PSC INC
Form 10-Q
May 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

|X| Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 29, 2002

OR

|_| Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No. 0-9919

PSC INC.
(Exact name of Registrant as Specified in Its Charter)

New York	16-0969362
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
111 S.W. Fifth Avenue, Suite 4100, Portland, Oregon	97204
(Address of principal executive offices)	(Zip Code)

503-553-3920
(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 12 months preceding (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 |_|

As of May 8, 2002, there were 12,834,467 shares of common stock outstanding.

PSC INC. AND SUBSIDIARIES

INDEX

PART I - FINANCIAL INFORMATION

Item 1: Financial Statements

PSC INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(All amounts in thousands)

	December 31, 2001
ASSETS	
Current Assets:	
Cash and cash equivalents	$1,865

Accounts receivable, net of allowance for doubtful accounts of $879 and $609, respectively	33,850
Inventories, net	17,885
Prepaid expenses and other	3,195
Total current assets	56,795
Property, Plant and Equipment, net of accumulated depreciation of $20,707 and $21,552, respectively	8,997
Intangible , net of accumulated amortization of $48,135 and $48,502, respectively	69,925
Total assets	$135,717

See accompanying notes to the Consolidated Financial Statements.

3

PSC INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(All amounts in thousands)
(Continued)

	December 31, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY/(DEFICIT)	
Current Liabilities:	
Current portion of long-term debt	$119,349
Accounts payable	17,325

Accrued expenses	19,889
Accrued payroll and related employee benefits	3,836
Total current liabilities	160,399
Long-Term Debt, less current maturities	-
Other Long-Term Liabilities	2,497
Shareholders' Equity (Deficit):	
Series A convertible preferred shares, par value $.01; 110 shares authorized, issued and outstanding ($11,000 aggregate liquidation value)	1
Series B preferred shares, par value $.01; 175 authorized, no shares issued and outstanding	-
Undesignated preferred shares, par value $.01; 9,715 authorized, no shares issued and outstanding	-
Common shares, par value $.01; 100,000 authorized 12,834 and 12,834 shares issued and outstanding	129
Additional paid-in capital	73,078
Accumulated deficit	(95,606)
Accumulated other comprehensive loss	(3,424)
Less treasury stock repurchased at cost, 180 shares	(1,357)
Total shareholders' equity (deficit)	(27,179)
Total liabilities and shareholders' equity (deficit)	$135,717

See accompanying notes to the Consolidated Financial Statements.

PSC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND ACCUMULATED DEFICIT
(All amounts in thousands, except per share data)

	Three Mont
	March 30, 2001
	(Unaudited)
Net Sales	$50,474
Cost of Sales	31,573

Gross profit	18,901
Operating Expenses:	
Engineering, research and development	4,889
Sales & marketing expense	7,796
General & administrative expense	3,966
Severance and other costs	525
Debt restructuring	1,836
Amortization of intangibles resulting from business acquisitions	2,764
Income (loss) from operations	(2,875)
Interest and Other (Income)/Expense:	
Interest expense, net	4,270
Other income	(50)
(Gain) loss from asset sale	(3,164)
Loss before income tax provision/(benefit)	(3,931)
Income tax provision/(benefit)	509
Net loss	$(4,440)
Net loss per common and common share equivalent:	
Basic	($0.36)
Diluted	($0.36)
Weighted average number of common and common equivalent shares outstanding:	
Basic	12,280
Diluted	12,280

See accompanying notes to the Consolidated Financial Statements.

5

PSC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(All amounts in thousands)

	Three Mont
	March 30, 2001
	(Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	($4,440)
Adjustments to reconcile net loss to net cash Provided by (used in) operating activities:	

Depreciation and amortization	4,213
Change in fair value of fee option and warrants	-
Gain on sale of asset	(3,164)
(Increase)/decrease in assets:	
Accounts receivable, net	939
Inventories	(576)
Prepaid expenses and other	1,028
Increase/(decrease) in liabilities:	
Accounts payable	1,181
Accrued expenses	659
Accrued payroll and related employee benefits	(906)
Additions/(Reductions) to other long-term liabilities, net	(49)
Net cash (used in)/provided by operating activities	(1,115)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Capital expenditures, net	(300)
Additions to intangible and other assets	(681)
Proceeds from sale of assets	3,800
Net cash provided by/(used in) investing activities	2,819
CASH FLOWS FROM FINANCING ACTIVITIES:	
Additions to long-term debt	-
Payments of long-term debt	(2,850)
Exercise of options and issuance of common shares	98
Net cash (used in)/provided by financing activities	(2,752)
Effect of exchange rate changes on cash and cash equivalents	(1,131)
Net (decrease)/ increase in cash and cash equivalents	(2,179)
CASH AND CASH EQUIVALENTS:	
Beginning of period	5,461
End of period	$3,282

See accompanying notes to the Consolidated Financial Statements.

