ADVANCED MARKETING SERVICES INC
Form 10-Q
August 13, 2002

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended June 29, 2002

Commission File Number: 0-16002

ADVANCED MARKETING SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-3768341**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5880 Oberlin Drive
San Diego, California 92121
(Address of principal executive offices)
(Zip Code)

(858) 457-2500
(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 [ ]

The number of shares of the Registrant s Common Stock outstanding as of July 29, 2002 was 19,298,888, net of treasury shares of 3,734,000.

TABLE OF CONTENTS

Table of Contents

ADVANCED MARKETING SERVICES, INC.

Index to Form 10-Q
June 29, 2002

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (See Note 1 for Basis of Presentation)

ADVANCED MARKETING SERVICES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited Amounts in Thousands, Except Share Data)

	June 29, 2002	March 31, 2002	June 30, 2001
ASSETS			
Current Assets:			
Cash and Cash Equivalents	$ 12,103	$ 21,115	$ 26,849
Investments, Available-for-Sale (Note 3)	1,441	2,010	4,379
Accounts Receivable, Net of Allowances for Uncollectible Accounts and Sales Returns of $8,934 at June 29, 2002, $9,239 at March 31, 2002 and $6,039 at June 30, 2001	151,371	156,193	98,896
Vendor and Other Receivables	4,478	6,485	3,807
Inventories	143,292	123,904	144,870
Deferred Income Taxes	7,074	7,242	7,874
Prepaid Expenses	3,689	3,439	2,232
Total Current Assets	323,448	320,388	288,907
Goodwill	37,738	37,444	9,785
Property and Equipment, Net (Note 3)	33,788	30,983	21,054
Investments, Available-for-Sale (Note 3)	4,294	3,631	1,213
Other Assets	10,252	10,406	5,060
TOTAL ASSETS	$409,520	$402,852	$326,019
LIABILITIES AND STOCKHOLDERS EQUITY			
Current Liabilities:			
Lines of Credit	$ 23,000	$ 25,000	$
Accounts Payable	230,799	223,960	197,884
Accrued Liabilities	20,075	20,046	13,122
Income Taxes Payable	1,170	1,522	2,904
Total Current Liabilities	275,044	270,528	213,910
Commitments and Contingencies (Note 7)			
Stockholders Equity:			
Common Stock, $0.001 Par Value, Authorized 100,000,000 Shares, Issued 23,031,000 Shares at June 29, 2002, 23,009,000 Shares at March 31, 2002 and 22,797,000 Shares at June 30, 2001	23	23	23
Additional Paid-In Capital	37,668	37,551	34,798
Deferred Compensation	(553)	(609)	(782)
Retained Earnings	115,892	113,503	94,263
Cumulative Other Comprehensive Loss	(2,363)	(1,953)	(990)
Less: Treasury Stock, 3,734,000 Shares at June 29, 2002 and March 31, 2002 and 3,669,000 Shares at June 30, 2001, at Cost	(16,191)	(16,191)	(15,203)
Total Stockholders Equity	134,476	132,324	112,109

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$409,520	$402,852	$326,019

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

Table of Contents

ADVANCED MARKETING SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited Amounts in Thousands, Except Per Share Data)

	Three Months Ended	
	June 29, 2002	**June 30, 2001**
Net Sales	$ 191,855	$ 146,978
Cost of Goods Sold	162,463	125,681
Gross Profit	29,392	21,297
Distribution and Administrative Expenses	25,806	16,399
Income From Operations	3,586	4,898
Interest Income	222	462
Equity in Net Loss of Affiliates	(135)	(240)
Interest Expense and Other	259	(40)
Income Before Provision For Income Taxes	3,932	5,080
Provision for Income Taxes	1,543	1,994
Net Income	$ 2,389	$ 3,086
Net Income Per Share:		
Basic	$ 0.12	$ 0.16
Diluted	$ 0.12	$ 0.16
Weighted Average Shares Used in Calculation:		
Basic	19,284	19,052
Diluted	20,182	19,823

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

4

Table of Contents

ADVANCED MARKETING SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited Amounts in Thousands)

