

CATALINA LIGHTING INC
Form 10-Q
February 14, 2003
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 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 0-49881

Catalina Lighting, Inc.

(Exact Name of Registrant as Specified in Its Charter)

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Florida
(State or Other Jurisdiction
of Incorporation or Organization)

59-1548266
(I.R.S. Employer
Identification No.)

18191 N.W. 68th Avenue

Miami, Florida
(Address of Principal Executive Offices)

33015
(Zip Code)

Registrant's Telephone Number, Including Area Code: (305) 558-4777

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

The number of shares of the registrant's common stock, \$.01 par value, outstanding as of the close of business on February 3, 2003 was 4,286,123.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

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Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(In thousands)**

	December 31, 2002	September 30, 2002
	(Unaudited)	(Audited)
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 1,742	\$ 2,657
Accounts receivable, net of allowance for doubtful accounts of \$543 and \$446, respectively	33,210	33,814
Inventories	36,699	34,511
Other current assets	4,520	5,660
	<u>76,171</u>	<u>76,642</u>
Total current assets	76,171	76,642
Property and equipment, net	17,768	18,102
Goodwill, net	28,282	28,282
Other intangible assets, net	2,200	2,634
Other assets, net	6,168	5,554
	<u>130,589</u>	<u>131,214</u>
Total assets	\$ 130,589	\$ 131,214

(Continued on Page 2)

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (continued)**

(In thousands, except share data)

	December 31, 2002	September 30, 2002
	(Unaudited)	(Audited)
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	\$ 29,487	\$ 29,498
Revolving credit facilities	8,750	1,477
Term loans	20,190	3,154
Current maturities of other long-term debt	235	340
Other current liabilities	13,897	13,700
	<u>72,559</u>	<u>48,169</u>
Total current liabilities	72,559	48,169
Revolving credit facilities	1,483	11,315
Term loans		17,574
Subordinated notes	2,863	2,804
Other long-term debt	685	721
Accrued pension and other liabilities	4,872	4,959
	<u>82,462</u>	<u>85,542</u>
Total liabilities	82,462	85,542
Minority interest	1,173	1,144
Stockholders equity		
Preferred stock, \$.01 par value authorized 1,000,000 shares; none issued		
Common stock, \$.01 par value authorized 20,000,000 shares; issued 4,414,260 shares; outstanding 4,285,873 shares	44	44
Additional paid-in capital	38,569	38,119
Retained earnings	9,770	7,623
Deferred compensation	(394)	
Accumulated other comprehensive income	1,426	1,203
Treasury stock, at cost, 128,387 shares	(2,461)	(2,461)
	<u>46,954</u>	<u>44,528</u>
Total stockholders equity	46,954	44,528
	<u>\$ 130,589</u>	<u>\$ 131,214</u>

See accompanying notes to condensed consolidated financial statements.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share data)

	Three Months Ended December 31,	
	2002	2001
Net sales	\$ 56,170	\$ 56,154
Cost of sales	44,591	46,236
Gross profit	11,579	9,918
Selling, general and administrative expenses	7,267	8,224
Operating income	4,312	1,694
Other expenses:		
Interest expense	(1,033)	(1,993)
Other income	25	11
Total other income (expenses)	(1,008)	(1,982)
Income (loss) before income taxes	3,304	(288)
Income tax expense (benefit)	1,157	(92)
Net income (loss)	\$ 2,147	\$ (196)
Weighted average number of shares outstanding		
Basic	5,555	3,176
Diluted	5,809	3,176
Earnings (loss) per share		
Basic	\$ 0.39	\$ (0.06)
Diluted	\$ 0.37	\$ (0.06)

See accompanying notes to condensed consolidated financial statements.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows****(Unaudited)****(In thousands)**

	Three Months Ended	
	December 31,	
	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 2,147	\$ (196)
Adjustments for non-cash items	892	1,751
Change in assets and liabilities	101	1,283
	<u>3,140</u>	<u>2,838</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(366)	(190)
Proceeds from sale of property and equipment	108	141
Decrease (increase) in restricted cash equivalents and short-term investments		(2)
	<u>(258)</u>	<u>(51)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on other long-term debt	(144)	(312)
Net payments on revolving credit facilities	(2,553)	(3,791)
Payments on term loans	(802)	(203)
Sinking fund redemption payments on bonds payable		(225)
	<u>(3,499)</u>	<u>(4,531)</u>
Effect of exchange rate changes on cash	(298)	16
Net decrease in cash and cash equivalents	(915)	(1,728)
Cash and cash equivalents at beginning of period	2,657	4,613
Cash and cash equivalents at end of period	<u>\$ 1,742</u>	<u>\$ 2,885</u>

Supplemental Cash Flow Information

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	Three Months Ended	
	December 31,	
	2002	2001
	(In thousands)	
Cash paid (refunded) for:		
Interest	\$ 686	\$ 948
Income taxes	\$ 161	\$ (142)

During the three months ended December 31, 2001, the Company issued warrants valued at \$36,000 as additional interest expense on subordinated debt.

