INTEGRITY MEDIA INC
Form 10-Q
November 14, 2003

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UNITED STATES
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 September 30, 2003

Commission File No. 000-24134

Integrity Media, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	63-0952549
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

1000 Cody Road
Mobile, Alabama 36695

(Address of Principal Executive Offices, Zip Code)

(251) 633-9000

(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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares outstanding of each of the issuer s classes of common stock, as of November 12, 2003, the latest practicable date, was as follows:

Class	Outstanding
Class A Common Stock, $0.01 par value	2,384,783
Class B Common Stock, $0.01 par value	3,385,000

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTEGRITY MEDIA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	Sep 30, 2003	Dec 31, 2002
	(Unaudited)	
ASSETS		
Current Assets		
Cash	$ 1,440	$ 4,821
Trade receivables, less allowance for returns and doubtful accounts of $2,197 and $2,415	9,636	6,842
Other receivables	65	67
Inventories	7,505	5,191
Other current assets	5,704	4,558
Total current assets	24,350	21,479
Property and equipment, net of accumulated depreciation of $6,827 and $6,055	10,759	7,337
Product masters, net of accumulated amortization of $21,784 and $19,387	4,242	3,806
Other assets	7,616	8,237
Total assets	$46,967	$40,859
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Current portion of long-term debt	$ 2,690	$ 2,690
Line of Credit	3,000	0
Accounts payable and accrued expenses	5,456	5,298
Royalties payable	6,186	6,256
Other current liabilities	1,742	997
Total current liabilities	19,074	15,241
Long-term debt	7,792	6,780
Other long-term liabilities	446	179
Total liabilities	27,312	22,200
Commitments and contingencies		
Minority interest	514	606
Stockholders Equity		
Preferred stock, $.01 par value; 500,000 shares authorized, none issued and outstanding	0	0
Class A common stock, $.01 par value; 7,500,000 shares authorized; 2,384,783 shares issued and outstanding	24	24
Class B common stock, $.01 par value, 10,500,000 shares authorized; 3,385,000 shares issued and outstanding	34	34
Additional paid-in capital	13,001	12,956
Unearned compensation	(399)	(479)
Retained earnings	6,659	5,452
Equity adjustments from foreign translation	(178)	66

Total stockholders equity	19,141	18,053
Total liabilities and stockholders equity	$46,967	$40,859

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

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INTEGRITY MEDIA, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30		Nine months Ended September 30	
	2003	**2002**	**2003**	**2002**
Net sales	$21,408	$22,582	$53,352	$49,809
Cost of sales	10,519	11,211	26,816	24,384
Gross profit	10,889	11,371	26,536	25,425
Marketing and fulfillment expenses	3,552	4,311	9,998	10,216
General and administrative expenses	4,915	4,598	14,056	11,958
Income (loss) from operations	2,422	2,462	2,482	3,251
Other expenses				
Interest expense, net	(114)	(46)	(319)	(186)
Other income (expenses), net	15	(64)	(22)	(161)
Income before minority interest and taxes	2,323	2,352	2,141	2,904
Provision for income taxes	887	884	776	1,066
Minority interest, less applicable taxes	48	64	158	207
Net income	$ 1,388	$ 1,404	$ 1,207	$ 1,631
Adjustments to determine comprehensive income				
Foreign currency translation adjustments	(145)	80	(244)	182
Comprehensive income	$ 1,243	$ 1,484	$ 963	$ 1,813
Net income, basic	$ 0.25	$ 0.25	$ 0.22	$ 0.29
Net income, diluted	$ 0.23	$ 0.23	$ 0.20	$ 0.27
Weighted average number of shares outstanding				
Basic	5,619	5,595	5,609	5,592
Diluted	5,980	6,002	5,968	6,005

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

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INTEGRITY MEDIA, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(Unaudited)

	Nine months ended September 30	
	2003	**2002**
Cash flows from operating activities		
Net income (loss)	$ 1,207	$ 1,631
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,747	1,119
Amortization of product masters	2,398	2,699
Minority interest	158	206
Stock compensation	80	80
Changes in operating assets and liabilities, net of the effects from purchase of Sarepta Music (Pty) Ltd and INO Records, LLC (formerly M2 Communications L.L.C.)		
Trade receivables (net)	(2,677)	(3,067)
Other receivables	2	38
Inventories	(2,174)	(1,019)
Other assets	(1,805)	(856)
Accounts payable, royalties payable and accrued expenses	311	2,872
Other current and non current liabilities	1,003	389
Net cash provided by (used in) operating activities	250	4,092
Cash flows from investing activities		
Purchases of property and equipment	(4,187)	(2,285)
Payments for product masters	(2,834)	(2,736)
Purchase of INO Records, LLC (formerly M2 Communications, L.L.C.), net of cash	0	(4,779)
Purchase of Sarepta Music (Pty) Ltd, net of cash	(191)	0
Net cash used in investing activities	(7,212)	(9,800)
Cash flows from financing activities		
Net borrowings under line of credit	3,000	0
Proceeds from issuance of stock	45	27
Principal payments of long-term debt	(2,017)	(1,704)
Borrowings under term facility	3,048	5,250
Distributions to joint venture partner	(250)	(250)
Net cash provided by (used in) financing activities	3,826	3,323
Effect of exchange rate changes on cash	(245)	182
Net decrease in cash	(3,381)	(2,203)
Cash, beginning of period	4,821	6,854
Cash, end of period	$ 1,440	$ 4,651
Supplemental disclosures of cash flow information		
Interest paid	$ 366	$ 178
Income taxes paid	$ 0	$ 359

