METATEC INTERNATIONAL INC
Form 10-Q
November 14, 2001

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, 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	31-1647405
(State of Incorporation)	(IRS Employer Identification No.)

7001 Metatec Boulevard Dublin, Ohio	43017
(Address of principal executive offices)	(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 November 13, 2001: 6,136,113

METATEC INTERNATIONAL, INC.

INDEX PAGE

PART I - FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

METATEC INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2001	At December 31, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 884,502	$ 2,086,228
Accounts receivable, net of allowance for doubtful accounts of $254,000 and $351,000	10,854,753	15,146,714
Inventory	3,053,942	2,970,219
Prepaid expenses	1,264,387	1,054,362

Deferred income taxes	588,107	588,107
Total current assets	16,645,691	21,845,630
Property, plant and equipment - net	44,115,136	50,455,317
Goodwill - net	4,053,862	4,631,036
Other long term assets	250,470	296,890
Deferred income taxes	104,000	104,000
TOTAL ASSETS	$ 65,169,159	$77,332,873
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,326,802	$ 6,472,385
Current maturities of long-term debt and capital lease obligations	19,607,491	6,978,028
Current maturities of long-term real estate debt	147,874	170,087
Accrued expenses:		
Royalties	4,953,781	3,712,796
Personal property taxes	834,675	1,270,425
Payroll	610,680	1,193,054
Other	1,570,353	1,209,600
Unearned income	181,530	234,235
Total current liabilities	32,233,186	21,240,610
Long-term real estate debt	18,575,795	18,623,708
Other long-term debt and capital lease obligations, less current maturities	1,093,782	16,769,506
Other long-term liabilities	652,078	527,172
Total liabilities	52,554,841	57,160,996
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	34,991,138
Accumulated deficit	(15,078,279)	(7,573,362)
Accumulated other comprehensive loss	(1,491,004)	(1,423,362)
Treasury stock, at cost - 1,081,742 shares	(5,822,537)	(5,822,537)
Unamortized restricted stock	(25,000)	--
Total shareholders' equity	12,614,318	20,171,877
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 65,169,159	$77,332,873

See notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2001	Three Months Ended September 30, 2000
NET SALES	$17,478,841	$26,351,076
Cost of sales	13,837,858	19,442,686
Gross profit	3,640,983	6,908,390
Selling, general and administrative expenses	5,886,266	6,989,379
Restructuring expenses	415,577	--
OPERATING LOSS	(2,660,860)	(80,989)
Other income (expense):		
Investment income	4,819	2,881
Interest expense	(826,732)	(1,042,518)
LOSS BEFORE INCOME TAXES	(3,482,773)	(1,120,626)
Income tax benefit	0	(234,000)
NET LOSS	$(3,482,773)	$ (886,626)
NET LOSS PER COMMON SHARE Basic and diluted	$ (0.57)	$ (0.15)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING Basic and diluted	6,136,113	6,087,771

See notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
NET SALES	$57,389,254	$80,166,339
Cost of sales	42,841,109	57,780,275
Gross profit	14,548,145	22,386,064
Selling, general and administrative expenses	18,901,782	20,024,690
Restructuring expenses	525,142	430,561
OPERATING EARNINGS (LOSS)	(4,878,779)	1,930,813
Other income (expense):		
Investment income	45,519	24,530
Interest expense	(2,671,657)	(3,251,008)
LOSS BEFORE INCOME TAXES	(7,504,917)	(1,295,665)
Income tax benefit	0	(311,000)
NET LOSS	$(7,504,917)	$ (984,665)
NET LOSS PER COMMON SHARE Basic and diluted	$ (1.22)	$ (0.16)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING Basic and diluted	6,135,965	6,081,863

See notes to condensed consolidated financial statements.

METATEC INTERNATIONAL, INC.
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)	$(5,822,53
Comprehensive Loss:				
Net loss		(7,504,917)		
Foreign currency translation adjustments			(67,642)	
Comprehensive loss				
Issuance of restricted shares	40,000			
Amortization of restricted stock				
BALANCE AT SEPTEMBER 30, 2001	$35,031,138	$(15,078,279)	$(1,491,004)	$(5,822,53

See notes to consolidated financial statements.