PSC INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 30, 2001 AND MARCH 29, 2002
(All amounts in thousands)
(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements have been prepared by the Company without audit. In the opinion of management, these financial statements include all adjustments necessary to present fairly the Company's financial position as of March 29, 2002, the results of operations for the three months ended March 30, 2001 and March 29, 2002 and its cash flows for the three months ended March 30, 2001 and March 29, 2002. The results of operations for the three months ended March 29, 2002 are not necessarily indicative of the results to be expected for the full year.

Certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's December 31, 2001 annual report on Form 10-K.

(2) INVENTORIES

Inventories are stated at the lower of cost or market using the first-in, first-out method. Inventory costs include material, direct labor and overhead and consist of the following:

	December 31, 2001	March 29, 2002
Raw materials	$14,586	$13,638
Work-in-process	3,522	4,009
Finished goods	4,071	4,542
	22,179	22,189
Less inventory reserve	(4,294)	(4,020)
	$17,885	$18,169

(3) CURRENT MATURITIES OF LONG TERM DEBT

Current maturities of long-term debt consists of the following:

	December 31, 2001	March 29, 2002
Term loan, net of debt discount of $1,265 and $0	$58,935	$60,106
Senior revolving credit	30,419	30,560
Subordinated term loan, net of discount of $943, and $868	29,057	29,132
Subordinated promissory note	938	938
Long term debt, net	$119,349	$120,736

PSC INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 30, 2001 AND MARCH 29, 2002
(All amounts in thousands)
(Unaudited)

(4) ASSET SALE

As part of the Company's overall restructuring plans, the Company sold its verification and imager product lines on February 16, 2001 for $3.8 million. The gain realized on the sale was approximately $3.2 million.

In connection with the sale, the Company was required to use 50% of the net cash proceeds to repay amounts borrowed under its senior credit facilities.

(5) SEVERANCE AND OTHER COSTS

As of December 31, 2001, the amount of the severance accruals was approximately $0.3 million. As of March 29, 2002, the amount of the severance accruals was approximately $0.2 million, which relates to current contractual obligations.

(6) SHAREHOLDERS' EQUITY

Other comprehensive loss reports changes in equity that result from transactions and economic events other than transactions with owners. Other comprehensive loss is the total of net loss and all other non-owner changes in equity.

	Three Months Ended	
	March 30, 2001	March 29, 2002
Net loss	$(4,440)	$(1,247)
Foreign currency translation adjustment	(1,130)	(1,006)
Comprehensive loss	$(5,570)	$(2,253)

PSC INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 30, 2001 AND MARCH 29, 2002
(All amounts in thousands)
(Unaudited)

Changes in the status of options under the Company's stock option plans are summarized as follows:

	January 1, 2001 to March 30, 2001	Weighted Average Price	January 1, 2002 to March 29, 2002	Weighted Average Price
Options outstanding at beginning of period	3,222	$3.55	3,521	$2.64
Options granted	52	1.41	161	.56
Options exercised	-	-	-	-
Options forfeited/canceled	(173)	4.15	(35)	2.50
Options outstanding at end of period	3,101	$3.95	3,647	$2.55
Number of options at end of period:				
Exercisable	1,900	$4.99	2,251	$3.28
Available for grant	263		535	

During the three month period ended March 29, 2002, 30 forfeited options were cancelled due to the expiration of the 1987 Stock Option Plan in December 1997. These options are not available for future grants.

