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METATEC INTERNATIONAL INC
Form 10-Q
April 30, 2001

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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2001

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 No. 0-9220

METATEC INTERNATIONAL, INC.
(Exact name of Registrant as specified in its charter)

OHIO
(State of Incorporation)

31-1647405
(IRS Employer Identification No.)

7001 Metatec Boulevard
Dublin, Ohio
(Address of principal executive offices)

43017
(Zip code)

Registrant's telephone number, including area code: (614) 761-2000

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, and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Number of Common Shares outstanding as of April 30, 2001: 6,136,113

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METATEC INTERNATIONAL, INC.

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PART I - FINANCIAL INFORMATION

ITEM I. CONDENSED FINANCIAL STATEMENTS

METATEC INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)	At March 31,
	2001
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 4,846,498
Accounts receivable, net of allowance for doubtful accounts of \$279,000 and \$351,000	12,598,567
Inventory	2,918,302
Prepaid expenses	1,454,835
Deferred income taxes	588,107
Total current assets	22,406,309
Property, plant and equipment - net	48,197,691
Goodwill - net	4,288,978
Other assets	281,417
Deferred income taxes	104,000
TOTAL ASSETS	\$75,278,395

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LIABILITIES & SHAREHOLDERS' EQUITY

Current liabilities:	
Accounts payable	\$ 4,740,556
Accrued expenses:	
Royalties	4,130,077
Personal property taxes	1,609,115
Payroll	586,340
Other	1,638,308
Unearned income	178,660
Current maturities of long-term real estate debt	173,598
Current maturities of other long-term debt and capital lease obligations	15,928,028
Total current liabilities	28,984,682
Long-term real estate debt	18,579,249
Other long-term debt and capital lease obligations, less current maturities	9,243,846
Other long-term liabilities	567,381
Total liabilities	57,375,158
Shareholders' equity:	
Common stock - no par value; authorized 10,000,000 shares; issued 2001 - 7,217,855, 2000 - 7,177,855 shares	35,031,138
Accumulated deficit	(9,499,962)
Accumulated other comprehensive loss	(1,770,402)
Treasury stock, at cost; 1,081,742 shares	(5,822,537)
Unamortized restricted stock	(35,000)
Total shareholders' equity	17,903,237
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	\$75,278,395

See notes to consolidated financial statements.

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METATEC INTERNATIONAL, INC. CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months
	2001
NET SALES	\$21,048,545
Cost of sales	15,306,172
Gross profit	5,742,373
Selling, general and administrative expenses	6,647,554
Restructuring expenses	109,564

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OPERATING EARNINGS (LOSS)	(1,014,745)
Other income and (expense):	
Investment income	35,046
Interest expense	(946,901)
LOSS BEFORE INCOME TAXES	(1,926,600)
Income tax benefit	0
NET LOSS	\$ (1,926,600)
NET LOSS PER COMMON SHARE	
Basic and diluted	\$ (0.31)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	
Basic and diluted	6,135,669

See notes to condensed consolidated financial statements.

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METATEC INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock
BALANCE AT DECEMBER 31, 2000	\$34,991,138	\$ (7,573,362)	\$ (1,423,362)	\$ (5,822,000)
Comprehensive Loss:				
Net loss		(1,926,600)		
Foreign currency translation adjustments			(347,040)	
Comprehensive loss				
Issuance of restricted shares	40,000			
Amortization of restricted stock				
BALANCE AT MARCH 31, 2001	\$35,031,138	\$ (9,499,962)	\$ (1,770,402)	\$ (5,822,000)

See notes to consolidated financial statements.

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METATEC INTERNATIONAL, INC.

 CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the three months ended March 31,

2001

2000

 CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$ (1,926,600)	\$ (16,380,000)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	2,778,346	3,660,000
Deferred income taxes	18,711	5,000
Net gain on sales of property, plant and equipment	(1,852)	(1,000)
Changes in assets and liabilities:		
Accounts receivable	2,415,418	2,480,000
Inventory	40,114	1,000
Prepaid expenses and other assets	(418,092)	(380,000)
Accounts payable and accrued expenses	(930,400)	(2,380,000)
Unearned income	(46,128)	10,000
Net cash provided by operating activities	1,929,517	3,380,000

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchase of property, plant and equipment	(551,243)	(2,170,000)
Proceeds from the sales of property, plant and equipment	3,000	1,000
Net cash used in investing activities	(548,243)	(2,150,000)

CASH FLOWS FROM FINANCING ACTIVITIES:

Increase in long-term debt	3,450,000	750,000
Payment of long-term debt and capital lease obligations	(2,066,608)	(2,570,000)
Stock options exercised	0	0
Net cash provided by (used in) financing activities	1,383,392	(1,810,000)

Effect of exchange rate on cash	(4,396)	130,000
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Increase (decrease) in cash and cash equivalents	2,760,270	(460,000)
Cash and cash equivalents at beginning of period	2,086,228	1,690,000

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 4,846,498	\$ 1,230,000
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SUPPLEMENTAL CASH FLOW DISCLOSURES:

Interest paid	\$ 854,645	\$ 1,030,000
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Income taxes paid/(refunds received)	\$ (122,267)	\$ 0
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Assets purchased by the assumption of a liability	\$ 123,230	\$ 440,000
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Issuance of restricted stock

\$ 35,000
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See notes to condensed consolidated financial statements.

