the Series A Preferred Stock to the Investor, and the remaining 400 shares will be issued when the registration

statement that registers the common stock underlying the Series A Preferred Stock becomes effective. As part of the Preferred Stock Purchase Agreement, the Company issued a common stock purchase warrant to the Investor. The warrant may be exercised at any time within 3 years from the date of issuance and entitles the Investor to purchase 300,000 shares of the Company's common stock at $1.20 per share and includes a cashless exercise provision. The Company also issued a common stock purchase warrant with the same terms and conditions for the purchase of 100,000 shares of the Company's common stock to a broker who facilitated the transaction as a commission.

The holder of the Series A Preferred Stock is entitled to cumulative dividends at the rate of 4% per annum, payable on each Conversion Date, as defined, in cash or by accretion of the stated value. Dividends must be paid in cash, if among other circumstances, the number of the Company's authorized common shares is insufficient for the conversion in full of the Series A Preferred Stock, or the Company's common stock is not listed or quoted on Nasdaq, NYSE or AMEX. Each share of Series A Preferred Stock is non-voting and entitled to a liquidation preference of the stated value plus accrued and unpaid dividends. A sale or disposition of 50% or more of the assets of the Company, or effectuation of transactions in which more than 33% of the voting power of the Company is disposed of, would constitute liquidation. At any time and at the option of the holder, each share of Series A Preferred Stock is convertible into shares of common stock at the Conversion Ratio, which is defined as the stated value divided by the Conversion Price. The Conversion Price is the lesser of (a) 120% of the average of the 5 Closing Prices immediately prior to the Closing Date on which the preferred stock was issued (the Set Price), and (b) 85% of the average of the 5 lowest VWAPs (the daily volume weighted average price as reported by Bloomberg Financial L.P. using the VAP function) during the 30 trading days immediately prior to the Conversion Date but not less than $0.75 (Floor Price). The Set Price and Floor Price are subject to certain adjustments, such as stock dividends.

The Company has the right to redeem the Series A Preferred Stock for cash at a price equal to 115% of the Stated Value plus accrued and unpaid dividends if (a) the Conversion Price is less than $1 during the 5 trading days prior to the redemption, or (b) the Conversion price is greater than 175% of the Set Price during the 20 trading days prior to the redemption. Upon the occurrence of a Triggering Event, such as failure to register the underlying common shares among other events as defined, the holder of the Series A Preferred Stock has the right to require the Company to redeem the Series A Preferred Stock in cash at a price equal to the sum of (a) the redemption amount (the greater of (i) 150% of the Stated Value or (ii) the product of the Per Share Market Value and the Conversion Ratio) plus other costs, and (b) the product of the number of converted common shares and Per Market Share Value. As of September 30, 2002, the liquidation value of the Series A Preferred Stock was $608,100. As the Series A Preferred Stock has conditions for redemption that are not solely within the control of the Company, such Series A Preferred Stock has been excluded from shareholders' equity. As of September 30, 2002, the redemption value of the Series A Preferred Stock, if the holder had required the Company to redeem the Series A Preferred Stock as of that date, was $912,200.

The Company has accounted for the sale of preferred stock in accordance with Emerging Issues Task Force (EITF) 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments." Proceeds of $329,200 (net of $80,500 cash issuance costs) were allocated to the Series A Preferred Stock and $148,300 was allocated to the detachable warrant based upon its fair value as computed using the Black-Scholes option pricing model. The $303,000 value of the beneficial conversion option on the 600 shares of Series A Preferred Stock and the $148,300 value of the warrant issued to the investor were recorded as a deemed dividend on the date of issuance. The allocated $49,400 value of the warrant issued to the broker who facilitated the transaction was recorded as a stock issuance cost relating to the sale of preferred stock. As of September 30, 2002, 810,800 shares of common stock could have been issued if the Series A Preferred Stock were converted into common stock.

14. STOCK OPTIONS

For the nine months ended September 30, 2002, the Company granted options to purchase 30,000 shares of the Company's common stock to certain members of the board of directors at exercise prices of $0.76 to $1.05 per share. During the nine months ended September 30, 2002, no outstanding options were exercised and options to purchase 271,560 shares of the Company's common stock were cancelled due to employee terminations or expiration of options. On July 24, 2002, the Company entered into a service agreement with a consultant for a term of 180 days. The consultant was paid by granting options to purchase an aggregate of 200,000 shares of the Company's common stock. On August 26, 2002 the Company terminated the agreement and cancelled the two stock options.

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15. LOSS PER SHARE

Basic loss per share is computed by dividing loss applicable to common shares by the weighted-average number of common shares outstanding for the period. During the three and nine month periods ended September 30, 2002, options and warrants to purchase 1,153,100 shares of the Company's common stock and 810,800 shares of common stock issuable upon conversion of Series A Preferred Stock were excluded from the calculation of diluted weighted average common shares outstanding because their effect would be antidilutive. During the three and nine month periods ended September 30, 2001, options to purchase 835,222 shares of the

Company's common stock were excluded from the calculation of diluted weighted average common shares outstanding because their effect would be antidilutive.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The accompanying discussion and analysis of financial condition and results of operations is based on the consolidated financial statements, which are included elsewhere in this Quarterly Report. The following discussion and analysis should be read in conjunction with the accompanying financial statements and related notes thereto. This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Our actual results could differ materially from those set forth in the forward-looking statements. Forward-looking statements, by their very nature, include risks and uncertainties. Accordingly, our actual results could differ materially from those discussed in this Report. A wide variety of factors could adversely impact revenues, profitability, cash flows and capital needs. Such factors, many of which are beyond our control, include, but are not limited to, those identified below under the heading "Cautionary Factors That May Affect Future Results."

GENERAL

As used herein and unless otherwise indicated, the terms "Company," "we," and "our" refer to Pacific Magtron International Corp. and each of our subsidiaries. We provide solutions to customers in several synergetic and growing segments of the computer industry. Our business is organized into five divisions: PMI, PMIGA, FNC, Lea/LiveMarket and LiveWarehouse. Our subsidiaries, PMI and PMIGA, provide the wholesale distribution of computer multimedia and storage peripheral products and provide value-added packaged solutions to a wide range of resellers, vendors, OEMs and systems integrators. PMIGA commenced operations in October 2000 and distributes PMI's products in the southeastern United States market. To capture the expanding corporate IT infrastructure market, we established the FrontLine Network Consulting division in 1998 to provide professional services to mid-market companies focused on consulting, implementation and support services of Internet technology solutions. During 2000, this division was incorporated as FNC. On September 30, 2001, FNC acquired certain assets of Technical Insights, Inc., a computer technical support company, in exchange for 16,142 shares of our common stock then valued at $20,000. The acquired business unit, Technical Insights, enables FNC to provide computer technical training services to corporate clients.

In 1999 we invested in a 50%-owned joint software venture, Lea Publishing, LLC, to focus on Internet-based software application technologies to enhance corporate IT services. Lea was a development stage company. In June 2000, we increased our direct and indirect interest in Lea to 62.5% by completing our purchase of 25% of the outstanding common stock of Rising Edge Technologies, Ltd., the other 50% owner of Lea. In December 2001, we entered into an agreement with Rising Edge and its principal owners to exchange the 50% Rising Edge ownership in Lea for our 25% interest in Rising Edge. As a consequence, we own 100% of Lea and no longer have an interest in Rising Edge. Certain LiveMarket assets, which were initially purchased through PMICC, were transferred to Lea in the fourth quarter of 2001. On May 28, 2002, Lea Publishing, Inc. was incorporated in California. Effective June 1, 2002, Lea Publishing, LLC transferred all of its assets and liabilities to Lea Publishing, Inc.

