ADVANCED MARKETING SERVICES INC
Form 10-Q
August 14, 2001
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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 30, 2001

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 June 30, 2001 was 19,127,742.

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PART I. FINANCIAL INFORMATION

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PART I. FINANCIAL INFORMATION

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

ADVANCED MARKETING SERVICES, INC.

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

	June 30, 2001	March 31, 2001	July 1, 2000
	(Unaudited)		(Unaudited)
ASSETS			
Current Assets:			
Cash and Cash Equivalents	$26,849	$29,774	$21,167
Investments, Available-For-Sale	4,379	4,395	3,145
Accounts Receivable , Net of Allowances for Uncollectible Accounts and Sales Returns of $6,039 at June 30, 2001, $5,622 at March 31, 2001 and $3,284 at July 1, 2000	102,703	105,621	91,265
Inventories, Net	144,870	119,845	145,436
Deferred Income Taxes			

	7,874	7,197	6,785
Prepaid Expenses	2,232	2,527	2,957
Total Current Assets	288,907	269,359	270,755
Property and Equipment, At Cost	34,141	30,021	23,700
Less: Accumulated Depreciation and Amortization	(13,087)	(12,223)	(10,673)
Net Property And Equipment	21,054	17,798	13,027
Investments, Available-For-Sale	1,213	4	871
Goodwill and Other Assets	14,845	13,887	9,139
TOTAL ASSETS	$326,019	$301,048	$293,792

LIABILITIES AND STOCKHOLDERS EQUITY

Current Liabilities:

Accounts Payable
$197,884 $175,385 $185,727
Accrued Liabilities
13,122 14,208 9,837
Income Taxes Payable
2,904 3,137 2,428

Total Current Liabilities
213,910 192,730 197,992

Commitments and Contingencies

Stockholders Equity:

Common Stock, $.001 Par Value, Authorized 100,000,000 Shares, Issued 22,797,000 Shares at June 30, 2001, 22,663,000 Shares at March 31, 2001 and 22,388,000 Shares at July 1, 2000
23 23 22
Additional Paid-In Capital
34,798 33,993 31,485
Deferred Compensation
(782) (830)
Retained Earnings
94,263 91,177 73,893
Cumulative Other Comprehensive Loss
(990) (842) (81)
Less: Treasury Stock, 3,669,000 shares at June 30, 2001 and March 31, 2001 and 3,146,000 shares at July 1, 2000, at cost
(15,203) (15,203) (9,519)

Total Stockholders Equity
112,109 108,318 95,800

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY
$326,019 $301,048 $293,792

The accompanying notes are an integral part of these consolidated balance sheets.

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ADVANCED MARKETING SERVICES, INC.

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

	Three Months Ended	
	June 30, 2001	**July 1, 2000**
Net Sales	$146,978	$148,189

Cost of Goods Sold
125,681 128,628

Gross Profit
21,297 19,561
Distribution and Administrative Expenses
16,399 15,041

Income From Operations	4,898	4,520
Interest Income, Net	422	400
Equity in Net Loss of Affiliate	(240)	(5)
Income Before Provision For Income Taxes	5,080	4,915
Provision for Income Taxes	1,994	1,929
Net Income	$3,086	$2,986
Net Income Per Share:		
Basic	$.16	$.16
Diluted	$.16	$.15
Weighted Average Shares Used in Calculation:		

Basic	19,052	19,102
Diluted	19,823	19,807

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

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ADVANCED MARKETING SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited Amounts in Thousands)

	Three Months Ended	
	June 30, 2001	July 1, 2000
Cash Flows From Operating Activities:		
Net Income	$3,086	$2,986
Adjustments to Reconcile Net Income to Net Cash Provided by (Used in) Operating Activities:		
Equity in Net Loss of Affiliate	240	5
Depreciation and Amortization	1,022	804
Provision for Uncollectible Accounts and Sales Returns	510	(359)
Provision for Markdown of Inventories	465	665
Deferred Income Taxes	(677)	
Deferred Compensation	55	