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METATEC INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of presentation - The condensed consolidated balance sheet as of March 31, 2001, the condensed consolidated statements of operations for the three months ended March 31, 2001 and 2000, the condensed consolidated statement of shareholders' equity for the three months ended March 31, 2001, and the condensed consolidated statements of cash flows for the three month periods then ended have been prepared by the Company, without audit. In the opinion of management, all adjustments, which consist solely of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position, results of operations and changes in cash flows for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's December 31, 2000 annual report on Form 10-K. The results of operations for the period ended March 31, 2001 are not necessarily indicative of the results for the full year.

Income taxes - In 2001, a valuation allowance has been provided to offset a portion of the net deferred tax assets due to the uncertainty surrounding the realizability of such assets.

Derivative Instruments and Hedging Activities - The Company adopted Statement of Financial Accounting Standards (SFAS) No. 133 on January 1, 2001. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The adoption of SFAS 133 did not have a significant impact on the financial position, results of operations, or cash flows of the Company.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2001 COMPARED TO THREE MONTHS ENDED MARCH 31, 2000

RESULTS OF OPERATIONS

Net sales for the three months ended March 31, 2001 were \$21,049,000, a decrease of \$6,589,000, or 24% over the same period of the prior year. This decrease resulted primarily from CD-ROM manufacturing sales decreasing \$6,328,000 to \$19,651,000 for the three months ended, or 24%. This decrease was due to several factors. The pricing for CD-ROM products and services continued to decline or remained at low levels industry-wide due to excess manufacturing capacity, a

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trend the Company anticipates will continue for the remainder of 2001. In addition, the demand for the Company's CD-ROM products and services declined due to several factors, including a decline in general economic conditions which caused many of the Company's software customers to delay or reduce their software

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releases, the continued increase in customers using on-line or electronic methods to distribute information, and the continued maturation of the CD-ROM market. The Company anticipates that these factors may continue to negatively impact the demand for the Company's CD-ROM products and services for the remainder of 2001. Radio syndication sales decreased \$456,000, or 54%, to \$386,000 for the three months ended March 31, 2001, primarily as a result of some customers choosing to use CD-Recordable as a distribution method for smaller size orders. The Company expects this trend to continue for the foreseeable future. DVD sales accounted for \$613,000 during the three months ended March 31, 2001, as compared to \$489,000 for the same period in the prior year.

Gross profit was 27% of net sales for the three months ended March 31, 2001 as compared to 30% of net sales for the same period of the prior year. This reduction was primarily caused by reduced utilization of the Company's manufacturing capacity.

Selling, general and administrative ("SG&A") expenses were \$6,648,000, or 32% of net sales, for the three months ended March 31, 2001 as compared to \$6,987,000, or 25% of net sales, for same period of the prior year. The increase in SG&A expenses as a percentage of net sales was primarily caused by the 24% decrease in net sales in relation to a 5% decrease in SG&A expenses.

Restructuring expenses of \$110,000 were incurred during the three months ended March 31, 2001. These restructuring expenses consisted primarily of severance and termination benefits related to the U.S. workforce reduction of approximately 6%. The workforce reduction was accomplished through attrition, unfilled vacancies, and layoffs of temporary and some full time employees. Restructuring expenses of \$430,000 related to U.S. workforce reductions of approximately 12% were incurred for the same period in the prior year.

Investment income was \$35,000 and \$11,000 for the three month periods ended March 31, 2001 and 2000, respectively.

Interest expense for the three months ended March 31, 2001 was \$947,000 as compared to \$1,056,000 for the same period of the prior year. The decrease in interest expense was due to decreased borrowings under revolving loan and term loan facilities, as well as decreases in interest rates.

No income tax benefit was realized for the three months ended March 31, 2001, due to the uncertainty of realizing the value of such benefit. In the prior year a \$136,000 income tax benefit was realized resulting in an effective tax rate of 45%.

Based upon the foregoing, the net loss for the three months ended March 31, 2001 was \$1,927,000, or net loss per basic or diluted common share of \$.31, as compared to a net loss in the same period of the prior year of \$168,000, or net loss per basic or diluted common share of \$.03.

