EDUCATIONAL DEVELOPMENT CORP
Form 10-Q
January 23, 2017

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 November 30, 2016

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ____________.

Commission file number: 000-04957

EDUCATIONAL DEVELOPMENT CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	73-0750007
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5402 South 122nd East Avenue, Tulsa, Oklahoma	74146
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (918) 622-4522

Indicate by check mark whether the registrant (1) has filed all reports 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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of January 11, 2017, there were 4,082,283 shares of Educational Development Corporation Common Stock, $0.20 par value outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED BALANCE SHEETS (UNAUDITED)

ASSETS	November 30, 2016	February 29, 2016
CURRENT ASSETS:		
Cash and cash equivalents	$979,700	$1,183,700
Accounts receivable, less allowance for doubtful accounts and sales returns of $379,900 (November 30) and $501,900 (February 29)	3,948,600	2,513,300
Inventories—Net	34,203,500	17,479,500
Prepaid expenses and other assets	2,689,400	1,028,100
Deferred income taxes	348,800	298,200
Total current assets	42,170,000	22,502,800
INVENTORIES—Net	257,400	169,000
PROPERTY, PLANT AND EQUIPMENT—Net	28,053,500	26,710,300
OTHER ASSETS	262,000	262,000
DEFERRED INCOME TAXES	35,700	50,900
TOTAL ASSETS	$70,778,600	$49,695,000
LIABILITIES AND SHAREHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$14,690,400	$7,801,300
Line of credit	2,880,000	3,331,800
Deferred revenues	9,557,700	2,925,200
Current maturities of long-term debt	21,772,600	615,400
Accrued salaries and commissions	1,578,100	1,202,500
Income taxes payable	1,379,900	803,100
Dividends payable	367,400	366,300
Other current liabilities	4,040,200	1,732,500
Total current liabilities	56,266,300	18,778,100
LONG-TERM DEBT-Net of current maturities	-	17,687,400
Total liabilities	56,266,300	36,465,500
COMMITMENTS (Note 7)		
SHAREHOLDERS’ EQUITY:		
Common stock, $0.20 par value; Authorized 8,000,000 shares; Issued 6,041,040 (November 30 and February 29) shares; Outstanding 4,082,283 (November 30) and 4,064,610 (February 29) shares	1,208,200	1,208,200
Capital in excess of par value	8,548,000	8,548,000

Retained earnings	15,669,800	14,557,500
	25,426,000	24,313,700
Less treasury stock, at cost	(10,913,700)	(11,084,200)
Total shareholders' equity	14,512,300	13,229,500
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$70,778,600	$49,695,000

See notes to condensed financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2016	2015	2016	2015
GROSS SALES	$34,397,300	$28,931,400	$91,657,200	$59,920,100
Discounts and allowances	(6,948,000)	(6,751,600)	(20,581,900)	(16,953,700)
Transportation revenue	3,248,300	2,244,400	8,299,500	3,702,400
NET REVENUES	30,697,600	24,424,200	79,374,800	46,668,800
COST OF SALES	8,328,100	7,386,200	22,500,300	15,537,400
Gross margin	22,369,500	17,038,000	56,874,500	31,131,400
OPERATING EXPENSES:				
Operating and selling	9,965,900	6,888,000	26,186,500	13,006,700
Sales commissions	9,521,000	7,549,400	24,802,200	12,924,800
General and administrative	1,080,300	564,800	2,842,000	1,561,700
Total operating expenses	20,567,200	15,002,200	53,830,700	27,493,200
OTHER INCOME (EXPENSE)				
Interest expense	(265,000)	(8,200)	(730,000)	(51,600)
Other income	502,800	5,500	1,251,600	17,200
Total income (expense)	237,800	(2,700)	521,600	(34,400)
EARNINGS BEFORE INCOME TAXES	2,040,100	2,033,100	3,565,400	3,603,800
INCOME TAXES	765,900	774,600	1,352,500	1,376,300
NET EARNINGS	$1,274,200	$1,258,500	$2,212,900	$2,227,500
BASIC AND DILUTED EARNINGS PER SHARE:				
Basic	$0.31	$0.31	$0.54	$0.55
Diluted	$0.31	$0.31	$0.54	$0.55
DIVIDENDS PER SHARE	$0.09	$0.09	$0.27	$0.26
WEIGHTED AVERAGE NUMBER OF COMMON AND EQUIVALENT SHARES OUTSTANDING:				
Basic	4,079,916	4,055,756	4,074,355	4,044,622
Diluted	4,084,863	4,060,293	4,079,833	4,046,192