Changes in Assets and Liabilities, Net of Effects of Business Acquired		
(Increase) Decrease in Accounts Receivable Trade	2,449	(12,053)
Increase in Inventories	(25,580)	(14,471)
(Increase) Decrease in Other Assets	293	(924)
Increase in Accounts Payable	22,472	20,300
Decrease in Accrued Liabilities	(1,077)	(1,113)
Decrease in Income Taxes Payable	(213)	(305)
Net Cash Provided by (Used In) Operating Activities	3,045	(4,465)
Cash Flows From Investing Activities:		
Purchase of Property and Equipment, Net	(4,088)	(2,825)
Investment in Equity of Affiliate	(1,323)	
Purchase of Investments, Available-For-Sale	(2,862)	(999)
Sale and Redemption of Investments, Available-For-Sale	1,639	2,325
Net Cash Used In Investing Activities	(6,634)	(1,499)

Cash Flows From Financing Activities:		
Proceeds from Exercise of Options and Related Tax Benefits	805	430
Purchase of Treasury Stock		(3,472)
Dividends Paid		(165)
Net Cash Provided by (Used In) Financing Activities	805	(3,207)
Effect of Exchange Rate Changes on Cash	(141)	(797)
Net Decrease in Cash and Cash Equivalents	(2,925)	(9,968)
CASH AND CASH EQUIVALENTS, Beginning of Period	29,774	31,135
CASH AND CASH EQUIVALENTS, End of Period	$26,849	$21,167

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

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ADVANCED MARKETING SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements as of and for the three months ended June 30, 2001 and July 1, 2000 have been prepared in accordance with accounting principles generally accepted in the United States and with instructions to Form 10-Q. 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, as amended on Form 10-K/A, for the fiscal year ended March 31, 2001. The accompanying financial statements were not examined by our independent public accountants, but include all adjustments, consisting of normal recurring adjustments, which in our management s opinion are necessary for a fair presentation of the financial condition, results of operations and cash flows for those periods. We have omitted certain information and footnote disclosures normally included in financial statements in accordance with accounting principles generally accepted in the United States pursuant to requirements of the Securities and Exchange Commission. Our management believes that the disclosures included in the accompanying interim financial statements and footnotes are adequate so that the information is not misleading. Certain prior year amounts have been reclassified to conform with the current year presentation.

The accompanying 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 Consolidated Statements of Income one-month in arrears. We have eliminated all significant inter-company accounts and transactions.

Our results of operations for the three-month period ended June 30, 2001 are not necessarily indicative of the results to be expected for our fiscal year ending March 31, 2002. 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.

Financial statements prepared in conformity with accounting principles generally accepted in the United States 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. Our actual results could differ from those estimates.

2. INTERIM ACCOUNTING PERIODS

In accordance 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 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.

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3. COMPREHENSIVE INCOME (LOSS)

Total comprehensive income for the three months ended June 30, 2001 was $2,938,000 and total comprehensive income for the three months ended July 1, 2000 was $2,959,000. The adjustments to income to arrive at total comprehensive income for the three months ended June 30, 2001 and July 1, 2000 were ($148,000) and ($27,000), respectively, and represent foreign currency translation adjustments and unrealized gains and losses on investments.

4. INVESTMENTS, AVAILABLE-FOR-SALE

Investments, available-for-sale consist principally of debt securities issued by States of the United States (U.S.) and political subdivisions of the States. The cost and estimated fair market value of investments at June 30, 2001, March 31, 2001 and July 1, 2000 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2001	$5,636	$	$ 44	$5,592
March 31, 2001	$4,416	$	$ 17	$4,399
July 1, 2000	$4,009	$ 8	$ 1	$4,016

As of June 30, 2001, we had investments in debt securities issued by States of the U.S. and political subdivisions of the States of approximately $4,379,000 scheduled to mature within one year and approximately $1,213,000 scheduled to mature within two years. For the quarter ended June 30, 2001, we sold no investment prior to its maturity date. We had investment maturities of approximately $1,639,000 for the quarter ended June 30, 2001 and we realized no gain or loss on these maturities. We received proceeds from the sale of investments during the same period of the previous year of approximately $2,325,000 on which we realized a net gain of approximately $4,000. We use the specific identification method in determining cost on these investments. Our net increase in unrealized loss on investments was approximately $30,000 for the quarter ended June 30, 2001. Our net increase in unrealized gain on investments for the quarter ended July 1, 2000 was approximately $5,000.

