ERGO SCIENCE CORP /DE/
Form 10-Q
November 15, 2002

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý 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-

o 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. 0-26988

ERGO SCIENCE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**04-3565746**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
790 Turnpike Street **North Andover, Massachusetts**	**01845**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(978) 689-0333**

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 ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

At October 31, 2002 there were 7,149,578 shares of common stock, par value $.01 per share, of the registrant outstanding.

ERGO SCIENCE CORPORATION

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CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2002	December 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 25,157,546	$ 25,808,028
Prepaid and other current assets	34,210	8,358
Total current assets	25,191,756	25,816,386
Equipment and leasehold improvements, net	3,172	6,815
Total assets	$ 25,194,928	$ **25,823,201**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 689,028	$ 927,535
Total current liabilities	689,028	927,535
Stockholders equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized; 6,903 shares of Series D preferred stock issued and outstanding at September 30, 2002 and December 31, 2001 (liquidation preference of $10,702,439 at September 30, 2002)	4,306,520	4,306,520
Common stock, $.01 par value, authorized 50,000,000 shares at September 30, 2002 and December 31, 2001; 7,149,578 shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively	71,496	71,496
Additional paid-in capital	111,880,321	111,880,321
Cumulative dividends on preferred stock	(2,296,953)	(2,296,953)
Accumulated deficit	(89,455,484)	(89,065,718)
Total stockholders equity	24,505,900	24,895,666
Total liabilities and stockholders equity	$ 25,194,928	$ 25,823,201

The accompanying notes are an integral part of the consolidated financial statements

ERGO SCIENCE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Operating expenses:				
Research and development	$ 9,600	$ 11,677	$ 28,620	$ 51,211
General and administrative	217,580	695,099	692,408	1,888,471
	227,180	706,776	721,028	1,939,682
Net operating loss	(227,180)	(706,776)	(721,028)	(1,939,682)
Other Income:				
Interest	111,857	288,054	331,262	1,011,905
Other		293		514
Net loss	$ (115,323)	$ (418,429)	$ (389,766)	$ (927,263)
Net Loss per common share:				
Basic and Diluted (revised)	$ (0.02)	$ (0.06)	$ (0.05)	$ (0.13)
Weighted average common shares outstanding:				
Basic and Diluted	7,149,578	7,149,578	7,149,578	7,149,578

The accompanying notes are an integral part of the consolidated financial statements

ERGO SCIENCE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2002	**2001**
Cash flows from operating activities:		
Net loss	$ (389,766)	$ (927,263)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	3,643	8,339
Loss on disposal of fixed assets		3,201
Changes in operating assets and liabilities:		
Prepaid and other current assets	(25,852)	5,736
Accounts payable and accrued expenses	(238,507)	147,708
Net cash used in operating activities	(650,482)	(762,279)
Cash flows from investing activities:		
Purchase of short-term investments		(33,444,552)
Proceeds from maturity of short-term investments		34,448,049
Proceeds from sale of fixed assets		1,920
Net cash provided by investing activities		1,005,417
Net (decrease) increase in cash and cash equivalents	(650,482)	243,138
Cash and cash equivalents at beginning of period	25,808,028	10,130,599
Cash and cash equivalents at end of period	$ 25,157,546	$ 10,373,737

The accompanying notes are an integral part of the consolidated financial statements

ERGO SCIENCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying financial statements are unaudited and have been prepared by Ergo Science Corporation (Ergo or the Company) in accordance with generally accepted accounting principles.

Certain information and footnote disclosure normally included in the Company s annual financial statements have been condensed or omitted. The interim financial statements, in the opinion of management, reflect all adjustments (including normal recurring accruals) necessary for a fair statement of the results for the interim periods ended September 30, 2002 and 2001.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2001, which are contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Cash Equivalents

The Company considers all highly liquid investments with a maturity of 90 days or less at the date of purchase to be cash equivalents.

Debt securities are classified as held-to-maturity when the Company has positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost.

At September 30, 2002 and December 31, 2001, cash equivalents were comprised primarily of investments in U.S. government obligations that mature within 90 days of purchase.

3. Net Loss Per Common Share

Basic earnings/loss per common share is computed by dividing net income/loss by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is computed by dividing net income by the sum of the weighted average number of common shares outstanding for the period plus all potentially dilutive securities, such as stock options.