See notes to condensed financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
FOR THE NINE MONTHS ENDED NOVEMBER 30, 2016

	Common Stock (par value $0.20 per share)				Treasury Stock		
	Number of Shares Issued	Amount	Capital in Excess of Par Value	Retained Earnings	Number of Shares	Amount	Shareholders' Equity
BALANCE—March 1, 2016	6,041,040	$1,208,200	$8,548,000	$14,557,500	1,976,430	$(11,084,200)	$13,229,500
Purchases of treasury stock	-	-	-	-	23	(200)	$(200)
Sales of treasury stock	-	-	-	-	(17,696)	170,700	170,700
Dividends paid ($.18/share)	-	-	-	(733,200)	-	-	(733,200)
Dividends declared ($.09/share)	-	-	-	(367,400)	-	-	(367,400)
Net earnings	-	-	-	2,212,900	-	-	2,212,900
BALANCE—November 30, 2016	6,041,040	$1,208,200	$8,548,000	$15,669,800	1,958,757	$(10,913,700)	$14,512,300

See notes to condensed financial statements.

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EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE NINE MONTHS ENDED NOVEMBER 30,

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:	$(169,400)	$9,412,700
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(2,123,600)	(846,000)
Net cash used in investing activities	(2,123,600)	(846,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash paid to acquire treasury stock	(200)	(1,600)
Cash received from sales of treasury stock	170,700	147,300
Net payments under line of credit	(451,800)	(1,400,000)
Proceeds from long-term debt	4,000,000	-
Payments on long-term debt	(530,200)	-
Dividends paid	(1,099,500)	(1,009,400)
Net cash provided by (used in) financing activities	2,089,000	(2,263,700)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(204,000)	6,303,000
CASH AND CASH EQUIVALENTS—BEGINNING OF PERIOD	1,183,700	383,900
CASH AND CASH EQUIVALENTS—END OF PERIOD	$979,700	$6,686,900
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$730,000	$51,600
Cash paid for income taxes	$811,100	$635,600

See notes to condensed financial statement

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NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – The information shown with respect to the three and nine months ended November 30, 2016 and 2015, which is unaudited, includes all adjustments which in the opinion of Management are considered to be necessary for a fair presentation of earnings for such periods. The adjustments reflected in the financial statements represent normal recurring adjustments. The results of operations for the three and nine months ended November 30, 2016 and 2015, are not necessarily indicative of the results to be expected at year end due to seasonality of the product sales.

These financial statements and notes are prepared pursuant to the rules and regulations of the Securities and Ex-change Commission for interim reporting and should be read in conjunction with the audited financial statements and accompanying notes contained in our annual report on Form 10-K for the fiscal year ended February 29, 2016.

Certain reclassifications have been made to the fiscal year 2016 condensed statements of earnings and cash flows to conform to the classifications used in fiscal year 2017. These reclassifications had no effect on net earnings.

Note 2 – Debt consists of the following:

	2016	
	November 30,	February 29,
Line of credit	$2,880,000	$3,331,800
Long-term debt	$21,772,600	$18,302,800
Less current maturities (1)	(21,772,600)	(615,400)
Long-term debt-net of current maturities	$-	$17,687,400

(1) At November 30, 2016, we were in violation of the debt to worth ratio covenant for which we have not yet received a waiver from the Bank. Accordingly, the related long-term debt has been classified as current. The debt to worth ratio requires the following: (1) For quarters ending August 31, 2016 and November 30, 2016: 3.50:1.00. (2) For quarters ending February 28, 2017, May 31, 2017, August 31, 2017, and November 30, 2017: 3.25:1:00. (3) Quarters thereafter: 3.00:1.00.

We have a Loan Agreement with MidFirst Bank (“the Bank”) including Term Loan #1 comprised of Tranche A of $13.4 million and Tranche B of $5.0 million both with the maturity date of December 1, 2025. The Loan Agreement also provided a $7.0 million revolving loan (“line of credit’) through June 15, 2017. Tranche A has a fixed interest rate of 4.23% and interest is payable monthly. For Tranche B, interest is payable monthly at the bank adjusted LIBOR Index plus 2.75% (3.783% at November 30, 2016). Term Loan #1 is secured by the primary office, warehouse and land.

We also have Term Loan #2 with the Bank in the amount of $4.0 million with the maturity date of June 28, 2021, and interest payable monthly at the bank adjusted LIBOR Index plus 2.75%. Term Loan #2 is secured by a warehouse, land, and inventory.