(7) NET LOSS PER COMMON AND COMMON EQUIVALENT SHARE

Basic EPS was computed by dividing reported earnings available to common shareholders by weighted average shares outstanding during the period. Diluted EPS was the same as basic EPS for the three months ended March 30, 2001 and March 29, 2002 as the affect of the dilutive securities would have been antidilutive. Options, warrants and preferred shares to purchase 3,101, 975 and 180 common shares, respectively, were outstanding for the three months ended March 30, 2001. Options, warrants and preferred shares to purchase 3,647, 975 and 180 of common shares were outstanding for the three months ended March 29, 2002.

	Three Months Ended				
	March 30, 2001			March 2	
	Net loss (numerator)	Shares (denominator)	Per Share Amount	Net loss (numerator)	Shares (denominator
Basic and Diluted EPS: Net loss available to common shareholders	($4,440)	12,280	($0.36)	($1,247)	12,834

9

(8) ADOPTION OF NEW ACCOUNTING PRONOUNCEMENT

Goodwill, which represented the excess of cost over the fair value of the acquisition, was previously being amortized using the straight-line method over 5-10 years. Effective January 1, 2002, the Company stopped amortizing its goodwill in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). The Company has completed its initial assessment of adopting SFAS 142 as to whether any identifiable intangibles may be associated with the previously recognized goodwill. Based on the Company's assessment, there are no identifiable intangibles that should be carved out of the previously recognized goodwill. Therefore, the next step, per SFAS 142, is to test for impairment based on the fair value of the goodwill. The Company has six months from the date it initially applies SFAS 142 to complete the first step of that transitional goodwill impairment test. However, the amounts used in the transitional goodwill impairment test shall be measured as of the beginning of the year of initial application. If the carrying amount of the net assets of a reporting unit (including goodwill) exceeds the fair value of that reporting unit, the second step of the transitional goodwill impairment test must be completed as soon as possible, but no later than the end of the year of initial application. The Company is in the process of completing its analysis and anticipates that it will record the impact, if any, of adopting SFAS 142 as an accounting change no later than June 30, 2002.

(9) RECLASSIFICATION

Certain amounts in prior years have been reclassified to conform to current year presentation.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements of the Company's December 31, 2001 annual report on Form 10-K.

Results of Operations: Three Months ended March 30, 2001 and March 29, 2002

Net Sales. Net sales during the three months ended March 29, 2002 decreased $7.7 million or 15.3% compared with the same period in 2001. $2.7 million of this decrease related to the sale of business and product lines in 2001, for which there was no revenue in 2002. The remaining decrease in net sales is attributed primarily to lower sales of handheld scanners and scan engines of $4.8.

Gross Profit. Gross profit during the three months ended March 29, 2002 decreased $1.8 million or 9.7% compared with the same period in 2001. As a percentage of sales, gross profit percentage increased to 39.9% for the first quarter of 2002, as compared to 37.4% in the first quarter of 2001. The increase in gross profit was a result of the streamlining of product lines and production operations that reduced costs.

Engineering, Research and Development (ER&D). ER&D expenses for March 29, 2002 decreased $1.4 million or 28.7 %, compared to the same period in 2001. As a percentage of sales, ER&D was 8.1% in the first quarter of 2002, versus 9.7% of net sales in the first quarter of 2001. The decrease in ER&D is primarily attributable to the cost savings efforts brought about by business restructuring.

Sales and Marketing. Sales and marketing expenses for March 29, 2002 were relatively unchanged compared to the first quarter of 2001. As a percentage of sales, sales and marketing expense was 18.0% in 2002 versus 15.4% in 2001. The percentage increase is primarily attributable to the increased investment in the direct sales organization to enhance contact with and expand relationships with end users.

10

General and Administrative. General and administrative expenses for the first quarter in 2002 were relatively unchanged. These costs are relatively fixed and are not subject to changes in the sales volume.

Severance and Other Costs. During the first quarter of 2001, the Company recorded a pretax charge of $0.5 million for employee severance and benefit costs resulting primarily from the consolidation of the Webster, New York operations with its Eugene, Oregon operations. For the first quarter of 2002, there was only a nominal amount of severance expense.

Debt Restructuring. Debt restructuring costs for the first quarter in 2002 decreased 77.1% to $0.4 million from $1.8 million for the same period in 2001. The decrease is due to reduced consulting costs necessary to manage banking relationship.

Amortization of Goodwill. Effective January 1, 2002, the Company ceased the amortization of goodwill, in accordance with Statement of Financial Accounting Standards No. 142 (SEE "ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS"). The amortization expense for goodwill was $2.8 million for the first quarter of 2001.