METATEC INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the nine months ended September 30,	2001	20
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (7,504,917)	$ (9
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	8,090,738	10,
Net (gain) loss on sales of property, plant and equipment	3,277	(
Changes in assets and liabilities:		
Accounts receivable	4,169,318	3,
Inventory	(86,781)	
Prepaid expenses and other assets	(207,972)	
Accounts payable and accrued expenses	(1,321,778)	(5,
Unearned income	(46,879)	
Net cash provided by operating activities	3,095,006	10,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(1,329,663)	(4,
Proceeds from the sales of property, plant and equipment	7,200	
Net cash used in investing activities	(1,322,463)	(4,

CASH FLOWS FROM FINANCING ACTIVITIES:

Increase in debt	20,247,419	4,
Payment of debt and capital lease obligations	(23,363,806)	(11,
Stock options exercised	0	
Net cash used in financing activities	(3,116,387)	(7,
Effect of exchange rate on cash	142,118	
Decrease in cash and cash equivalents	(1,201,726)	(1,
Cash and cash equivalents at beginning of period	2,086,228	1,
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 884,502	$

SUPPLEMENTAL CASH FLOW DISCLOSURES:

Interest paid	$ 2,430,566	$ 3,
Income taxes paid/(refunds received)	$ (122,267)	$
Assets purchased by the assumption of a liability	$ 174,830	$
Amortization of Restricted Stock	$ 15,000	$

See notes to condensed consolidated financial statements.

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

1. Basis of presentation - The consolidated balance sheet as of September 30, 2001, the consolidated statements of operations for the three and nine months ended September 30, 2001 and 2000, the consolidated statement of shareholders' equity for the nine months ended September 30, 2001, and the consolidated statements of cash flows for the nine month ended September 30, 2001 and 2000 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 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 September 30, 2001 are not necessarily indicative of the results for the full year.

2. Accounting Pronouncements - 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.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, "Goodwill and Other Intangibles." SFAS 142 is effective for all fiscal years beginning after December 15, 2001, and requires changes in the amortization of certain goodwill and intangible assets. These assets, which were previously being amortized, will be assessed at least annually for impairment. The Company has not yet evaluated the impact the adoption of SFAS 142 will have on its operations and financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." While this statement supercedes SFAS No. 121, "Accounting for Impairment of Long-Lived Assets to Be Disposed Of" it retains the fundamental provisions of SFAS No. 121 for recognition and impairments of assets to be held and used, and assets to be disposed of by sale. This statement is effective for the first quarter in the year ended December 31, 2002.

3. Long-term Debt - The Company's credit facilities include a term note, revolving line of credit and real estate debt. On October 25, 2001, the banks declared the Company in default of the credit facilities due to the Company's failure to satisfy a financial covenant contained in the loan agreement. The Company is negotiating a standstill agreement with the banks pursuant to which the banks would agree to forebear exercising their rights and remedies under the loan agreement. However, there can be no assurance that the Company will be able to reach agreement with the banks as to such a standstill arrangement. The Company is also in default on certain equipment leases which have cross default provisions with the above mentioned credit facilities. Such leases have remaining lease payments of approximately $1,103,000.

4. Subsequent Event - During the fourth quarter of 2001, the Company announced its plans to close its Milpitas, California (Silicon Valley) operations. The Company will incur restructuring charges related to this plan during the fourth quarter of 2001. Included in these charges will be approximately $700,000 in severance and related costs. The Company may sell fixed assets with an approximate net book value of $1,500,000 or transfer a portion of those assets to its other operations. However in the current market, it is

unlikely that the Company will realize the full net book value of this equipment. In addition to the above charges, the Company will likely incur charges related to the lease obligation of its Silicon Valley facility. The remaining lease payments under this obligation are approximately $1,200,000 per year through May, 2009.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2000 AND THE NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2000.

RESULTS OF OPERATIONS

Net sales for the three months ended September 30, 2001 were $17,479,000, a decrease of $8,872,000, or 34% over the same period of the prior year. This decrease resulted primarily from CD-ROM manufacturing sales decreasing $8,389,000 to $16,054,000 for the three months ended, or 34%. 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 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, compounded by the events of September 11, 2001, 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 impact the demand for the Company's CD-ROM products and services for the remainder of 2001. Radio syndication sales decreased $725,000, or 64%, to $400,000 for the three months ended September 30, 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 $535,000 during the three months ended September 30, 2001, as compared to $472,000 for the same period in the prior year.