In December 2001, LiveWarehouse, Inc. was incorporated as a wholly-owned subsidiary of PMIC, to provide consumers a convenient way to purchase computer products via the internet.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain selected financial data as a percentage of sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	94.2	93.0	93.2	93.1
Gross margin	5.8	7.0	6.8	6.9
Operating expenses	11.5	8.6	13.2	10.6
(Loss)from operations	(5.7)	(1.6)	(6.4)	(3.7)
Other income (expense), net	(0.3)	(0.3)	(0.3)	(0.6)
Income tax benefit	1.9	0.0	2.2	0.6
Minority interest	0.0	0.0	0.0	0.0
Net (loss)	(4.1)%	(1.9)%	(4.5)%	(3.7)%

THREE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2001

Sales for the three months ended September 30, 2002 were $18,231,100, a decrease of $2,609,100, or approximately 12.5%, compared to $20,840,200 for the three months ended June 30, 2001. The decrease was primarily attributable to decreased revenues at PMI and PMIGA partially offset by the revenues of newly formed LiveWarehouse and newly acquired Lea.

The combined sales of PMI and PMIGA were $17,179,700 for the three months ended September 30, 2002, a decrease of $3,022,100, or approximately 15.0%, compared to $20,201,800 for the three months ended September 30, 2001. Sales for PMI decreased by $1,709,700, or 10.1%, from $16,993,600 for the three months ended September 30, 2001 to $15,283,900 for the three months ended September 30, 2002. PMIGA's sales decreased by $1,312,400, or 40.9%, from $3,208,200 for the three months ended September 30, 2001 to $1,895,800 for the three months ended September 30, 2002. The decrease in PMI and PMIGA sales was primarily due to a continuing decline in the computer component market and the intense competition in pricing in the computer component market during the quarter ending September 30, 2002 compared to the comparable quarter in 2001.

Sales generated by FNC for the three months ended September 30, 2002 were $650,100, an increase of $11,700 or 1.8%, compared to $638,400 for the three months ended September 30, 2001. FNC sales were essentially flat due to a slow and stagnant economy. Our customers have not increased their purchases from us in computer networking.

In the fourth quarter of 2001, PMICC acquired certain assets of LiveMarket. These assets were subsequently transferred to Lea. Prior to the LiveMarket acquisition, Lea did not generate any revenues as it was in the development stage. Revenues, primarily from services performed, generated by Lea were $79,000 for the three months ended September 30, 2002.

In December 2001, LiveWarehouse, Inc. (LW) was incorporated as a wholly-owned subsidiary of PMIC, to provide consumers a convenient way to purchase computer products via the internet. Sales generated by LW were $322,300 for the three months ended September 30, 2002.

Consolidated gross margin for the three months ended September 30, 2002 was $1,052,100, or 5.8% of sales, compared to $1,465,200, or 7.0% of sales, for the three months ended September 30, 2001. The decrease in gross margin was primarily attributable to the intense competition on pricing in the computer component market experienced by PMI and PMIGA.

The combined gross margin for PMI and PMIGA was $794,200, or 4.6% of sales for the three months ended September 30, 2002, compared to $1,343,500 or 6.7% of sales for the three months ended September 30, 2001. PMI's gross margin was $687,800, or 4.5%, of sales for the three months ended September 30, 2002 compared to $1,141,700, or 6.7%, for the three months ended September 30, 2001. PMIGA's gross margin was $106,400, or 5.6%, of sales for the three months ended September 30, 2002 compared to $201,800, or 6.3%, of sales for the three months ended September 30, 2001. The decrease in gross margin was primarily due to an intense competition in market pricing of computer component products during the three months ending September 30, 2002 compared to the comparable three months in 2001. We expect the pricing competition in the market will continue in a slow economy. This would have an adverse impact on our gross margin.

FNC's gross margin was $143,100, or 22.0% of sales, for the three months ended September 30, 2002 compared to $121,700, or 19.1% of sales, for the three months ended September 30, 2001. The higher gross margin percentage in 2002 was due to an increase in service revenues earned as a percent of total sales for the three months ended September 30, 2002 compared to the three months ended September 30, 2001. Service revenues were $115,600 for the three months ended September 30, 2002 compared to $35,600 for the three months ended September 30, 2001. In general, FNC has a higher gross margin on consulting and implementation service revenues than product sales revenues. We expect to maintain the similar mix of service/equipment revenues as the economy continues to stagnate.

Lea experienced an overall gross margin of $49,600, or 62.8% of sales, for the three months ended September 30, 2002. Lea's gross margin was generated primarily from services performed.

Gross margin for LW was $65,000, or 20.1% of sales, for the three months ended September 30, 2002. The gross margin realized in retail sales is generally higher than wholesale distribution.

Consolidated operating expenses, which consist of research and development and selling, general and administrative expenses, were $2,086,300 for the three months ended September 30, 2002, an increase of $301,800, or 16.9%, compared to $1,784,500 for the three months ended September 30, 2001.

The increase in consolidated operating expenses was partially due to the inclusion of the operating and development support expenses of $211,500 for Lea for the three months ended September 30, 2002 which were not incurred during the same period in 2001.

LW began its operations in the first quarter of 2002. The increase in consolidated operating expenses was partially due to the inclusion of the operating expenses of $91,800 for LW for the three months ended September 30, 2002 which were not incurred during the same period in 2001.

Consolidated expense for the Company's investor relations and other expenses for maintaining the status of PMIC as a publicly-held company increased from $17,600 for the three months ended September 30, 2001 to $84,900 for the three months ended September 30, 2002. These expenses were partially offset by, among other cost-cutting measures, reducing our employee count from 97 as of September 30, 2001 to 93 as of September 30, 2002 for PMI, PMIGA, and FNC and decreasing our labor cost by $146,500 for the three months ended September 30, 2002 compared to the same period in 2001.

PMI's operating expenses were $1,133,600 for the three months ended September 30, 2002 compared to $1,148,000 for the three months ended September 30, 2001. The decrease of $14,400, or 1.3%, was mainly due to a reduction in our employee count from 66 as of September 30, 2001 to 62 as of September 30, 2002 resulting in a decrease in payroll expenses of approximately $177,000 and was mostly offset by an increase in allocated corporate expenses from PMIC to PMI. These allocated expenses primarily relate to maintaining the status of PMIC as a publicly-held company, and include among others, investor relations expenses and professional service expenses. Investor relations and professional service expense increased by $58,200 and $67,200, respectively, for the three months ended September 30, 2002 compared to the same period in 2001.

PMIGA's operating expenses were $257,500 for the three months ended September 30, 2002, a decrease of $31,600, or 10.9%, compared to $289,100 for the three months ended September 30, 2001. The decrease was primarily due to a reduction in our employee count from 19 as of September 30, 2001 to 15 as of September 30, 2002 resulting in a decrease in payroll expense of approximately $52,800.