Interest Expense. Interest expense was relatively unchanged for the first quarter of 2002 as compared the same period in 2001.

Income Tax Provision/(Benefit). The Company's effective tax rate was (49.1%) for the three months ended March 31, 2002 versus 13.0% for the three months ended March 31, 2001. The Company recognized a $1.3 million tax receivable, in the quarter ended March 29, 2002 associated with the expected refund from a net operating loss carryback to prior years. A valuation allowance has been placed against the Company's deferred tax assets including the current operating losses, based on the Company's estimate of realizing its deferred tax assets in the future.

Liquidity and Capital Resources:

Current assets were relatively unchanged from December 31, 2001. Current liabilities increased by $2.1 million from December 31, 2001. The increase is primarily due to the increase, in accrued interest and warranty reserves.

Property, plant and equipment expenditures totaled $0.6 million for the three months ended March 29, 2002 compared with $0.3 million for the three months ended March 30, 2001. The 2002 expenditures are related to new product tooling and computer software and hardware.

At March 29, 2002, liquidity immediately available to the Company consisted of cash and cash equivalents of $1.7 million. The Company had a revolving credit facility totaling $34.0 million, of which $30.6 million, was outstanding at March 29, 2002. The Company is required to use at least 50% of its net cash proceeds from its non-core asset sales to repay amounts borrowed under its senior credit facilities.

The Company is required to meet certain financial covenants in relation to its senior and subordinated credit facilities including, but not limited to, adjusted EBITDA and capital expenditures. The senior debt and subordinated term loan agreements also restrict payment of dividends and limit stock repurchases. The Company is also required to achieve certain milestones in its recapitalization process. The Company was in compliance with or has received waivers for these covenants as of March 29, 2002. However, management is uncertain as to whether the Company will remain in compliance with these covenants.

11

In March 2002, the Company and its lenders reached an agreement in principle to extend the maturities of the Company's existing financing facilities to August 1, 2002. The extension documents were signed and effective on April 3, 2002.

The terms of the financing arrangements with the Company's senior lenders are substantially unchanged from the previously disclosed April 13, 2001 modification agreement. Among other provisions, the commitment from the senior lender for the working capital facility is $34.0 million and the commitment for fixed financing is $60.2 million. The interest rate for the senior credit facilities is prime + 3.50%. The Company is required to apply 50% of net cash proceeds from asset sales to repay amounts borrowed under its senior credit facilities.

In connection with the subordinated credit facility, the terms of the financing arrangements are substantially unchanged from the previously disclosed April 13, 2001 modification agreement.

In connection with the debt modification agreements reached with its lenders on April 13, 2001, the Company accrued $4.1 million for debt modification fees payable and recorded a related discount on the debt. Debt discount is being amortized through the expiration date of the prior amendment, which was dated April 1, 2002.

The Company has experienced recurring losses from operations, has undergone repeated renegotiations with its lenders of senior and subordinated indebtedness and has a significant working capital deficit. All of the Company's debt, totaling $120.7 million at March 29, 2002, is current.

These matters present the Company with a liquidity issue and raises substantial doubts about its ability to continue as a going concern. Management's plans in regard to these matters are discussed below. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result, should the Company be unable to continue as a going concern.

Management's Plans

In November 2000, the Company announced a restructuring plan to reduce its debt and to achieve future profitability and growth. These restructuring plans included replacement of executive management, consolidation of redundant administrative activities, sale or disposal of unprofitable operations and streamlining of product lines and production operations to reduce cost and increase profit contribution for products sold.

In February 2001, the Company sold its verification and imager product lines for $3.8 million. The gain on the sale was $3.2 million, recorded in other income/expense on the consolidated statement of operations.

In May 2001, the Company sold its Webster, New York facility for $5.0 million. The transaction resulted in a gain of $0.1 million in 2001, after a write-down of the facility value in 2000 of $7.9 million.

In July 2001, the Company sold its LazerData business for $6.4 million. The loss on the sale was $2.9 million recorded in other (income)/expense in the consolidated statement of operations.

During 2001, 50% of all asset disposition proceeds were applied to reduce indebtedness to PSC's senior lenders.

In July 2001, the Company substantially completed the process of hiring a new executive management team and relocated its Corporate headquarters to Portland Oregon.