See accompanying notes to condensed consolidated financial statements.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****1. Summary of Significant Accounting Policies****Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of Catalina Lighting, Inc. and Subsidiaries (the Company) have been prepared in accordance with the accounting policies described in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2002 and should be read in conjunction with the consolidated financial statements and notes which appear in that report. These statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, the condensed consolidated financial statements include all adjustments (which consist mostly of normal, recurring accruals) considered necessary for a fair presentation. The results of operations for the three months ended December 31, 2002 may not necessarily be indicative of operating results to be expected for any subsequent quarter or for the full fiscal year due to seasonal fluctuations in the Company's business, changes in economic conditions and other factors.

Comprehensive Income (Loss)

Comprehensive income (loss) consisted of the following:

	Three Months Ended	
	December 31,	
	2002	2001
	(In thousands)	
Net income (loss)	\$ 2,147	\$ (196)
Foreign currency translation gain (loss)	223	(238)
Change in unrealized loss on derivative instrument, net of taxes		19
Total comprehensive income (loss)	\$ 2,370	\$ (415)

New Accounting Pronouncements

Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142) was issued in July 2001. SFAS 142 addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. SFAS 142 also addresses financial accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. With the adoption of SFAS 142, goodwill is no longer subject to amortization. Rather, goodwill will be subject to at least an annual assessment for impairment by applying a fair-value based test. The impairment loss is the amount, if any, by which the implied fair value of goodwill is less than carrying or book value. SFAS 142 is effective for fiscal years beginning after December 15, 2001. Impairment loss for goodwill arising from the initial application of SFAS 142 is to be reported as resulting from a change in accounting principles. As of December 31, 2002, the Company had not fully assessed the impact of adopting SFAS 142. Application of the non-amortization provisions of SFAS 142 will result in an increase in pretax income of approximately \$1.6 million per year (\$396,000 for the quarter ended December 31, 2002). The Company is in the process of completing a transitional fair value based impairment test. Preliminary results indicate that there will be no impairment of recorded goodwill. Should final results differ, the Company would need to report any such impairment loss.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Restructuring Costs (SFAS 146). SFAS 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (continued)

(Unaudited)

lines, terminating employees and contracts and relocating plant facilities or personnel. SFAS 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002, with earlier adoption encouraged. The Company does not believe the adoption of this standard will have a material impact on its financial statements.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* an amendment of FASB Statement No. 123 (SFAS 148). SFAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS 123 to require prominent disclosures about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. SFAS 148 also amends APB Opinion No. 28, *Interim Financial Reporting*, to require disclosures about those effects in interim financial information. The amendments to SFAS 123 in paragraphs 2(a)-2(e) of the statement are effective for financial statements for fiscal years ending after December 15, 2002. The amendment to SFAS 123 in paragraph 2(f) of the statement and the amendment to Opinion 28 in paragraph 3 are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. The Company currently accounts for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS 123. The Company believes that it will continue to account for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and will adopt the additional disclosure provisions of SFAS 148 during the second quarter of its year ending September 30, 2003.

In December 2002, the FASB issued Interpretation 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. For a guarantee subject to FIN 45, a guarantor is required to:

measure and recognize the fair value of the guarantee at inception. For many guarantees, fair value will likely be determined using the expected present value method described in FASB Concepts Statement 7, *Using Cash Flow Information and Present Value in Accounting Measurements*; and

provide new disclosures regarding the nature of any guarantees, the maximum potential amount of future guarantee payments, the current carrying amount of the guarantee liability, and the nature of any recourse provisions or assets held as collateral that could be liquidated and allow the guarantor to recover all or a portion of its payments in the event guarantee payments are required.

FIN 45 is effective for financial statements for fiscal years ending after December 15, 2002. The Company does not believe FIN 45 will have a material effect on its financial statements.

Reclassifications

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Certain amounts presented in the financial statements of prior periods have been reclassified to conform to the current year presentation.

Reverse Stock Split

Effective April 8, 2002, the Company effected a one-for-five reverse stock split. All information in the consolidated financial statements related to common shares, share prices, per share amounts, stock option plans, stock warrants and stock rights has been restated retroactively for the reverse stock split, unless otherwise noted.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (continued)****(Unaudited)****2. Inventories**

Inventories consisted of the following:

	December 31,	September 30,
	2002	2002
	(In thousands)	
Raw materials	\$ 2,977	\$ 2,383
Work-in-progress	702	440
Finished goods	33,020	31,688
Total inventories	\$ 36,699	\$ 34,511

3. Goodwill and Intangible Assets

In July 2001, the FASB issued SFAS 142 (see note 1 above), which establishes new accounting and reporting requirements for goodwill and other intangible assets. The new standards require that all intangible assets acquired that are obtained through contractual or legal right, or are capable of being separately sold, transferred, licensed, rented or exchanged must be recognized as an asset apart from goodwill. Goodwill and intangibles with indefinite lives are no longer amortized, but are subject to an annual assessment for impairment by applying a fair value based test.