The line of credit interest is payable monthly at a tiered rate based on our funded debt to EBITDA ratio (“ratio”), whereby pricing tier one is effective for a ratio greater than 4.00 and has a bank adjusted LIBOR Index plus 3.25% and pricing tier two applies for a ratio less than or equal to 4.00, with a bank adjusted LIBOR Index plus 2.75%. EBITDA is defined as earnings before interest expense, income tax expense (benefit) and depreciation and amortization expenses.

We had $2,880,000 in borrowings outstanding on our revolving credit agreement at November 30, 2016 and $3,331,800 in borrowings at February 29, 2016. Available credit under the revolving credit agreement was $4,120,000 at November 30, 2016. Subsequent to November 30, 2016, we utilized the remaining availability on our revolving credit agreement.

The Loan Agreement also contains a provision for our use of the Bank's letters of credit. The Bank agrees to issue, or obtain issuance of commercial or stand-by letters of credit provided that no letters of credit will have an expiry date later than June 15, 2017, and that the sum of the line of credit plus the letters of credit would not exceed the borrowing base in effect at the time. The agreement contains provisions that require us to maintain specified financial ratios, restrict transactions with related parties, prohibit mergers or consolidation, disallow additional debt, and limit the amount of compensation, salaries, investments, capital expenditures and leasing transactions. For the nine months ended November 30, 2016, we had no letters of credit outstanding.

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Note 3 – Inventories consist of the following:

	2016 November 30,	February 29,
Current:		
Book inventory	$34,228,500	$17,504,500
Inventory valuation allowance	(25,000)	(25,000)
Inventories net–current	$34,203,500	$17,479,500
Non-current:		
Book inventory	$517,400	$469,000
Inventory valuation allowance	(260,000)	(300,000)
Inventories net–non-current	$257,400	$169,000

Book inventory quantities in excess of what will be sold within the normal operating cycle, are included in non-current inventory.

Significant portions of our inventory purchases are concentrated with an England-based publishing company. Purchases from this company were approximately $10.9 million and $4.5 million for the three months ended November 30, 2016 and 2015, respectively. Total inventory purchases from all suppliers were $15.2 million and $6.6 million for the three months ended November 30, 2016 and 2015, respectively.

Purchases from this company were approximately $29.9 million and $13.0 million for the nine months ended November 30, 2016 and 2015, respectively. Total inventory purchases from all suppliers were $43.7 million and $17.9 million for the nine months ended November 30, 2016 and 2015, respectively.

Note 4 – Basic earnings per share (“EPS”) is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS is based on the combined weighted average number of common shares outstanding and dilutive potential common shares issuable which include, where appropriate, the assumed exercise of options. In computing diluted EPS we have utilized the treasury stock method. The computation of weighted average common and common equivalent shares used in the calculation of basic and diluted EPS is shown below.

Earnings Per Share:

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2016	2015	2016	2015
Net earnings	$1,274,200	$1,258,500	$2,212,900	$2,227,500
Shares:				
Weighted average shares outstanding - basic	4,079,916	4,055,756	4,074,355	4,044,622
Assumed exercise of options	4,947	4,537	5,478	1,570
Weighted average shares outstanding - diluted	4,084,863	4,060,293	4,079,833	4,046,192

Basic Earnings Per Share	$0.31	$0.31	$0.54	$0.55
Diluted Earnings Per Share	$0.31	$0.31	$0.54	$0.55

Our Board of Directors has adopted a stock repurchase plan in which we may purchase up to a total of 3,000,000 shares as market conditions warrant. This plan has no expiration date. During the nine months ended November 30, 2016, we repurchased 23 shares of common stock. The maximum number of shares that can be repurchased in the future is 303,129.

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Note 5 – We account for stock-based compensation whereby share-based payment transactions with employees, such as stock options and restricted stock, are measured at estimated fair value at date of grant and recognized as compensation expense over the vesting period. No such transactions occurred during the nine months ended November 30, 2016 and 2015.

Note 6 – Outbound freight and handling costs incurred are included in operating and selling expenses and were $4,569,900 and $3,267,800 for the three months ended November 30, 2016 and 2015, respectively. These costs were $12,134,700 and $5,872,900 for the nine months ended November 30, 2016 and 2015, respectively.

Note 7 –We have a 15-year lease with a third party, who leases 181,300 square feet, or 45.3% of our main facility. The lease is being accounted for as an operating lease.

The lessee pays $105,800 per month, with a 2.0% annual increase adjustment on the anniversary of the lease. The lease terms allow for one five-year extension, which is not a bargain renewal option, at the expiration of the 15-year term. Revenue associated with the lease is being recorded on a straight-line basis over the 15-year lease and is reported in other income on the condensed statement of earnings.