In September 2001, the Company completed its restructuring process with a further reduction in costs and expenses, including staffing costs. Total severance and other restructuring costs during 2001 and 2000 were approximately

$1.5 million and $4.9 million, respectively. Debt restructuring costs for legal and consulting totaled $3.6 million in 2001. Total cost reductions related to all restructuring activities, including sales of businesses referred to above, was estimated to be approximately $40.0 million on an annualized basis.

Also in September 2001, the Company initiated efforts to attract new equity capital to reduce and refinance its indebtedness and provide additional equity resources to support ongoing operations. The Company has secured the services of an investment banking firm to assist in this effort. At March 29, 2002. these efforts are ongoing. These efforts relating to a restructuring may result in a material dilution of all currently issued and outstanding equity interests, and it is possible that under certain circumstances all such interests may be extinguished.

Management's cash flow projections for the Company balances the cash collections from revenue activities with the disbursement requirements for suppliers, capital expenditures and personnel costs. The Company's cost reduction efforts have been focused on achieving a neutral or positive cashflow from operations. Successfully continuing to operate in this neutral to positive cashflow pattern is dependent upon the Company's ability to effectively achieve its sales plan as well as its continued cost control performance. Management believes that its revenue and cost performance objectives are achievable and sustainable during this period of recapitalization. If the Company's performance deviates negatively from the 2002 operating plan, management intends to take all steps necessary to reduce cash costs to rebalance the Company's operations to return to a neutral or positive cashflow performance.

In March 2002, the Company and its lenders reached an agreement in principle to extend the maturities of the Company's existing financing facilities to August 1, 2002. The extension documents were signed and became effective on April 3, 2002. The terms of the extended financing arrangements were substantially unchanged from the prior agreements. The Company is required to achieve certain milestones in its recapitalization process and maintain certain financial covenants related to its senior and subordinated credit facilities. Management believes that a restructuring transaction acceptable to the Company's lenders can be achieved, although there can be no assurance that such a transaction will be accomplished. In the event that the Company is unsuccessful in these restructuring efforts, the lenders would be entitled to exercise their respective rights and remedies under the credit facilities and applicable law, in which case the Company would not have sufficient funds to repay its outstanding debt and no assurance can be given that alternative sources of sufficient financing would be available on acceptable terms, or not at all.

In the opinion of management, inflation has not had a material effect on the operations of the Company.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

No significant change in market risk from that disclosed in the Company's December 31, 2001 annual report on Form 10-K.

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

Certain statements contained in this Management's Discussion and Analysis may be forward-looking in nature, or "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Management cautions that these statements are estimates of future performance and are highly dependent upon a variety of important factors, which could cause actual results to differ materially from the estimate. These factors include the market acceptance of existing and new products, competitive product offerings and pricing pressures, the successful completion of the Company's recapitalization efforts, successfully negotiatiing extensions

to existing financing or the negotiation of new financing on acceptable terms, foreign currency and interest rate flunctuations, fulfillment of lending agreements and the disposition of legal issues. Profits and available cash flows also will be affected by the Company's ability to control manufacturing and operating costs. Reference should be made to filings with the Securities and Exchange Commission for further discussion of factors that could affect the Company's future results.

PART II: OTHER INFORMATION

Item 1: Legal Proceedings:

The description of the Company's legal proceedings set forth in Item 3 of the Company's Annual Report on Form 10-K for the fiscal period ended December 31, 2001 is incorporated herein by reference.

Item 2: Changes in Securities: None

Item 3: Defaults upon Senior Securities: None

Item 4: Submission of Matters of Shareholders to a Vote of Security Holders: None

Item 5: Other Information: None

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits:

10.1 Amendment to Borey Employment Agreement, dated February 2, 2001

(b) Reports on Form 8-K: None

Item 7: Critical Accounting Policies and Estimates

There has been no change in the Company's critical accounting policies and estimates from those disclosed in the Company's December 31, 2001 annual report on Form 10-K.

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.

PSC Inc.

DATE: May 14, 2002 By: /s/ Edward J. Borey

Edward J. Borey
President, Chief Executive Officer and Director

DATE: May 15, 2002 By: /s/ Paul M. Brown

Paul M. Brown
Vice President and Chief Financial Officer
(Principal Financial Officer)