Supplemental disclosure of non-cash investing activities:
On March 31, 2003, the Company purchased Sarepta Music (Pty) Ltd. In conjunction with the purchase, the Company assumed all outstanding assets and liabilities as of the purchase date.

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

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INTEGRITY MEDIA, INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002
(UNAUDITED)**

Note 1 BASIS OF PRESENTATION AND SUMMARY OF ACCOUNTING POLICIES

Integrity Media, Inc. (the Company) is a media/communications company that produces, publishes and distributes Christian music, books and related products. The Integrity Music Group consists of two areas: Integrity Music, the leader in Praise and worship music, and INO Records, LLC, a Christian artist label. The Integrity Music Group s product formats include cassettes, compact discs, videos, DVDs and printed music. Integrity Music produces Praise and Worship music in different musical styles for specific audiences such as live worship music, gospel music and children s music. INO Records produces Adult Contemporary/Pop music by several well-known Christian artists. The Integrity Music Group sells all music-related products and Integrity Publishers, Inc. sells all book products. Products are sold mainly by direct-to-consumer marketing and wholesale trade methods. A principal direct-to-consumer marketing method of distribution is continuity programs whereby subscribers receive products at regular intervals. On September 30, 2003, the name of M2 Communications L.L.C. was changed to INO Records LLC.

Integrity Music Europe Limited was formed in 1988, Integrity Media Australasia Pty Ltd (formerly Integrity Music PTY Limited) was formed in 1991, Integrity Media Asia Pte Ltd was formed in 1995, and Sarepta Music (Pty) Ltd was acquired in March 2003. These subsidiaries serve to expand the Company s presence in Western Europe, Australia and New Zealand, Singapore and South Africa, respectively, and all are wholly-owned by the Company. Celebration Hymnal LLC was formed in 1997 as a 50/50 joint venture with Word Entertainment for the purpose of producing and promoting The Celebration Hymnal. Due to the Company s ability to control the venture, the Company consolidates the venture and Word Entertainment s interest in the joint venture is presented as minority interest in these financial statements. Integrity Publishers, Inc. was formed in August 2001 for the purpose of publishing and distributing Christian books. This division began shipping its first books in the third quarter of 2002. Enlight, Inc. was purchased in March 2002 to acquire certain book publishing trademarks and domain names. INO Records, LLC (formerly M2 Communications L.L.C.), an artist-based, independent Christian music company, was purchased in June 2002. Integrity Direct, LLC was formed December 31, 2002, to create a smoother interaction between the Company and its direct sales to churches and individuals.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the financial statements for the year ended December 31, 2002 contained in the Company s Annual Report on Form 10-K. The unaudited condensed financial information has been prepared in accordance with the Company s customary accounting policies and practices. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of results for the interim period, have been included.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

Operating results for the quarter and nine months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

For a summary of the Company s significant accounting policies, please see the financial statements for the year ended December 31, 2002 contained in the Company s Annual Report on Form 10-K.

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EARNINGS PER SHARE OF COMMON STOCK

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average of common shares outstanding for the period. Diluted earnings per share is calculated by dividing income available to common stockholders by the weighted average of common shares outstanding assuming issuance of potential dilutive common shares related to options, warrants, restricted stock, convertible debt, or other stock agreements.

Recent Accounting Pronouncements:

In August 2001, FASB issued SFAS No. 143, (SFAS 143), *Accounting for Asset Retirement Obligations*, which is effective for fiscal years beginning after June 15, 2002. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS 143 requires, among other things, that the retirement obligations be recognized when they are incurred and displayed as liabilities on the balance sheet. In addition, the asset s retirement costs are to be capitalized as part of the asset s carrying amount and subsequently allocated to expense over the asset s useful life. The adoption of SFAS No. 143 had no effect on the Company s financial position, results of operations or cash flows.

In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, such as restructuring, involuntarily terminating employees, and consolidating facilities, initiated after December 31, 2002. The Company s adoption of SFAS 146 did not have a significant impact on its financial position, results of operations or cash flows.

In November 2002, the FASB Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others was issued. The interpretation provides guidance of the guarantor s accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others. The Company has adopted the disclosure requirements of the interpretation as of December 31, 2002. The accounting guidelines are applicable to guarantees issued after December 31, 2002 and require that the Company record a liability for the fair value of such guarantees in the balance sheet. The Company s adoption of FIN No. 45 did not have a significant impact on its financial position, results of operations or cash flow.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN No. 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company s adoption of FIN No. 46 did not have a significant impact on its financial position, results of operations or cash flow.