During the three and nine month periods ended September 30, 2002 and 2001, options to purchase 213,625 and 186,875 shares of common stock, respectively, were not included in the computation of diluted net loss per share since their inclusion would be antidilutive.

4. Revision of Consolidated Financial Statements

The Company has revised its consolidated financial statements for the three months and nine months ended September 30, 2001. This revision involved the elimination of the accretion of dividends on the Series D Preferred Stock for all periods subsequent to the Company s initial public offering, or IPO, in December 1995. The dividends on the Series D Preferred Stock had been accreted at the rate of 6% compounded semi-annually from the time of issuance in April 1995 and such accretion had been reflected as an adjustment to net loss to determine net loss applicable to common stockholders. However, upon completion of the Company s IPO, the Series D Preferred Stock was no longer redeemable. After the Series D Preferred Stock became permanent equity, dividends on the preferred stock are only accounted for when and if declared by the Board of Directors. This revision did not affect net income or loss as previously reported; however, as a result of this revision, the previously reported net loss applicable to common stockholders for the three and nine months ended September 30, 2001 has decreased by $147,630 and $437,158, respectively.

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

This discussion contains forward-looking statements. Forward-looking statements reflect Ergo s current views with respect to future events. Actual results may vary materially and adversely from those anticipated, believed, assumed, estimated or otherwise indicated. Important factors that could cause actual results to differ materially include, without limitation,

we are a Company in transition;

we may not be able to identify or complete an acquisition of a suitable established business on favorable terms and, if acquired, that business may not generate sufficient income to realize the benefits of our net operating loss carryforwards;

our common stock is subject to rules relating to low-priced or penny stock, which may make it more difficult for our stockholders to buy or sell shares and for us to enter into future equity financings or to effect an acquisition or merger with other businesses; and

the transfer restrictions implemented in the merger may delay or prevent takeover bids by third parties and may delay or frustrate any attempt by our stockholders to replace or remove the current management.

Further information and additional important factors are set forth in reports and other filings of the Company with the Securities and Exchange Commission, including, without limitation, the 2001 Annual Report on Form 10-K, generally under the section entitled Risk Factors. Ergo does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

Overview

Ergo Science is a company in transition. From our incorporation through March 2001, we were engaged in the development of ERGOSET® tablets for the treatment of type 2 diabetes. We are now working to sell our drug assets and to purchase an established income-producing business.

In March 2001, we decided that the next phase of the development of ERGOSET® would be better undertaken by a company that has more experience with human drug development and more resources for regulatory approval and marketing than we do. We are currently seeking to acquire one or more established businesses. We have substantial unrecognized tax benefits and approximately $25 million in cash. We believe that the most advisable use of these assets is the purchase of one or more established, income-generating businesses. In part, this strategy may permit us to offset future tax liability with our existing tax benefits. In light of our strategic direction, we are also in the process of attempting to sell or license our interests in ERGOSET® including our intellectual property rights and other human drug related assets. If we enter into an agreement to dispose of any of our human drug-related assets, we will seek stockholder approval for that transaction only if it is required by Delaware or other applicable law or our Board of Directors determines it is advisable to seek such approval.

At our Annual Meeting of Stockholders held on October 15, 2001, stockholders approved the imposition of transfer restrictions on our common stock. These transfer restrictions were implemented on October 19, 2001. At that annual meeting, stockholders also approved an arrangement by which we may issue and sell up to 3,750,000 shares of our common stock to Court Square Capital Limited, our largest stockholder, at a per share price of $2.30 subject to adjustment. During our transition period, we intend to continue to conserve our cash and other assets. The only securities we currently hold are U. S. Government obligations with maturities of 90 days or less.

From inception through September 30, 2002, the Company has been unprofitable.

Results of Operations

Three Months and Nine Months Ended September 30, 2001 and 2002

Research and development expenses decreased from $11,677 to $9,600 and from $51,211 to $28,620 for the three and nine month periods ended September 30, 2001 and 2002, respectively. The decreases were primarily a result of a reduction in FDA related activity.

General and administrative expenses decreased from $695,099 to $217,580 and from $1,888,471 to $692,408 for the three and nine month periods ended September 30, 2001 and 2002, respectively. These decreases were mostly attributable to a significant reduction in legal costs and professional fees incurred by the Company in evaluating its strategic alternatives and the process of attempting to sell or license its interest in ERGOSET® and its other human drug related assets.