Net sales for the nine months ended September 30, 2001 were $57,389,000, a decrease of $22,777,000, or 28% over the same period of the prior year. This decrease resulted primarily from CD-ROM manufacturing sales decreasing $22,158,000 to $53,145,000 for the nine months ended, or 29%. This decrease was due to the factors noted above. Radio syndication sales decreased $1,247,000, or 49%, to $1,306,000 for this same period as a result of the factors noted above. DVD sales accounted for $1,673,000 during the nine months ended September 30, 2001, as compared to $1,417,000 for the same period in the prior year.

Gross profit was 21% of net sales for the three months ended September 30, 2001 as compared to 26% of net sales for the same period of the prior year. Gross profit was 25% of net sales for the nine months ended September 30, 2001 as compared to 28% of net sales for the same period of the prior year. The reductions for the three-month and six-month periods were primarily caused by reduced utilization of the Company's manufacturing capacity and the continued decline of pricing for CD-ROM products and services.

Selling, general and administrative ("SG&A") expenses were $5,886,000, or 34% of net sales, for the three months ended September 30, 2001 as compared to $6,989,000, or 27% of net sales, for same period of the prior year. SG&A expenses were $18,902,000, or 33% of net sales, for the nine months ended September 30, 2001 as compared to $20,025,000, or 25% of net sales, for same period of the prior year. The expense reductions for the three-month and six-month periods were primarily attributed to restructuring and work force reductions which occurred in the quarters ended March 31, 2001 and September 30, 2001, although the Company's decreased sales caused SG&A expenses to increase as a percentage of net sales.

Interest expense for the three months ended September 30, 2001 was $827,000 as compared to $1,043,000 for the same period of the prior year. Interest expense for the nine months ended September 30, 2001 was $2,672,000 as compared to $3,251,000 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 nine months ended September 30, 2001, due to the uncertainty of realizing the value of such benefit. In the prior year a $311,000 income tax benefit was realized resulting in an effective tax rate of 24%.

As a result of the foregoing, the net loss for the three months ended September 30, 2001 was $3,483,000, or a net loss per common share of $.57, as compared to a net loss in the same period of the prior year of $887,000, or a net loss per common share of $.15. The net loss for the nine months ended September 30, 2001 was $7,505,000, or a net loss per common share of $1.22, as compared to a net loss in the same period of the prior year of $985,000, or a net loss per common share of $.16.

FINANCIAL CONDITION - LIQUIDITY AND CAPITAL RESOURCES

The Company financed its business during the nine months ended September 30, 2001 through cash generated from operations, the use of debt, and the use of available cash balances. Cash flow from operating activities was $3,095,000 for the nine months ended September 30, 2001, as compared to $10,160,000 for the nine months ended September 30, 2000. The Company had cash and cash equivalents of $885,000 as of September 30, 2001.

The Huntington National Bank and Bank One, NA (collectively, the "Banks") have provided a $12,958,000 term loan facility and a $13,000,000 revolving loan facility to the Company (the "Credit Facilities") pursuant to an amended and restated loan agreement dated as of March 31, 2001 (the "Loan Agreement"). As of September 30, 2001, $10,458,000 and $9,037,000 were outstanding under the term loan facility and the revolving loan facility, respectively.

On October 25, 2001, the Banks declared the Company in default of the Credit Facilities due to the Company's failure to satisfy a financial covenant contained in the Loan Agreement. The Company is negotiating a standstill agreement with the Banks pursuant to which the Banks would agree to forebear exercising their rights and remedies under the Loan Agreement. However, there can be no assurance that the Company will be able to reach agreement with the Banks as to such a standstill arrangement. Under the terms of the Loan Agreement, all principal and accrued interest under the Credit Facilities, or approximately $19,680,000, is immediately due and payable to the Banks. In addition, the Banks have notified the Company that the Credit Facilities will bear interest at the default rate under the Loan Agreement, which is 3.5% in excess of the prime interest rate of 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.

In addition, the Company has an equipment lease agreement with Banc One Leasing Company ("BOLC") relating to certain equipment used in the manufacturing operations of the Company. Under the cross-default provisions contained in the equipment lease agreement, on October 31, 2001, BOLC declared the Company to be in default of the equipment lease agreement due to the Company's default under the Loan Agreement. The Company is negotiating a standstill agreement with BOLC pursuant to which BOLC would agree to forebear exercising its rights and remedies under the equipment lease. However, there can be no assurance that the Company will be able to reach agreement with BOLC as to such a standstill arrangement. BOLC has notified the Company that BOLC contemplates the exercise of its remedies against certain foreign currency exchange contracts by using the proceeds therefrom to reduce the Company's obligations under the equipment lease agreement.