FNC's operating expenses were $392,100 for the three months ended September 30, 2002, an increase of $94,300 or 31.7%, compared to $297,800 for the three months ended September 30, 2001. The increase was primarily the result of the operating expenses of Technical Insight (TI), whose assets were acquired in September 20, 2001, which were not incurred in the comparative prior year period. This increase was partially offset by a decrease in professional service expenses of approximately $21,900.

Consolidated loss from operations for the three months ended September 30, 2002 was $1,034,200 compared to $319,300 for the three months ended September 30, 2001, an increase of 223.9%. As a percent of sales, consolidated loss from operations was 5.7% for the three months ended September 30, 2002 compared to 1.6% for the three months ended September 30, 2001. The increase in consolidated loss from operations was primarily due to a 16.9% increase in consolidated operating expenses and a decrease in gross margin experienced during the current period. Loss from operations for the three months ended September 30, 2002, including allocations of PMIC corporate expenses, for PMI, PMIGA, FNC, Lea and LW were $505,800, $54,200, $38,000, $14,200, and $39,700, respectively.

Consolidated interest income was $4,300 for the three months ended September 30, 2002 compared to $20,000 for the three months ended September 30, 2001. The decrease in interest income was mainly due to a decline in interest rates and funds on deposit in interest bearing accounts.

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Consolidated interest expense was $45,800 for the three months ended September 30, 2002 compared to $60,200 for the three months ended September 30, 2001. The decrease in interest expense was mainly due to a decrease in the floating interest rate charged on one of our mortgages on our office building facility located in Milpitas, California.

In March 2002, legislation was enacted to extend the general federal net operating loss carryback period from 2 years to 5 years for net operating losses incurred in 2001 and 2002. As a result, we computed the weighted average effective tax rate which originated the net operating losses and recorded an income tax benefit of $341,400 on the net operating tax loss incurred for the three months ended September 30, 2002 using the weighted average effective tax rate.

On May 31, 2002 the Company issued 600 shares of its 4% Series A Redeemable Convertible Preferred Stock and a warrant for 300,000 shares of common stock to an investor. The value of the beneficial conversion option of these 600 shares of 4% Series A Redeemable Convertible Preferred Stock and the warrant was $303,000 and $148,300, respectively. The accretion of the 4% Series A Preferred Stock was $6,100 from the three months ended September 30, 2002. The value of the accretion of the preferred stock was included in the loss applicable to the common shareholders in the calculation of the loss per common share.

NINE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2001

Sales for the nine months ended September 30, 2002 were $51,241,200, a decrease of $4,516,900, or approximately 8.1%, compared to $55,758,100 for the nine months ended September 30, 2001. The decrease was primarily attributable to decreased revenues at PMI and PMIGA partially offset by the revenues of newly formed LiveWarehouse and newly acquired Lea.

The combined sales of PMI and PMIGA were $48,238,000 for the nine months ended September 30, 2002, a decrease of $5,335,800 or approximately 10.0%, compared to $53,573,800 for the nine months ended September 30, 2001. Sales for PMI decreased by $4,319,100, or 9.6%, from $44,993,700 for the nine months ended September 30, 2001 to $40,674,600 for the nine months ended September 30, 2002. PMIGA's sales decreased by $1,016,700, or 11.8%, from $8,580,100 for the nine months ended September 30, 2001 to $7,563,400 for the nine months ended September 30, 2002. The decrease in PMI and PMIGA sales was primarily due to a continuing decline in the computer component market and the intense competition in pricing in the computer component market during the nine months ending September 30, 2002 compared to the comparable nine months in 2001.

Sales recognized by FNC for the nine months ended September 30, 2002 were $2,131,200, a decrease of $53,100 or 2.4%, compared to $2,184,300 for the nine month ended September 30, 2001. FNC sales were essentially flat due to a slow and stagnant economy. Our customers had not increased their purchases from us in computer networking.

In the fourth quarter of 2001, PMICC acquired certain assets of LiveMarket. Subsequently, these assets were transferred to Lea. Prior to the LiveMarket acquisition, Lea did not generate any revenues as it was in the development stage. Revenues generated by Lea were $412,000 for the nine months ended September 30, 2002.

In December 2001, LiveWarehouse, Inc. (LW) was incorporated as a wholly-owned subsidiary of PMIC to provide consumers a convenient way to purchase computer products via the internet. Sales generated by LW were $460,000 for the nine months ended September 30, 2002.

Consolidated gross margin for the nine months ended September 30, 2002 was $3,507,600, or 6.8% of sales, compared to $3,824,900, or 6.9% of sales, for the nine months ended September 30, 2001. The decrease in gross margin was primarily attributable to the intense competition on pricing of computer component products in the market experienced by PMI and PMIGA.

The combined gross margin for PMI and PMIGA was $2,847,100, or 5.9% of sales, for the nine months ended September 30, 2002, compared to $3,521,800 or 6.6% of sales, for the nine months ended September 30, 2001. PMI's gross margin was $2,476,600, or 6.1% of sales, for the nine months ended September 30, 2002 compared to $3,091,700, or 6.9% of sales, for the nine months ended September 30, 2001. PMIGA's gross margin was $370,500, or 4.9% of sales, for the nine months ended September 30, 2002 compared to $430,100, or 5.0% of sales, for the nine months ended September 30, 2001. The decrease in PMI and PMIGA gross margin

was primarily due to an intense competition on pricing of computer component products in the market during the nine months ending September 30, 2002 compared to the comparable nine months in 2001. We expect the pricing competition in the market will continue in a slow economy. This would have an adverse impact on our gross margin.

FNC's gross margin was $392,600, or 18.4% of sales, for the nine months ended September 30, 2002 compared to $303,100, or 13.9% of sales, for the nine months ended September 30, 2001. The higher gross margin percentage in 2002 was due to an increase in service revenues earned as a percent of total sales for the nine months ended September 30, 2002 compared to the nine months ended September 30, 2001. Service revenues were $366,800 for the nine months ended September 30, 2002 compared to $114,100 for the nine months ended September 30, 2001. In general, FNC has a higher gross margin on consulting and implementation service revenues than product sales revenues. We expect to maintain the similar mix of service/equipment revenues as the economy continues to stagnate.

Lea experienced an overall gross margin of $175,600, or 42.6% of sales, for the nine months ended September 30, 2002. Lea's gross margin was derived primarily from service revenues.

Gross margin for LW was $92,300, or 20.1% of sales, for the nine months ended September 30, 2002. The gross margin realized in retail sales is generally higher than wholesale distribution.

Consolidated operating expenses, which consist of research and development and selling, general and administrative expenses, were $6,763,100 for the nine months ended September 30, 2002, an increase of $837,400, or 14.1% compared to $5,925,700 for the nine months ended September 30, 2001.

The increase in consolidated operating expenses was partially due to the inclusion of the operating and development support expenses of $787,000 for Lea for the nine months ended September 30, 2002 which were not incurred during the same period in 2001.

LW began its operations in the first quarter of 2002. The increase in consolidated operating expenses was partially due to the inclusion of the operating expenses of $274,000 for LW for the nine months ended September 30, 2002 which were not incurred during the same period in 2001.