	Three Months Ended	
	June 29, 2002	**June 30, 2001**
Net income	$ 2,389	$ 3,086
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Equity in net loss of affiliates	135	240
Depreciation and amortization	1,329	1,022
Provision for uncollectible accounts and sales returns	(305)	510
Markdown of inventories	577	465
Deferred income taxes	168	(677)
Amortization of deferred compensation	56	55
Changes in working capital components:		
(Increase) decrease in:		
Accounts receivable	6,387	2,449
Inventories	(21,130)	(25,580)
Other assets	(848)	293
Increase (decrease) in:		
Accounts payable	6,872	22,472
Accrued liabilities	1,294	(1,077)
Income taxes payable	(381)	(213)
Net cash (used in) provided by operating activities	(3,457)	3,045
Purchase of property and equipment	(4,287)	(4,088)
Investment in equity of affiliate		(1,323)
Purchase of investments, available-for-sale	(622)	(2,862)
Sale and redemption of investments, available-for-sale	587	1,639
Net cash used in investing activities	(4,322)	(6,634)
Repayments on lines of credit	(2,000)	
Proceeds from exercise of options	117	805
Net cash (used in) provided by financing activities	(1,883)	805
Effect of exchange rate changes on Cash and Cash Equivalents	650	(141)
Net Decrease in Cash and Cash Equivalents	(9,012)	(2,925)
CASH AND CASH EQUIVALENTS, Beginning of period	21,115	29,774
CASH AND CASH EQUIVALENTS, End of period	$ 12,103	$ 26,849
Supplemental Disclosures of Cash Flow Information:		
Cash Paid For:		
Income Taxes	$ 2,275	$ 2,717
Interest	$ 183	$

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

5

Table of Contents

ADVANCED MARKETING SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying interim Condensed Consolidated Financial Statements as of and for the three month periods ended June 29, 2002 and June 30, 2001 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with instructions to Form 10-Q, without an audit by our independent public accountants, and therefore, do not necessarily include all the information and footnotes necessary for a fair presentation of consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America. Reference should be made to the annual financial statements, including footnotes thereto, included in the Advanced Marketing Services, Inc. (AMS, we, us and our) Annual Report on Form 10-K, for the fiscal year ended March 31, 2002. The accompanying unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments, which, in our management s opinion, are necessary for a fair presentation. Our management believes that the disclosures included in the accompanying Condensed Consolidated Financial Statements and footnotes are adequate so that the information is not misleading.

Operating results for interim periods are not necessarily indicative of operating results to be expected for our fiscal year ending March 31, 2003. Our net sales in the third fiscal quarter have historically been, and we expect them to continue to be, significantly greater than in any other quarter of our fiscal year due to increased demand during the holiday season.

Consistent with wholesale distribution industry practice, our net sales and cost of goods sold for interim periods are cut off on the Saturday nearest to the end of the calendar month. The cut-off for the fourth fiscal quarter is always March 31. This practice may result in differences in the number of business days for which our sales and cost of goods sold are recorded both as to quarter-to-quarter comparisons, and as to comparisons of quarters between years.

Financial statements prepared in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect amounts reported as assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and amounts reported as revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior period amounts have been reclassified to conform to the current period presentation.

The accompanying Condensed Consolidated Financial Statements include our accounts and those of our wholly owned subsidiaries. Our policy is to include the operating results of our foreign subsidiaries in our Condensed Consolidated Statements of Income one-month in arrears. We have eliminated all significant intercompany accounts and transactions.

Table of Contents

2. COMPREHENSIVE INCOME

Comprehensive income is summarized as follows (in thousands):

	Three Months Ended	
	June 29, 2002	June 30, 2001
Net Income	$2,389	$3,086
Foreign Currency Translation Adjustment	(469)	(118)
Unrealized Gains/(Losses) on Investments	59	(30)
Comprehensive Income	$1,979	$2,938

We do not provide for US income taxes on foreign currency translation adjustments because such amounts are considered to be invested indefinitely.

3. COMPONENTS OF CERTAIN BALANCE SHEET CAPTIONS

Investments, Available-for-Sale

Investments, available-for-sale consist principally of debt securities issued by the federal government of the United States of America and state and local municipalities. Available-for-sale securities are stated at fair market value as determined by the most recently traded price of each security at the balance sheet date. The cost and estimated fair market value of investments are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 29, 2002	$5,684	$ 51	$	$5,735
March 31, 2002	$5,648	$	$ (7)	$5,641
June 30, 2001	$5,636	$	$(44)	$5,592

As of June 29, 2002, we had investments in debt securities amounting to approximately $1.4 million that were scheduled to mature within one year and approximately $4.3 million that were scheduled to mature within two years. For each of the periods presented, we sold no investment prior to its maturity date. We use the specific identification method in determining cost on these investments.

Table of Contents

3. COMPONENTS OF CERTAIN BALANCE SHEET CAPTIONS (continued)

Property and Equipment

A summary of property and equipment is as follows (in thousands):

	As of		
	June 29, 2002	March 31, 2002	June 30, 2001
Leasehold improvements	$ 5,151	$ 5,869	$ 1,897
Office furniture, equipment and software	15,937	14,459	12,340
Warehouse equipment	11,736	11,625	10,036
	32,824	31,953	24,273
Less accumulated depreciation and amortization	(17,347)	(16,001)	(13,087)
	15,477	15,952	11,186
Assets not yet placed in service	18,311	15,031	9,868
Property and equipment, net	$ 33,788	$ 30,983	$ 21,054

We account for our internal-use software in accordance with Statement of Position (SOP) 98-1, Accounting for Costs of Computer Software Developed or Obtained for Internal Use. SOP 98-1 requires capitalization of certain costs incurred in the development of internal-use software, including external direct material and service costs, employee payroll and payroll-related costs.