5. ACCOUNTS RECEIVABLE ALLOWANCES

In accordance with industry practice, we sell a significant portion of our products to customers with the right of return. We have provided allowances of $3,514,000 as of June 30, 2001, $3,054,000 as of March 31, 2001 and $1,730,000 as of July 1, 2000 for the gross profit effect of estimated future sales returns after considering historical results and evaluating current conditions. We also have provided allowances for uncollectible trade accounts receivable of $2,525,000 as of June 30, 2001, $2,568,000 as of March 31, 2001 and $1,554,000 as of July 1, 2000, respectively.

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6. INVENTORIES

Our inventories consist primarily of books and, to a lesser extent, music CDs, CD-ROMs and prerecorded audio cassettes purchased for resale and are stated at the lower of cost (first-in, first-out) or market.

7. LINE OF CREDIT

We had available at June 30, 2001 an unsecured bank line of credit with a maximum borrowing limit of $12,000,000. The interest rate on bank borrowings is based on the prime rate and LIBOR rates. The line of credit expires on August 31, 2002. As of and during the respective periods ended June 30, 2001, March 31, 2001 and July 1, 2000, we had no borrowings on our bank line of credit.

8. INCOME TAXES

We currently provide for taxes on income regardless of when such taxes are payable in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes . Deferred income taxes result from temporary differences in the recognition of income and expense for tax and financial reporting purposes. We paid income taxes in the three months ended June 30, 2001 totaling $2,717,000. We paid income taxes paid during the same period of the previous year of $2,184,000.

9. 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. The total number of shares of Common Stock currently remaining authorized for repurchases under the plan is approximately 600,000 shares. Under the plan, we have repurchased approximately 1,247,000 shares at an average market price of approximately $10.50. The repurchase program has no expiration date and will be financed through internal cash flows.

We recognize deferred compensation for stock options granted under our Stock Option Plan. The compensation is being amortized to expense over the vesting period of the options and we have expensed approximately $55,000 during the three months ended June 30, 2001. The net balance of the remaining deferred compensation has been recorded as a separate component of stockholders equity.

10. PER SHARE INFORMATION

On February 15, 1999, we effected a three for two stock split to stockholders of record on February 1, 1999. On January 17, 2000, we effected a three for two stock split to stockholders of record on January 3, 2000. On May 11, 2001, we effected an additional three for two stock split to stockholders of record on April 27, 2001. Accordingly, all references to shares and earnings per share amounts included in these Consolidated Financial Statements have been restated to reflect the stock splits.

The following financial data summarizes information relating to the per share computations (in thousands, except per share data):

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	Period Ended	
	June 30, 2001	July 1, 2000
Net Income	$ 3,086	$ 2,986
Weighted Average Common Shares Outstanding	19,052	19,102
Basic Earnings Per Share	$ .16	$ .16
Weighted Average Common Shares Outstanding	19,052	19,102
Dilutive Common Stock Options	771	705
Total Diluted Weighted Average Common Shares	19,823	19,807

Diluted Earnings Per Share	$ .16	$ .15

11. INDUSTRY SEGMENT AND GEOGRAPHICAL DATA

We operate in one industry segment and in several geographic regions. Net sales by geographic region are as follows (in thousands):

	Three Months Ended	
	June 30, 2001	July 1, 2000
United States	$133,555	$137,918
United Kingdom	11,077	8,710
Mexico	1,584	1,054
Australia	762	507
	$146,978	$148,189

Net identifiable assets of our operations in different geographic areas are as follows (in thousands):

	As of		
	June 30, 2001	March 31, 2001	July 1, 2000
United States	$274,936	$252,378	$256,858
United Kingdom	42,669	41,728	31,765
Mexico	4,112	3,271	2,197
Australia	4,302	3,671	2,972

$326,019	$301,048	$293,792