The Company has also experienced a lower level of bad debt write-offs. The consolidated bad debt expense decreased from $297,000 for the nine months ended September 30, 2001 to $189,800 for the nine months ended September 30, 2002. Consolidated expense for the Company's investor relations for maintaining the status of PMIC as a publicly-held company was $335,300 for the nine months ended September 30, 2002 compared to $116,400 for the nine months ended September 30, 2001. These expenses were partially offset by, among other cost-cutting measures, reducing our employee count from 97 to 93 for PMI, PMIGA, and FNC and decreasing our labor cost by $462,000 for the nine months ended September 30, 2002 compared to the same period in 2001.

PMI's operating expenses were $3,561,200 for the nine months ended September 30, 2002 compared to $3,868,300 for the nine months ended September 30, 2001. The decrease of $307,100, or 7.9%, was mainly due to a reduction in our employee count from 66 as of September 30, 2001 to 62 as of September 30, 2002 resulting in a decrease in payroll expenses of approximately $462,600 and the decrease in bad debt expense of $144,100 and was mostly offset by an increase in allocated corporate expenses from PMIC to PMI. These allocated expenses primarily relate to maintaining the status of PMIC as a publicly-held company, and include among others, investor relations and professional service expenses. Investor relations and professional service expense increased by $174,000 and $83,000, respectively, for the nine months ended September 30, 2002 compared to the same period in 2001.

PMIGA's operating expenses were $878,200 for the nine months ended September 30, 2002, a decrease of $65,500, or 6.9% compared to $943,700 for the nine months ended June 30, 2001. The decrease was primarily due to a reduction in our employee count from 19 as of September 30, 2001 to 15 as of September 30, 2002 resulting in a decrease in payroll expense of approximately $155,900 which was partially offset by the increase in bad debt expense of $26,400 and allocated corporate expenses from PMIC to PMIGA. These allocated expenses primarily relate to maintaining the status of PMIC as a publicly-held company, and include, among others, investor relations and professional service expenses. Investor relations expense increased by $35,500 for the nine months ended September 30, 2002 compared to the same period in 2001.

FNC's operating expenses were $1,262,700 for the nine months ended September 30, 2002, an increase of $220,500, or 21.2%, compared to $1,042,200 for the nine months ended September 30, 2001. FNC acquired certain assets of a computer technical support company, Technical Insight (TI) on September 30, 2001. The operating expenses for the nine months ended September 30, 2002 included the expenses of operating TI. Payroll expense, including TI, was $999,300 for the nine months ended September 30, 2002 compared to $838,900 for the nine months ended September 30, 2001, an increase of $160,400. Rent expense for TI was $27,400 for the nine months ended September 30, 2002. FNC also experienced an increase in bad debt expense of $10,500 for the nine months ended September 30, 2002. The increases were partially offset by a decrease in professional service expenses of approximately $63,100.

Consolidated loss from operations for the nine months ended September 30, 2002 was $3,255,500 compared to $2,100,800 for the nine months ended September 30, 2001, an increase of 55.0%. As a percent of sales, consolidated loss from operations was 6.4% for the nine months ended September 30, 2002 compared to 3.8% for the nine months ended September 30, 2001. The increase in consolidated loss from operations was primarily due to an 8.1% decrease in consolidated sales and a 14.1% increase in consolidated operating expenses. Loss from operations for the nine months ended September 30, 2002, includes allocations of PMIC corporate expenses, for PMI, PMIGA, FNC, Lea and LW was $1,591,500, $252,600, $141,200, $69,900, and $151,700, respectively.

Consolidated interest income was $14,600 for the nine months ended September 30, 2002 compared to $107,900 for the nine months ended September 30, 2001. The decrease in interest income was mainly due to a decline in interest rates and funds available to earn interest.

Consolidated interest expense was $138,900 for the nine months ended September 30, 2002 compared to $201,900 for the nine months ended September 30, 2001. The decrease in interest expense was largely due to a decrease in the floating interest rate charged on one of our mortgages on our office building facility located in Milpitas, California.

In June 2001, the Company established a 100% reserve on the investment in TargetFirst Inc. as a result of an evaluation of the net realizable value of this investment. An impairment loss of $250,000 was recorded in June 2001.

In March 2002, legislation was enacted to extend the general federal net operating loss carryback period from 2 years to 5 years for net operating losses incurred in 2001 and 2002. As a result, we computed the weighted average effective tax rate which originated the net operating losses and recorded an income tax benefit of $1,107,000 on the net operating tax loss incurred for the nine months ended September 30, 2002 using the weighted average effective tax rate.

On May 31, 2002 the Company issued 600 shares of its 4% Series A Redeemable Convertible Preferred Stock and a warrant for 300,000 shares of common stock to an investor. The value of the beneficial conversion option of these 600 shares of 4% Series A Redeemable Convertible Preferred Stock and the warrant was $303,000 and $148,300, respectively. The accretion of the 4% Series A Preferred Stock was $8,100 from the issuance date (May 31, 2002) to September 30, 2002. The value of the beneficial conversion option, the warrant, and the accretion of the preferred stock, totaling $459,400 was included in the loss applicable to the common shareholders in the calculation of the loss per common share for the nine months ended September 30, 2002.

LIQUIDITY AND CAPITAL RESOURCES

It is our business plan that we finance our operations primarily through cash generated by operations and borrowings under our floor plan inventory loans and line of credit. The continued decline in sales, the continuation of operating losses or the loss of credit facilities could have a material adverse effect on the operating cash flows of the Company.

As of June 30, 2002, the Companies did not meet the revised minimum tangible net worth and profitability covenants, giving Transamerica, among other things, the right to call the loan and immediately terminate the credit facility. On October 23, 2002, Transamerica issued a waiver of the default occurring on June 30, 2002 and revised the terms and covenants under the credit agreement. Under the revised terms, the credit facility includes FNC as an additional borrower and PMIC continues as a guarantor. Effective October 2002, the new credit limit is $3 million in aggregate for inventory loans and the letter of credit facility. The letter of credit facility is limited to $1 million. The credit limits for PMI and FNC are $1,750,000 and $250,000, respectively. As of September 30, 2002, the Companies did not meet the revised covenants relating to profitability and

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tangible net worth. This gives Transamerica, among other things, the right to call the loan and immediately terminate the credit facility.

On May 31, 2002 the Company entered into a Preferred Stock Purchase Agreement with an investor. Under the agreement, the Company agreed to issue 1,000 shares of its preferred stock at $1,000 per share. The Company issued 600 shares of its preferred stock and warrants for purchasing 400,000 shares of the Company's common stock for a net proceeds of $477,500 on May 31, 2002. We expect to issue the additional 400 shares for an estimated gross proceeds of $370,000 in the fourth quarter 2002. Even though we have completed the required registration of the underlying common stock in October 2002, there is no assurance these remaining 400 shares will be sold.

At September 30, 2002, the Company had consolidated cash and cash equivalents totaling $2,667,400 (excluding $250,000 in restricted cash) and working capital of $3,960,400, a decrease of $1,774,500 compared to the working capital at December 31, 2001. At December 31, 2001, we had consolidated cash and cash equivalents totaling $3,110,000 (excluding $250,000) in restricted cash) and working capital of $5,734,900. The decrease in working capital is primarily due to an increase in accounts payable.

Net cash used in operating activities during the nine months ended September 30, 2002 was $233,600, which principally reflected the net loss incurred during the period, and an increase in inventories, which was partially offset by an increase in accounts payable and a decrease in accounts receivable. On June 12, 2002, the Company received a Federal income tax refund of $1,034,700.