Assets not yet placed in service consist primarily of computer hardware and software related to the enhancement of our management information systems. The cumulative balance in Assets not yet placed in service relating to the enhancement of our management information systems amounted to approximately $18.1 million, $14.4 million and $9.2 million at June 29, 2002, March 31, 2002 and June 30, 2001, respectively. Once these systems are placed in service, the related costs that have accumulated will be depreciated on a straight-line basis over a seven-year period, the expected life of the assets. A significant portion of these upgraded systems have been placed in service in the second quarter of Fiscal 2003.

Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of the assets, ranging from three to seven years. Leasehold improvements are amortized over the lesser of the lease term or the remaining useful lives of the underlying assets. Maintenance, repairs and minor renewals are charged to earnings when they are incurred. Upon the disposition of an asset, its accumulated depreciation is deducted from the original cost, and any gain or loss is reflected in current earnings.

Table of Contents

3. COMPONENTS OF CERTAIN BALANCE SHEET CAPTIONS (continued)

Investments in Affiliates

From time to time we make strategic investments intended to promote our worldwide business, which primarily consists of buying and/or selling books. We use the equity method to account for investments in entities in which we hold a voting interest of 20% to 50% or in which we otherwise have the ability to exercise significant influence. We regularly monitor and evaluate the realizable value of our investments. If events or circumstances indicate that a decline in the value of these assets has occurred and is other than temporary, we will record a charge to Equity in Net Income of Affiliates. Our investments in affiliates are included as part of Other Assets in the accompanying Condensed Consolidated Balance Sheets. Consistent with our policy regarding international subsidiaries, we include our portion of the investment s operating results in our Condensed Consolidated Statements of Income one-month in arrears.

In June 2001, we acquired a 25% equity interest in The Templar Company, PLC (Templar) for approximately $1.3 million. During Fiscal 2002, we capitalized an additional $0.1 million in costs related to the acquisition, bringing our total investment to approximately $1.4 million. Located in the United Kingdom, Templar is a designer of children s books that incorporate sophisticated pop-up pictures using high-quality art, including the award-winning Maurice Pledger wildlife series. Templar markets its products on a worldwide basis.

In September 1999, we acquired a 25% equity interest in Raincoast Book Distribution, Limited (Raincoast Books), a leading Canadian book distributor, for approximately $0.9 million. Headquartered in Vancouver, British Colombia, Raincoast Books has the exclusive distribution rights for approximately 40 publishers in Canada. In addition, Raincoast Books, through its own proprietary imprint label, publishes a wide variety of books.

During the first quarter of Fiscal 2003, we recognized $0.3 million of income related to the change in fair value on stock appreciation rights issued in connection with certain acquisitions. This amount was included with Interest Expense and Other in the Condensed Consolidated Statements of Income. The liability for stock appreciation rights is included with Accrued Liabilities in our accompanying Condensed Consolidated Balance Sheets.

Equity Transactions

On July 22, 1999, we adopted a stock repurchase program pursuant to which we may repurchase in the open market or private transactions, from time to time, based upon existing market conditions, shares of our Common Stock not to exceed 450,000 shares. On March 16, 2000, we announced that our Board of Directors had approved an increase in the repurchase program of 525,000 shares. On July 27, 2000, our Board of Directors approved an additional 525,000-share increase in the repurchase program and on May 25, 2001, our Board of Directors approved an additional 350,000-share increase in our stock repurchase program. Under the plan, we have repurchased a total of approximately 1,312,275 shares through June 29, 2002 at an average market price of approximately $10.71. The repurchase program has no expiration date and will be financed through internal cash flows.

We recognize deferred compensation for certain stock options granted under our Stock Option Plan. The compensation is being amortized over the vesting period of the options, and we have expensed approximately $56,000 and $55,000 for the three months ended June 29, 2002 and June 30, 2001, respectively. The net balance of the remaining deferred compensation amounted to approximately $553,000, $609,000 and $782,000 at June 29, 2002, March 31, 2002 and June 30, 2001, respectively, and has been recorded as a separate component of Stockholders Equity in the accompanying Condensed Consolidated Balance Sheets.

Table of Contents

4. ACQUISITIONS

PUBLISHERS GROUP WEST

On January 31, 2002, we acquired all of the outstanding capital stock of Publishers Group West, Incorporated (PGW), located in Berkeley, California, for cash consideration of approximately $38.7 million, subject to customary post-closing adjustments. The acquisition of PGW was to further expand our higher-margin contract distribution business consistent with our strategic plan. The transaction was structured as a merger of Nautilus Merger Sub, Inc., our wholly owned subsidiary, with and into Publishers Group Incorporated (PGI). PGW is a wholly owned subsidiary of PGI. The acquisition was accounted for using the purchase method of accounting with approximately $25.0 million of the purchase price provided under borrowings from bank line of credit facilities.

PGI is a holding compa