The Company adopted the disclosure requirements of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure-an Amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, effective January 1, 2003. SFAS No. 148 amends SFAS No. 123 Accounting for Stock-Based Compensation to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, the Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments pertaining to the alternative methods of transition are effective for financial statements for fiscal years ended after December 15, 2002. The amendments to

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the disclosure requirements are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. As permitted by SFAS No. 148 and SFAS No. 123, we continue to apply the accounting provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations in accounting for our stock option plans and our employee stock purchase plan and the disclosure-only provisions of SFAS No. 123 as amended by SFAS 148. We did not record stock-based compensation expense in the nine months ended September 30, 2003 and September 30, 2002, as all options granted under our plans had an exercise price equal to fair market value. The adoption of the additional disclosure requirement did not have a significant impact on our reported results of operations, financial position or cash flows.

SFAS No. 148 requires us to provide pro forma disclosure of the impact on our results of operations had we adopted the expense measurement provisions of SFAS No. 123. SFAS No. 123 permits the use of either a fair value based method or the intrinsic value method to measure the expense associated with our stock option plans and our employee stock purchase plan. The pro forma impact on our results of operations had we adopted the fair value based method of SFAS No. 123 using the Black-Scholes option-pricing model are shown below:

	Nine Months Ended September 30	
	2003	**2002**
Net income (loss) as reported	$1,207	$1,631
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	$ 139	$ 139
Pro forma net income (loss)	$1,068	$1,492
Net income (loss) per share:		
Basic as reported	$ 0.22	$ 0.29
Diluted as reported	$ 0.20	$ 0.27
Basic Pro forma	$ 0.19	$ 0.27
Diluted Pro forma	$ 0.18	$ 0.25

In April 2003, the FASB issued Financial Accounting Standard No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities , (FAS No.149). This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and other hedging activities entered into after June 30, 2003. The Company does not expect the adoption of FAS No. 149, to have a material effect on its financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS 150 did not have a material effect on the Company s financial statements.

Note 2 LONG TERM DEBT

On April 25, 2001, the Company entered into a $20 million, five-year secured credit facility with LaSalle Bank. The credit agreement included a $6 million line of credit, an $11 million secured term loan, and a $3 million mortgage term loan. Through this credit facility, the Company refinanced its previous

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credit facility with Bank Austria. Of the $11 million initial term facility, $3.0 million was used to pay-off its previous credit facility with Bank Austria, $3.4 million was used for stock warrant repurchases, and $3.1 million expired, leaving $1.5 million available at December 31, 2001. The $3.1 million portion expired on December 19, 2001 due to time and use restrictions. On March 30, 2002, the credit facility was amended to decrease the allowed borrowings under this secured term facility to $6.4 million and the mortgage term loan was amended to increase the allowed borrowings for this facility to $4.6 million. On June 28, 2002, the term facility was again amended to increase total allowed borrowings to $9.4 million, an increase of $3.0 million. On June 28, 2002, this additional $3.0 million was then used to partially fund the acquisition of INO Records (formerly M2 Communications). On December 31, 2002, the mortgage term facility was amended to increase the allowed borrowings to $5.1 million. At September 30, 2003, the Company had available borrowings of $3.0 million under the line of credit, zero available under the mortgage term loan, and zero under the secured term loan. At September 30, 2003 there was $3.0 million outstanding under the line of credit, $5.9 million outstanding under the secured term loan, and $4.6 million outstanding under the mortgage term loan. At December 31, 2002, there was zero outstanding under the line of credit, $7.6 million outstanding under the secured term loan, and $1.8 million outstanding under the mortgage term loan.

During the first nine months of 2003, the Company amended its credit facility with LaSalle Bank. The Company is in compliance with all covenants as of September 30, 2003.

Note 3 SEGMENT INFORMATION

Summarized financial information concerning the Company s reportable segments is shown in the following table, in thousands:

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	Nine months Ended September 30	
	2003	**2002**
Net Sales		
Retail	$24,152	$24,207
Direct to Consumer	11,665	12,999
International	7,239	6,859
Book Publishing	5,259	2,406
Other	8,089	7,724
Eliminations	(3,052)	(4,386)
Consolidated	$53,352	$49,809
Operating profit (before minority interest)		
Retail	$ 3,773	$ 4,067
Direct to Consumer	2,420	1,551
International	204	1,061
Book Publishing	(202)	(576)
Other	2,810	2,943
Eliminations	(353)	(94)
Consolidated	8,652	8,952
General corporate expense	(6,065)	(5,862)
Interest expense, net	(447)	(186)
Income before income taxes and minority interest	$ 2,140	$ 2,904

	Three Months Ended September 30	
	2003	**2002**
Net Sales		
Retail	$ 10,142	$ 11,928