Net cash used by investing activities during the nine months ended September 30, 2002 was $102,300, resulting from the purchases of property and equipment of $128,000 and an increase of $22,700 in deposits and other assets. These uses were partially offset by the proceeds from the sale of property and equipment.

Net cash used in financing activities was $106,700 for the nine months ended September 30, 2002, primarily due to net decreases in the floor plan inventory loans and principal payments on the mortgages on our office facility. This was partially offset by the net proceeds of $477,500 from the issuance of preferred stock.

On July 13, 2001, PMI and PMIGA (the Companies) obtained a new $4 million (subject to credit and borrowing base limitations) accounts receivable and inventory financing facility from Transamerica Commercial Finance Corporation (Transamerica). This credit facility has a term of two years, subject to automatic renewal from year to year thereafter. The credit facility can be terminated by either party upon 60 days' prior written notice and immediately if the Companies lose the right to sell or deal in any product line of inventory. The Companies are subject to an early termination fee equal to 1% of the then established credit limit. The facility includes a $2.4 million inventory line (subject to a borrowing base of up to 85% of eligible accounts receivable plus up to $1,500,000 of eligible inventories), a $600,000 working capital line and a $1 million letter of credit facility used as security for inventory purchased on terms from vendors in Taiwan. Borrowing under the inventory loans are subject to 30 to 60 days repayment, at which time interest begins to accrue at the prime rate, which was 4.75% at September 30, 2002. Draws on the working capital line also accrue interest at the prime rate.

Under the agreement, PMI and PMIGA granted Transamerica a security interest in all of their accounts, chattel paper, cash, documents, equipment, fixtures, general intangibles, instruments, inventories, leases, supplier benefits and proceeds of the foregoing. The Companies are also required to maintain certain financial covenants. As of December 31, 2001, the Companies were in violation of the minimum tangible net worth covenant. On March 6, 2002, Transamerica issued a waiver of the default and revised the covenants under the credit agreement retroactively to September 30, 2001. The revised covenants require the Companies to maintain certain financial ratios and to achieve certain levels of profitability. As of December 31, 2001 and March 31, 2002, the Companies were in compliance with these revised covenants. As of June 30, 2002, the Companies did not meet the revised minimum tangible net worth and profitability covenants, giving Transamerica, among other things, the right to call the loan and immediately terminate the credit facility.

On October 23, 2002, Transamerica issued a waiver of the default occurring on June 30, 2002 and revised the terms and covenants under the credit agreement. Under the revised terms, the credit facility includes FNC as an additional borrower and PMIC continues as a guarantor. Effective October 2002, the new credit limit was reduced to $3 million in aggregate for inventory loans and the letter of credit facility. The letter of credit facility is limited to $1 million. The credit limits for PMI and FNC are $1,750,000 and $250,000,

respectively. As of September 30, 2002, there were outstanding draws of $990,800 on the credit facility. As of September 30, 2002, the Companies did not meet the covenants as revised on October 23, 2002 relating to profitability and tangible net worth, constituting a technical default. This gives Transamerica, among other things, the right to call the loan and immediately terminate the credit facility. We are currently in discussions with Transamerica to obtain a waiver of the covenant default. There is no assurance that a waiver will be obtained from Transamerica nor that the covenants will be revised with terms favorable to us.

In March 2001, FNC obtained a $2 million discretionary credit facility from Deutsche Financial Services Corporation (Deutsche) to purchase inventory. To secure payment, Deutsche obtained a security interest in all of FNC's inventory, equipment, fixtures, accounts, reserves, documents, general intangible assets and all judgments, claims, insurance policies, and payments owed or made to FNC. Under the loan agreement, all draws matured in 30 days. Thereafter, interest accrued at the lesser of 16% per annum or at the maximum lawful contract rate of interest permitted under applicable law.

FNC was required to maintain certain financial covenants to qualify for the Deutsche bank credit line, and was not in compliance with certain of these covenants as of June 30, 2002 and December 31, 2001, which constituted a technical default under the credit line. This gave Deutsche the right to call the loan and terminate the credit line. The credit facility was guaranteed by PMIC and could be terminated by Deutsche immediately given the default. On April 30, 2002, Deutsche elected to terminate the credit facility effective July 1, 2002. Upon termination, the outstanding balance must be repaid in accordance with normal terms and provisions of the financing agreement. As of September 30, 2002, there were outstanding draws of $11,600 on the credit line. The entire outstanding balance was repaid on October 9, 2002.

Pursuant to one of our bank mortgage loans with a $2,393,700 balance at September 30, 2002, we are required to maintain certain financial covenants. During 2001, we were in violation of a consecutive quarterly loss covenant and an EBITDA coverage ratio covenant, which is an event of default under the loan agreement that gives the bank the right to call the loan. A waiver of these loan covenant violations was obtained from the bank in March 2002, retroactive to September 30, 2001, and through December 31, 2002. As a condition for this waiver, we transferred $250,000 to a restricted account as a reserve for debt servicing. This amount has been reflected as restricted cash in the consolidated financial statements.

We presently have insufficient working capital to pursue our long-term growth plans with respect to expansion of our service and product offerings. We believe, however, that our existing cash, trade credits from suppliers, anticipated income tax refunds, and proceeds from issuance of additional preferred stock will satisfy our anticipated requirements for working capital to support our present operations through the next 12 months, provided we are able to maintain our existing credit lines or obtain comparable replacement credit facilities.

On May 31, 2002 we received net proceeds of $477,500 from the issuance of 600 shares of 4% Series A Preferred Stock. We expect an additional 400 shares will be issued in the fourth quarter 2002. Even though we have completed the required registration of the underlying common stock in October 2002, there is no assurance these remaining 400 shares will be sold or that we will be able to obtain additional capital beyond the issuance of these 1,000 shares of Preferred stock. Upon the occurrence of a Triggering Event, such as the Company were a party in a "Change of Control Transaction," among others, as defined, the holder of the preferred stock has the rights to require us to redeem its preferred stock in cash at a minimum of 1.5 times the Stated Value. As of September 30, 2002, the redemption value of the Series A Preferred Stock, if the holder had required us to redeem the Series A Preferred Stock as of that date, was $912,200. Even though we do not expect those Triggering Events will occur, there is no assurance that those events will not occur. In the event we are required to redeem our Series A Preferred Stock in cash, we might experience a reduction in our ability to operate the business at the current level.

We are actively seeking additional capital to augment our working capital and to finance our new business. However, there is no assurance that we can obtain such capital, or if we can obtain capital that it will be on terms that are acceptable to us.

Our stock is currently traded on the Nasdaq SmallCap Market. On August 19, 2002 we received a letter from the Nasdaq Stock Market informing us that we did not meet the criteria for continued listing on the Nasdaq SmallCap Market. The letter stated that Nasdaq will monitor our common stock and if it closes above $1.00 for a minimum of ten consecutive trading days, Nasdaq will notify us of our compliance with its continued listing standards. If we do not meet the

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continued listing standards by February 18, 2003, Nasdaq will evaluate whether we meet the initial listing criteria of the SmallCap Market. If we do not, Nasdaq will inform us of its intent to delist our common stock. If we do, Nasdaq will provide an additional 180 days to come into compliance with the continued listing criteria. If we still do not meet the continued listing criteria at the end of the additional period, Nasdaq will inform us of its intent to delist our common stock. We cannot assure you that we will meet any of such deadlines or criteria. If our common stock is delisted, the market for our common stock will decline and it will be more difficult to trade in our common stock, which will likely cause a decrease in the price of our common stock.

RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2002, the Company made short-term salary advances to a shareholder/officer totaling $30,000, without interest. These advances were recorded as a bonus to the shareholder/officer during the second quarter ended June 30, 2002.

We sell computer products to a company owned by a member of our Board of Directors. Management believes that the terms of these sales transactions are no more favorable than given to unrelated customers. For the nine months ended September 30, 2002, and 2001, the Company recognized $494,400 and $476,200, respectively, in sales revenues from this customer. Included in accounts receivable as of September 30, 2002 is $96,300 due from this related customer.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2000, the EITF reached a consensus on Issue 00-14, "Accounting for Certain Sales Incentives." This issue addresses the recognition, measurement and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or are exercisable by a customer as a result of, a single exchange transaction. In April 2001, the EITF reached a consensus on Issue 00-25, "Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services." This issue addresses the recognition, measurement and income statement classification of consideration, other than that directly addressed by Issue 00-14, from a vendor to a retailer or wholesaler. Issue 00-25 is effective for the Company's 2002 fiscal year. Both Issue 00-14 and 00-25 have been codified under Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products." The adoption of Issue 01-09 during the first quarter of 2002 did not have a material impact on the Company's financial position or results of operations.

In June 2001, the Financial Accounting Standards Board finalized SFAS No. 141, BUSINESS COMBINATIONS, and No.142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS No. 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS No. 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS No. 142 that the Company reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS No. 141. The Company recorded its acquisition of Technical Insights and LiveMarket in September and October 2001 in accordance with SFAS No. 141 and did not recognize any goodwill relating to these transactions. However, certain intangibles totaling $59,400, including intellectual property and vendor reseller agreements, were identified and recorded in the consolidated financial statements in deposits and other assets.

SFAS No. 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS No. 142 requires that the Company identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS No. 142. SFAS No. 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS No. 142 requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS No. 142. The adoption of SFAS No. 142 did not have a material effect on the Company's financial position, results of operations or cash flows since the value of intangibles recorded is relatively insignificant and no goodwill has been recognized.

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In August 2001, the FASB issued SFAS No. 143 Accounting for Obligations associated with the Retirement of Long-Lived Assets. SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. SFAS No. 143 states that companies should recognize the asset retirement cost, at its fair value, as part of the cost asset and classify the accrued amount as a liability in the balance sheet. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the ability would be subsequently updated for revised estimates of the discounted cash outflows. SFAS No. 143 will be effective for fiscal years beginning after June 15, 2002. The Company does not expect the adoption of SFAS No. 143 to have a material effect on its financial position, results of operations, or cash flows.

In October 2001, the FASB issued SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes the SFAS No. 121 by requiring that one accounting model to be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by broadening the presentation of discontinued operation to include more disposal transactions. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The adoption of SFAS No. 144 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Statement of Financial Accounting Standards No. 145, "Rescission of SFAS Statements No. 4, 44, and 64, Amendment of SFAS Statement No. 13, and Technical Corrections" ("SFAS 145"), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt." SFAS 145 amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No. 4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. The Company does not expect the adoption of SFAS No. 145 to have a material effect on its financial position, results of operations, or cash flows.

Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 replaces Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of SFAS 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS No. 146 to have a material effect on its financial position, results of operations, or cash flows.

INFLATION

Inflation has not had a material effect upon our results of operations to date. In the event the rate of inflation should accelerate in the future, it is expected that to the extent increased costs are not offset by increased revenues, our operations may be adversely affected.

CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS

WE HAVE INCURRED OPERATING LOSSES AND DECREASED REVENUES RECENTLY AND WE CANNOT ASSURE YOU THAT THIS TREND WILL CHANGE. We incurred net losses for the year ended December 31, 2001 and the nine months ended September 30, 2002 of $2,850,700 and $2,310,300, respectively, and we may continue to incur losses. In addition, our revenues decreased 15.6% during the year ended December 31, 2001 as compared to the corresponding period in 2000 and 8.1% for the nine months ended September 30, 2002 as compared to the corresponding period in 2001. Our future ability to execute our business plan will depend on our efforts to increase revenues and return to profitability. We have implemented plans to reduce overhead and operating costs (such as reducing our labor costs), and to build upon our existing business and capture new business. No assurance can be given, however, that these actions will result in increased revenues, decreased expenses, and profitable operations, which may have an adverse impact on our ability to execute our business plan.

WE CAN PROVIDE NO ASSURANCE THAT WE WILL BE ABLE TO SECURE ADDITIONAL CAPITAL REQUIRED BY OUR BUSINESS. We recently completed a private placement of 600 shares of our Series A Convertible Preferred Stock with net proceeds of $477,500. We expect to complete the sale of an additional 400 shares of Series A

Preferred Stock for gross proceeds of approximately $370,000 in the fourth quarter 2002. Based on our present operations, we anticipate that our working capital, including the $477,500 raised in our recent placement, the $370,000 expected to be raised in the fourth quarter 2002 and the income tax refunds to be received in 2003, will satisfy our working capital needs for the next twelve months, provided we are able to maintain our existing credit lines or obtain comparable replacement credit facilities. If we fail to raise additional working capital prior to the end of that time or if the sale of the additional 400 shares of Series A Preferred Stock is not completed in a timely manner, we will be unable to pursue our business plan involving expansion of our service and product offerings. We must obtain additional financing to continue to expand our distribution business, and to develop our FNC business. We can give no assurance that we will be able to obtain additional capital when needed or, if available, that such capital will be available at terms acceptable to us.

WE HAVE VIOLATED CERTAIN FINANCIAL COVENANTS CONTAINED IN TWO OF OUR CURRENT LOANS AND MAY DO SO AGAIN IN THE FUTURE. We have a mortgage on our offices with Wells Fargo Bank under which we must maintain certain financial covenants. They are:

1) Our total liabilities must not be more than twice our tangible net worth;

2) Our net income after taxes must not be less than one dollar on an annual basis and for net losses no more than two consecutive quarters; and

3) We must maintain annual EBITDA of one and one half times our debt service.

We are currently in violation of covenants number 2 and 3 above, but we have received a waiver for such violation through the end of 2002.

Our subsidiaries, PMI, PMIGA and FNC also have a flooring line with Transamerica Commercial Finance Corporation. We must also meet certain financial covenants with respect to this line. These covenants are:

1) The combined total indebtedness of PMI and PMIGA and FNC may not exceed 3.25 times their tangible net worth on a quarterly basis;

2) The combined tangible net worth of PMI and PMIGA and FNC may not be less than $4,250,000;

3) The combined EBIT of PMI and PMIGA and FNC must be greater than $0 for the quarter ended September 30, 2002 and $275,000 for the quarter ended December 31, 2002.