The Company applied the provisions of SFAS 142 beginning on October 1, 2002 and is in the process of completing a transitional fair value based impairment test. Preliminary results indicate that there will be no impairment of recorded goodwill. Should final results differ, the Company would need to report any such impairment loss. Under SFAS 142, any impairment adjustment would be reflected as a cumulative effect of change in accounting principles. In accordance with the provisions of SFAS 142, the Company will no longer record annual amortization of goodwill of approximately \$1.6 million per year.

SFAS 142 requires the allocation of purchase price, including goodwill, at a reporting unit level, which is defined as an operating segment or one level below an operating segment .

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In connection with adopting SFAS 142, the Company also reassessed the identification of intangible assets and determined that the Company has no identifiable intangible assets related to its past acquisitions. The components of the Company's other intangible assets subject to amortization are as follows:

	Average Remaining Life (Years)	December 31, 2002		September 30, 2002	
		Gross		Gross	
		Carrying	Accumulated	Carrying	Accumulated
		Amount	Amortization	Amount	Amortization
		(In thousands)			
Merchandising costs and other	1	\$ 1,792	\$ 1,287	\$ 1,840	\$ 1,212
Financing costs	2	3,326	1,943	3,290	1,646
Non-compete	2	600	288	600	238
		\$ 5,718	\$ 3,518	\$ 5,730	\$ 3,096

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (continued)****(Unaudited)**

Amortization expense for intangible assets during the first quarter of the year ending September 30, 2003 was \$467,000. The following table provides information regarding estimated amortization expense for each of the following years ended September 30 (in thousands):

2003	\$ 1,807
2004	625
2005	136
2006	99

The following table adjusts earnings per share for the adoption of SFAS 142:

	Three Months Ended December 31,	
	2002	2001
Reported net income (loss)	\$ 2,147	\$ (196)
Goodwill amortization, net of income tax effect		326
Adjusted net income	\$ 2,147	\$ 130

Basic and diluted earnings per share:

	Three Months Ended December 31,			
	2002		2001	
	Basic	Diluted	Basic	Diluted
Reported net earnings (loss)	\$ 0.39	\$ 0.37	\$ (0.06)	\$ (0.06)
Goodwill amortization, net of income tax effect			0.10	0.10
Effect of including warrants and options previously anti-dilutive			(0.01)	(0.01)
Adjusted net earnings	\$ 0.39	\$ 0.37	\$ 0.03	\$ 0.03

4. Revolving Credit Facility

The Company has a \$75 million credit facility which funded the Company's acquisition of Ring Limited and provides funds through revolving facilities for the Company's U.S. and U.K. operations. The facility matures on December 31, 2003, and accordingly all amounts due have been classified as current liabilities at December 31, 2002.

5. Segment Information

Information on operating segments and a reconciliation to income (loss) before income taxes for the quarters ended December 31, 2002 and 2001 are as follows (in thousands):

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (continued)****(Unaudited)****Net Sales by Business Segment:****Three Months Ended December 31,**

	2002			2001		
	External			External		
	customers	Intersegment	Total	customers	Intersegment	Total
North America	\$ 17,980		\$ 17,980	\$ 20,502		\$ 20,502
United Kingdom	33,858		33,858	29,985		29,985
China Manufacturing and Distribution	4,332	3,356	7,688	5,667	2,009	7,676
Eliminations		(3,356)	(3,356)		(2,009)	(2,009)
Total	\$ 56,170		\$ 56,170	\$ 56,154		\$ 56,154

Net Sales by Location of External Customers:**Three Months Ended December 31,**

	2002		2001	
United States	\$ 10,864	\$ 14,055		
United Kingdom	32,936	29,511		
Canada	6,110	5,708		
Other	6,260	6,880		
Net sales	\$ 56,170	\$ 56,154		

Net Sales by Product Class:**Three Months Ended December 31,**

2002	2001
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Lighting	\$	43,371	\$	45,330
Automotive after-market		9,921		8,126
Industrial consumables		2,878		2,698
		<u> </u>		<u> </u>
Net sales	\$	56,170	\$	56,154
		<u> </u>		<u> </u>

Segment Contribution:

	Three Months Ended December 31,	
	2002	2001
	<u> </u>	<u> </u>
North America	\$ (649)	\$ (128)
United Kingdom	4,031	243
China Manufacturing and Distribution	734	732
	<u> </u>	<u> </u>
Subtotal for segments	4,116	847
Parent/administrative expenses	(812)	(1,135)
	<u> </u>	<u> </u>
Income (loss) before income taxes	\$ 3,304	\$ (288)
	<u> </u>	<u> </u>

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (continued)

(Unaudited)

Interest Expense ⁽¹⁾:

Three Months Ended December 31,