Note 8 – We have two reportable segments: EDC Publishing and Usborne Books & More ("UBAM"). These reportable segments are business units that offer different methods of distribution to different types of customers. They are managed separately based on the fundamental differences in their operations. EDC Publishing markets its products to retail accounts, which include book, school supply, toy and gift stores and museums, through commissioned sales representatives, trade and specialty wholesalers and an internal telesales group. UBAM markets its products through a network of independent sales consultants using a combination of internet web sales/home shows and school programs such as book fairs.

The accounting policies of the segments are the same as those of the rest of the Company. We evaluate segment performance based on earnings before income taxes of the segments, which is defined as segment net sales reduced by cost of sales and direct expenses. Corporate expenses, depreciation, interest expense, lease income, and income taxes are not allocated to the segments, but are listed in the "other" row below. Corporate expenses include the executive department, accounting department, information services department, general office management and building facilities management. Our assets and liabilities are not allocated on a segment basis.

Information by industry segment for the three and nine-month periods ended November 30, 2016 and 2015, follows:

NET REVENUES

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2016	2015	2016	2015
EDC Publishing	$3,075,000	$2,642,500	$7,244,600	$8,936,200
UBAM	27,622,600	21,781,700	72,130,200	37,732,600
Total	$30,697,600	$24,424,200	$79,374,800	$46,668,800

EARNINGS BEFORE INCOME TAXES

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2016	2015	2016	2015
EDC Publishing	$979,500	$796,200	$2,138,700	$2,762,100
UBAM	4,719,800	3,376,400	11,286,200	5,408,700

Other	(3,659,200)	(2,139,500)	(9,859,500)	(4,567,000)
Total	$2,040,100	$2,033,100	$3,565,400	$3,603,800

Note 9 - The Financial Accounting Standards Board ("FASB") periodically issues new accounting standards in a continuing effort to improve standards of financial accounting and reporting. We have reviewed the recently issued accounting standards updates ("ASU") and concluded that the following recently issued accounting standards apply to us.

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In May 2014, FASB issued ASU No. 2014-09, and amended with ASU No. 2015-14 "Revenue from Contracts with Customers," which provides a single revenue recognition model which is intended to improve comparability over a range of industries, companies and geographical boundaries and will also result in enhanced disclosures. The changes are effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, which means the first quarter of our fiscal year 2019. We are currently reviewing the ASU and assessing the potential impact on our financial statements.

In July 2015, FASB issued ASU No. 2015-11 "Inventory - Simplifying the Measurement of Inventory", which is intended to allow measurement of inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, which means the first quarter of our fiscal year 2018. We anticipate this ASU having minimal impact on our financial statements.

In August 2015, FASB issued ASU No. 2015-15 "Interest—Imputation of Interest," which modifies the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. These changes allow an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The changes are effective for financial statements issued for annual periods beginning after December 15, 2015, and interim periods within those annual periods, which means the first quarter of our fiscal year 2017. This ASU did not have a significant impact on our financial statements.

In November 2015, FASB issued ASU No. 2015-17 "Income Taxes – Balance Sheet Classification of Deferred Taxes", which is intended to improve how deferred taxes are classified on organizations' balance sheets by eliminating the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will now be required to classify all deferred tax assets and liabilities as noncurrent. The changes are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods, which means the first quarter of our fiscal year 2018. We anticipate this ASU having minimal impact on our financial statements.

In February 2016, FASB issued ASU No. 2016-02, "Leases," which is intended to establish a comprehensive new lease accounting model. The new standard clarifies the definition of a lease, requires a dual approach to lease classification similar to current lease classifications, and causes lessees to recognize leases on the balance sheet as a lease liability with a corresponding right-of-use asset. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP, in that the vast majority of operating leases should remain classified as operating leases and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. The new standard is effective for interim and annual periods beginning after December 15, 2018, which means the first quarter of our fiscal year 2020. The new standard requires a modified retrospective transition for capital or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. We are currently reviewing the ASU and evaluating the potential impact on our financial statements.

In March 2016, FASB issued ASU No. 2016-09, "Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting," which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard is effective for interim and annual periods beginning after December 15, 2016, which means the first quarter of our fiscal year 2018. We are currently reviewing the ASU and evaluating the potential impact on our financial statements.

In June 2016, FASB issued ASU No. 2016-13 "Financial Instruments—Credit Losses", which requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, which means the first quarter of our fiscal year 2020. We anticipate this ASU having minimal impact on our financial statements.