Interest income decreased from $288,054 to $111,857 and from $1,011,905 to $331,262 for the three and nine-month periods ended September 30, 2001 and 2002, respectively. The decrease is due primarily to a general reduction in market interest rates and the use of cash to fund the Company s operations resulting in less cash available for investment.

Liquidity and Capital Resources

Since its inception, the Company s primary source of cash has been financing activities, which have consisted of private placements of equity securities, two public offerings, and the sale of common stock in conjunction with the Joint Collaboration Agreement. Private placements of equity securities provided the Company with aggregate proceeds of $42,999,000 through 1998. On December 19, 1995, the Company raised $23,030,476 from the sale of stock in an initial public offering, net of commissions and offering costs. Subsequently, on August 14, 1996, the Company raised an additional $32,218,487, net of commissions and offering costs, from the sale of stock in a second public offering.

On February 23, 1998, Ergo and Johnson & Johnson entered into the Joint Collaboration Agreement to develop and commercialize ERGOSET® tablets as well as other potential collaboration products for the treatment of type 2 diabetes and obesity. In March 1998, Johnson & Johnson made payments to Ergo totaling $20 million, including payment of a $10 million license fee and the purchase of $10 million of Ergo common stock. In addition, Johnson & Johnson had committed to provide Ergo with significant, additional financial support in the form of milestone payments upon achievement of other specified development, regulatory and commercial objectives and reimbursement of certain development expenses subject to the terms of the Joint Collaboration Agreement. The Joint Collaboration Agreement was terminated on January 3, 1999; therefore, there will be no further financial support from this arrangement.

On May 23, 2001, the Company entered into a common stock purchase agreement with Court Square Capital Limited, the Company s largest stockholder, to provide the Company with additional capital for general corporate purposes, including the acquisition of one or more new lines of business. Subject to certain conditions, including stockholder approval, the agreement provides for the Company to issue and sell to Court Square and its affiliates up to 3,750,000 shares of the Company s common stock at a per share price of $2.30 subject to adjustment. The agreement expires on May 23, 2003.

Cash and cash equivalents were $25,808,028 and $25,157,546 at December 31, 2001 and September 30, 2002, respectively. The overall decrease in cash and cash equivalents at September 30, 2002, was due primarily to the funding of the operating activities of the Company.

The Company believes its current cash and cash equivalents will fund its current operations at least through 2003. In the event that the Company purchases an income-producing business, the Company may require additional capital.

The terms of the Company s Series D Preferred Stock prohibit the Company from paying dividends on the common stock.

New Accounting Pronouncements

In August 2001, FASB issued SFAS 143, Accounting for Obligations Associated with the Retirement of Long-Lived Assets. SFAS 143 provides the accounting requirements for retirement obligations associated with tangible long-lived assets. SFAS 143 is effective for financial statements for fiscal years beginning after June 15, 2002. The Company has determined that SFAS 143 will not have an impact on its financial position or results of operations.

In July 2002, the FASB issued SFAS 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 and nullifies 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). SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company has determined that SFAS 146 will not have an impact on its financial position or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the Company s exposure to market risk from December 31, 2001.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* Within 90 days prior to the filing date of this report, the Company s principal executive officer and acting financial officer carried out an evaluation of the effectiveness of the Company s disclosure controls and procedures. Based on that evaluation, the Company s principal executive officer and acting principal financial officer believe (i) that the Company s disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the periods specified in the SEC s rules and forms and that such information is accumulated and communicated to the Company s management as appropriate to allow timely decisions required disclosure, and (ii) that the Company s disclosure controls and procedures are effective.

(b) *Changes in internal controls.* There have been no significant changes in the Company s internal controls or in other factors that could significantly affect the Company s internal controls subsequent to the evaluation referred to in Item 4. (a) above, nor have there been any corrective actions with regard to significant deficiencies or material weaknesses.

PART II

OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ERGO SCIENCE CORPORATION

By:	/s/ David R. Burt
	David R. Burt
	Chief Executive Officer, Principal Financial and Accounting Officer and Director
Date:	November 14, 2002

CERTIFICATION

I, David R. Burt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Ergo Science Corporation;

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 I 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.

/s/ David R. Burt
David R. Burt
Chief Executive Officer and acting Chief Financial Officer

Date: November 14, 2002