The Company's closure of its Milpitas, California (Silicon Valley) operations will also impact the Company's liquidity and capital resources. See "Subsequent Event."

The Company has a $19,000,000 loan facility administered by 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.

As of September 30, 2001, the Company had a working capital deficiency of approximately $15,600,000 primarily due to the $19,495,000 of term and revolving notes (under the Loan Agreement described above) being due on April 1, 2002. As described above, the Banks have declared the Company in default of the Credit Facilities, and all principal and accrued interest under the Credit Facilities, or approximately $19,680,000, is immediately due and payable to the Banks. The Company is negotiating a standstill agreement with the Banks pursuant to which the Banks would agree to forebear exercising their rights and remedies under the Loan Agreement. However, there can be no assurance that the Company will be able to reach agreement with the Banks as to such a standstill arrangement. However, the Company's liquidity and its current ability to meet its financial obligations as they become due are dependent upon the Company entering into a standstill agreement with the Banks. The Company's failure to reach agreement with the Banks as to a standstill arrangement will have a material adverse impact on the Company's financial position and continuing operations.

SUBSEQUENT EVENT

The Company announced publicly on October 23, 2001, that it was initiating the closing of its Milpitas, California (Silicon Valley) operations. The Silicon Valley site focused primarily on optical disc production and offered limited value-added services that characterize Metatec's sales and marketing focus today. The plant was expensive to operate and was essentially limited to offering a commodity service in an expensive market hit hard by the economic downturn. The Company is currently projecting significant cost savings by transferring business to its more efficient Dublin, Ohio facility.

The Company will be incurring a restructuring charge during the fourth quarter of 2001 related to this closure. Included in these charges are approximately $700,000 in severance and related costs. The Company may sell fixed assets with an approximate net book value of $1,500,000 or transfer a portion of those assets to its other operations. However in the current market, it is unlikely that the Company will realize the full net book value of this equipment. In addition to the above charges, the Company will likely incur charges related to the lease obligation of its Silicon Valley facility. The remaining lease payments under this obligation are approximately $1,200,000 per year through May, 2009.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Except for historical information, all other statements made in this report are "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 actual results to differ materially from those projected. Such risks and uncertainties that might cause such a difference include, but are not limited to, changes in general business and economic conditions, changes in demand for CD-ROM products, 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.
In addition to the disclosures contained in the Company's Form 10-K for its fiscal year ended December 31, 2000 regarding the quantitative and qualitative disclosures about the Company' market risk, refer to the above mentioned information.

PART II - OTHER INFORMATION

Items 1-2. Inapplicable.

Item 3. Defaults Upon Senior Securities.

The Huntington National Bank and Bank One, NA (collectively, the "Banks") have provided a $12,958,000 term loan facility and a $13,000,000 revolving loan facility to the Company (the "Credit Facilities") pursuant to an amended and restated loan agreement dated as of March 31, 2001 (the "Loan Agreement"). As of September 30, 2001, $10,458,000 and $9,037,000 were outstanding under the term loan facility and the revolving loan facility, respectively.

On October 25, 2001, the Banks declared the Company in default of the Credit Facilities due to the Company's failure to satisfy a financial covenant contained in the Loan Agreement. The Company is negotiating a standstill agreement with the Banks pursuant to which the Banks would agree to forebear exercising their rights and remedies under the Loan Agreement. However, there can be no assurance that the Company will be able to reach agreement with the Banks as to such a standstill arrangement. Under the terms of the Loan Agreement, all principal and accrued interest under the Credit Facilities, or approximately $19,680,000, is immediately due and payable to the Banks. In addition, the Banks have notified the Company that the Credit Facilities will bear interest at the default rate under the Loan Agreement, which is 3.5% in excess of the prime interest rate of 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.

Items 4. Submission of Matters to a Vote of Security Holders

Inapplicable.

Item 5. Inapplicable.

Item 6. Exhibits and Reports on Form 8-K

None

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.

/s/ Julia A. Pollner

BY: Julia A. Pollner
Senior Vice President, Finance
(authorized signatory-
principal financial and
accounting officer)

Date: November 14, 2001