We were in violation of our tangible net worth covenant (prior to revisions discussed below) as of December 31, 2001. However, Transamerica waived the violation and revised the credit agreement retroactively to September 30, 2001. We received a letter from Transamerica stating that PMI and PMIGA were in compliance with all of the above covenants as of March 31, 2002. We were also in violation of our tangible net worth covenant and the EBIT covenant as of June 30, 2002 which gave Transamerica, among other things, the right to call the loan and immediately terminate the credit facility. On October 23, 2002, Transamerica issued a waiver of the default as of June 30, 2002 and revised the terms and covenants under the credit agreement. Under the revised terms, PMIC continues as a guarantor of the loans and the credit facility and includes FNC as a borrower. The new credit limit was reduced to $3 million in aggregate for inventory loans and the letter of credit facility. The letter of credit facility is limited to $1 million. The credit limits for PMI and FNC are $1,750,000 and $250,000, respectively. As of September 30, 2002, the Companies did not meet the covenants as revised on October 23, 2002 relating to profitability and tangible net worth. This constitutes a technical default and gives Transamerica, among other things, the right to call the loan and immediately terminate the credit facility.

We cannot assure you that we will be able to meet all of these financial covenants in the future. If we fail to meet the covenants, the respective lenders may declare us in default and accelerate the loans. If that was to occur, we would be unable to continue our operations without replacement loans or other alternate financing.

OUR COMMON STOCK DOES NOT MEET THE REQUIREMENTS FOR CONTINUED LISTING ON THE NASDAQ SAMLLCAP MARKET. Our stock is currently traded on the Nasdaq SmallCap Market. On August 19, 2002 we received a letter from the Nasdaq Stock Market informing us that we did not meet the criteria for continued listing on the

Nasdaq SmallCap Market. The letter stated that Nasdaq will monitor our common stock and if it closes above $1.00 for a minimum of ten consecutive trading days, Nasdaq will notify us of our compliance with its continued listing standards. If we do not meet the continued listing standards by February 18, 2003, Nasdaq will evaluate whether we meet the initial listing criteria of the SmallCap Market. If we do not, Nasdaq will inform us of its intent to delist our common stock. If we do, Nasdaq will provide an additional 180 days to come into compliance with the continued listing criteria. If we still do not meet the continued listing criteria at the end of the additional period, Nasdaq will inform us of its intent to delist our common stock. We cannot assure you that we will meet any of such deadlines or criteria. If our common stock is delisted, the market for our common stock will decline and it will be more difficult to trade in our common stock, which will likely cause a decrease in the price of our common stock.

OUR FAILURE TO ANTICIPATE OR RESPOND TO TECHNOLOGICAL CHANGES COULD HAVE AN ADVERSE EFFECT ON OUR BUSINESS. The market for computer systems and products is characterized by constant technological change, frequent new product introductions and evolving industry standards. Our future success is dependent upon the continuation of a number of trends in the computer industry, including the migration by end-users to multi-vendor and multi-system computing environments, the overall increase in the sophistication and interdependency of computing technology, and a focus by managers on cost-efficient information technology management. These trends have resulted in a movement toward outsourcing and an increased demand for product and support service providers that have the ability to provide a broad range of multi-vendor product and support services. There can be no assurance these trends will continue into the future. Our failure to anticipate or respond adequately to technological developments and customer requirements could have a material adverse effect on our business, operating results and financial condition.

IF WE WERE UNABLE TO SECURE PRICE PROTECTION PROVISIONS IN OUR VENDOR AGREEMENTS, THE VALUE OF OUR INVENTORY WOULD QUICKLY DIMINISH. As a distributor, we incur the risk that the value of our inventory will be adversely affected by industry wide forces. Rapid technology change is commonplace in the industry and can quickly diminish the marketability of certain items, whose functionality and demand decline with the appearance of new products. These changes and price reductions by vendors may cause rapid obsolescence of inventory and corresponding valuation reductions in that inventory. We currently seek provisions in the vendor agreements common to industry practice that provide price protections or credits for declines in inventory value and the right to return unsold inventory. No assurance can be given, however, that we can negotiate such provisions in each of our contracts or that such industry practice will continue.

EXCESSIVE CLAIMS AGAINST WARRANTIES THAT WE PROVIDE COULD ADVERSELY AFFECT OUR BUSINESS. Our suppliers generally warrant the products that we distribute and allow us to return defective products, including those that have been returned to us by customers. We do not independently warrant the products that we distribute, except that we do warrant services provided in connection with the products that we configure for customers and that we build to order from components purchased from other sources. If excessive claims are made against these warranties our results of operations would suffer.

WE MAY NOT BE ABLE TO SUCCESSFULLY COMPETE WITH SOME OF OUR COMPETITORS. All aspects of our business are highly competitive. Competition within the computer products distribution industry is based on product availability, credit availability, price, speed and accuracy of delivery, effectiveness of sales and marketing programs, ability to tailor specific solutions to customer needs, quality and breadth of product lines and services, and the availability of product and technical support information. We also compete with manufacturers that sell directly to resellers and end-users.

Competition within the corporate information systems industry is based primarily on flexibility in providing customized network solutions, resources and contracts to provide products for integrated systems and consultant and employee expertise needed to optimize network performance and stability.

A number of our competitors in the computer distribution industry, and most of our competitors in the information technology consulting industry, are substantially larger and have greater financial and other resources than we do.

FAILURE TO RECRUIT AND RETAIN TECHNICAL PERSONNEL WILL HARM OUR BUSINESS. Our success depends upon our ability to attract, hire and retain technical personnel who possess the skills and experience necessary to meet our personnel needs and staffing requirements of our clients. Competition for individuals with proven technical skills is intense, and the computer industry in general experiences a

high rate of attrition of such personnel. We compete for such individuals with other systems integrators and providers of outsourcing services, as well as temporary personnel agencies, computer systems consultants, clients and potential clients. Failure to attract and retain sufficient technical personnel would have a material adverse effect on our business, operating results and financial condition.

WE DEPEND UPON CONTINUED CERTIFICATION FROM CERTAIN OF OUR SUPPLIERS. The future success of FNC depends in part on our continued certification from leading manufacturers. Without such authorizations, we would be unable to provide the range of services currently offered. There can be no assurance that such manufacturers will continue to certify us as an approved service provider, and the loss of one or more of such authorizations could have a material adverse effect on FNC and thus to our business, operating results and financial condition.

WE DEPEND ON KEY SUPPLIERS FOR A LARGE PORTION OF OUR INVENTORY, LOSS OF THOSE SUPPLIERS COULD HARM OUR BUSINESS. One supplier, Sunnyview/CompTronic, accounted for approximately 9%, 10%, 16% and 20% of our total purchases for the nine months ended September 30, 2002 and for the years ended December 31, 2001, 2000 and 1999, respectively. During the year ended December 31, 1999, one additional supplier located in Taiwan accounted for approximately 11% of our total purchases. Although we have not experienced significant problems with suppliers, there can be no assurance that such relationships will continue or, in the event of a termination of our relationship with any given supplier, that we would be able to obtain alternative sources of supply on comparable terms without a material disruption in our ability to provide products and services to our clients. This may cause a possible loss of sales that could adversely affect our business, financial condition and operating results.