FINANCIAL CONDITION - LIQUIDITY AND CAPITAL RESOURCES

The Company financed its business during the three months ended March 31, 2001 through cash generated from operations, the use of debt, and the use of

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available cash balances. Cash flow from operating activities was \$1,930,000 for the three months ended March 31, 2001, as compared to \$3,385,000 for the three months ended March 31, 2000. The Company had cash and cash equivalents of \$4,846,000 as of March 31, 2001.

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The Huntington National Bank and Bank One, NA have provided a \$37,000,000 term loan facility and a \$13,000,000 revolving loan facility to the Company (the "Credit Facilities"). As of March 31, 2001, \$12,958,000 and \$10,950,000 was outstanding under the term loan facility and the revolving loan facility, respectively.

On April 2, 2001, the banks and the Company amended certain terms and financial covenants of the Credit Facilities. The following is a summary of the terms of the amended Credit Facilities. As part of the amended Credit Facilities, the revolving loan and the term loan will mature on April 1, 2002. The revolving loan has been changed to an asset based lending arrangement wherein a \$13,000,000 borrowing base will be limited by the amounts of any outstanding letters of credit and 80% of eligible domestic accounts receivable, 80% of eligible insured foreign accounts receivable, 30% of eligible domestic inventory, and 20% of domestic machinery and equipment at net book value, eligibility to be determined by the banks. The Credit Facilities are secured by a first lien on all non-real estate business assets of the Company and a pledge of the stock of the Company's subsidiaries. The Company is required to comply with certain financial and other covenants. In addition, effective March 31, 2001, interest accrues at 2% in excess of the prime rate of the banks, and quarterly commitment fees are required to be paid. The Company expects that it will be able to negotiate a new borrowing facility prior to April 1, 2002, however, there can be no assurance that the Company will be able to do so.

The Company has a \$19,000,000 loan facility with Huntington Capital Corp which is payable in monthly principal and interest payments based upon a thirty year amortization schedule and bears interest at a fixed rate of 8.2%. This term loan facility was used to permanently finance the Company's new Dublin, Ohio distribution center and to pay down other bank debt. This loan facility is payable in monthly installments over 10 years, with a 30 year amortization period, and is secured by a first lien on all real property of the Company and letters of credit in favor of the lender, in an aggregate amount of \$1,650,000.

Management believes that current cash balances, plus the funds available under its current credit facilities, plus cash to be generated from future operations should provide sufficient capital to meet the current business needs of the Company.

During the first quarter 2001, the Company's board of directors approved a plan to restructure certain of the Company's operations. As part of the plan, the Company implemented a workforce reduction for its Dublin facility during the first quarter of 2001, and the Company expects to implement other portions of this plan during the remainder of 2001.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995
Statements contained in this Form 10-Q or any other reports or documents prepared by the Company or made by management of the Company may be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause the Company's operating results to differ materially from those projected. Forward-looking statements include, by way of example and without limitation, statements concerning plans, objectives, goals, strategies, future events of performance and underlying assumptions and other

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statements, which are other than statements of historical facts, and information concerning future results of the operations of the Company. Forward-looking statements may be identified, preceded by, followed by or otherwise include, without limitation, words such as "believes," "expects," "anticipates," "intends," "estimates" or similar expressions. Such forward-looking statements are subject to certain risks and uncertainties that could cause the Company's actual results to differ materially from

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those projected. Such risks and uncertainties that might cause such a difference include, but are not limited to, the Company's product concentration in CD-ROM manufacturing sales, a decrease in the demand for the Company's products caused by various factors, such as the continuation of customers increasing their electronic methods to distribute information rather than CD-ROM and the continuation of the maturing market for CD-ROM products, changes in general business and economic conditions, excess capacity levels in the CD-ROM industry, the introduction of new products by competitors, increased competition (including pricing pressures), changes in manufacturing efficiencies, changes in technology, and other risks indicated in the company's filings with the Securities and Exchange Commission, including Form 10-K for Metatec's year ended December 31, 2000.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

There is no change in the quantitative and qualitative disclosures about the Company' market risk from the disclosures contained in the Company's Form 10-K for its fiscal year ended December 31, 2000.

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PART II - OTHER INFORMATION

Items 1-5. Inapplicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit No. Description of Exhibit

10.1 Letter agreement dated March 30, 2001, among Metatec International, Inc., Metatec Worldwide, Inc., The Huntington National, Bank, and Bank One, NA.

(b) No reports on Form 8-K have been filed during the quarter ended March 31, 2001.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. Metatec International, Inc.

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/s/ Julia A. Pollner

Date: April 30, 2001

BY: Julia A. Pollner
Senior Vice President and
Secretary/Treasurer
(authorized signatory-
principal financial and
accounting officer)

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Exhibit Index

Exhibit Number	Description of Exhibit
10.1	Letter agreement dated March 30, 2001, among Metatec International, Inc., Metatec Worldwide, Inc., The Huntington National Bank, and Bank One, NA.