IF A CLAIM IS MADE AGAINST US IN EXCESS OF OUR INSURANCE LIMITS WE WOULD BE SUBJECT TO POTENTIAL EXCESS LIABILITY. The nature of our corporate information systems engagements expose us to a variety of risks. Many of our engagements involve projects that are critical to the operations of a client's business. Our failure or inability to meet a client's expectations in the performance of services or to do so in the time frame required by such client could result in a claim for substantial damages, regardless of whether we were responsible for such failure. We are in the business of employing people and placing them in the workplace of other businesses. Therefore, we are also exposed to liability with respect to actions taken by our employees while on assignment, such as damages caused by employee errors and omissions, misuse of client proprietary information, misappropriation of funds, discrimination and harassment, theft of client property, other criminal activity or torts and other claims. Although we maintain general liability insurance coverage, there can be no assurance that such coverage will continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, operating results and financial condition.

WE ARE DEPENDENT ON KEY PERSONNEL. Our continued success will depend to a significant extent upon our senior management, including Theodore Li, President and Hui Cynthia Lee, Executive Vice President and head of sales operations, and Steve Flynn, general manager of FrontLine. The loss of the services of Messrs. Li or Flynn or Ms. Lee, or one or more other key employees, could have a material adverse effect on our business, financial condition or operating results. We do not have key man insurance on the lives of any of members of our senior management.

WE CANNOT ASSURE YOU THAT OUR PURSUIT OF NEW BUSINESS THROUGH LIVEMARKET WILL BE SUCCESSFUL. We have limited experience in developing commercial software products. While we have experience in marketing computer related products, we have not marketed software or a proprietary line of our own products. This market is very competitive and nearly all of the software publishers or distributors with whom Lea/LiveMarket will compete have greater financial and other resources than Lea/LiveMarket. Presently we are exploring the opportunities to sell this line of business. There can be no assurance that Lea/LiveMarket will generate a profit.

WE ARE SUBJECT TO RISKS BEYOND OUR CONTROL SUCH AS ECONOMIC AND GENERAL RISKS OF OUR BUSINESS. Our success will depend upon factors that may be beyond our control and cannot clearly be predicted at this time. Such factors include general economic conditions, both nationally and internationally, changes in tax laws, fluctuating operating expenses, changes in governmental regulations, including regulations imposed under federal, state or local environmental laws, labor laws, and trade laws and other trade barriers.

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ESTABLISHMENT OF OUR NEW BUSINESS-TO-CONSUMER WEBSITE LIVEWAREHOUSE.COM MAY NOT BE SUCCESSFUL. We have established a new business-to-consumer website, LiveWarehouse.com. While sales from this segment have been increasing, we cannot assure you that we will achieve market acceptance for this project and achieve a profit, that we will be able to hire and retain personnel with experience in online retail marketing and management, that we will be able to execute our business plan with respect to this market segment or that we will be able to adapt to technological changes once operational. Further, while we have experience in the wholesale marketing of computer-related products, we have no experience in retail marketing. This market is very competitive and some of our competitors have substantially greater resources than we have.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk for changes in interest rates relates primarily to one of our bank mortgage loans with a $2,393,700 balance at September 30, 2002 which bears fluctuating interest based on the bank's 90-day LIBOR rate. In addition, our flooring and working capital line bears interest at the bank's prime rate. However, interest expenses incurred in connection with this financing agreement have historically been insignificant. We believe that fluctuations in interest rates in the near term would not materially affect our consolidated operating results. We are not exposed to material risk based on exchange rate fluctuation or commodity price fluctuation.

ITEM 4. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this Form 10-Q, we carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer and other accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-14 of the Securities Exchange Act of 1934. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer and other accounting officer, concluded that our disclosure controls and procedures were effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) required to be included in this quarterly report Form 10-Q. There have been no significant changes in our internal controls and procedures or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

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PART II

ITEM 1. LEGAL PROCEEDINGS.

We are not involved as a party to any legal proceeding other than various claims and lawsuits arising in the normal course of our business, none of which, in our opinion, is individually or collectively material to our business.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On May 31, 2002 the Company entered into a Preferred Stock Purchase Agreement with an investor (Investor). Under the agreement, the Company agreed to issue 1,000 shares of its Series Preferred Stock at $1,000 per share. On May 31, 2002, the Company issued 600 shares of the Series A Preferred Stock to the Investor. the Company expects the remaining 400 shares to be issued in the fourth quarter 2002 as the last condition precedent to the sale, the effectivity of a registration statement that registers the common stock underlying the Series A Preferred Stock, has been completed. As part of the Preferred Stock Purchase Agreement, the Company issued a common stock purchase warrant to the Investor. The warrant may be exercised at any time within 3 years from the date of issuance and entitles the Investor to purchase of 300,000 shares of the Company's common stock at $1.20 per share and includes a cashless exercise provision. The Company also issued a common stock purchase warrant with the same terms and condition for the purchase of 100,000 shares of the Company's common stock to a broker who facilitated the transaction as a commission. The Series A Preferred Stock and the related warrants were issued under the exemption provided by Section 4(2) of the Securities Act of 1933.

ITEM 5. OTHER INFORMATION

Effective June 17, 2002, the Board of Directors appointed Raymond M. Crouse to the Board and as the chairman of the Audit Committee. Mr. Crouse, age 43, is a Director of Litigation & Recovery of De Lage Landen Financial Services.

ITEM 6. - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit	Description	Reference
3.1	Articles of Incorporation	(1)

3.2	Bylaws, as amended and restated	(1)
4.1	Certificate of Designations for theSeries A Preferred Stock	(2)
10.1	Securities Purchase Agreement dated May 31, 2002, between the Company and Stonestreet L.P.	(2)
10.2	Registration Rights Agreement dated May 31, 2002, between the Company and Stonestreet, L.P.	(2)
10.3	Escrow Agreement dated May 31, 2002, between the Company, Feldman Weinstein LLP and Stonestreet L.P.	(2)
10.4	Stock Purchase Warrant dated May 31, 2002 issued to Stonestreet L.P.	(2)
10.5	Stock Purchase Warrant dated May 31, 2002 issued to M.H. Meyerson	(2)
10.6	Amendment No. 2 to Accounts Receivable and Inventory Financing Agreement by and between Transamerica Commercial Finance Corporation and Pacific Magtron, Inc. and Pacific Magtron (GA), Inc.	(3)
10.6	Amendment No. 1 to Accounts Receivable and Inventory Financing Agreement by and between Transamerica Commercial Finance Corporation and Pacific Magtron, Inc. and Pacific Magtron (GA), Inc.	(3)

10.6	Amendment No. 3 to Accounts Receivable and Inventory Financing Agreement by and between Transamerica Commercial Finance Corporation and Pacific Magtron, Inc. and Pacific Magtron (GA), Inc.	*
99.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	*

(1) Incorporated by reference from the Company's registration statement on Form 10SB-12G filed January 20, 1999.

(2) Incorporated by reference from the Company's current report on Form 8-K filed June 13, 2000.

(3) Filed with Form 10-K, dated December 31, 2001, and incorporated herein by reference.

* Filed herewith

(b) Reports on Form 8-K

The Company filed a current report on Form 8-K on June 30, 2002 under Item 5 reporting the sale of its Series A Preferred Stock in a private placement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, this 14th day of November 2002.

PACIFIC MAGTRON INTERNATIONAL CORP.,
a Nevada corporation

By /s/ Theodore S. Li

Theodore S. Li
President and Chief Financial Officer

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CERTIFICATION

I, Theodore Li, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pacific Magtron International Corp.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

By: /s/ Theodore S. Li

Theodore S. Li
Chief Executive Officer/Chief
Financial Officer