

PERFECTDATA CORP  
Form 10QSB  
November 15, 2004

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-QSB**

ý **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

**For the quarterly period ended September 30, 2004**

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 Number 0-12817**

**PERFECTDATA CORPORATION**

(Exact Name of Small Business Issues as Specified in Its Charter)

**CALIFORNIA**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**95-3087593**  
(I.R.S. Employer  
Identification Number)

**1445 East Los Angeles Avenue**  
**Suite 208**  
**Simi Valley, California 93065**  
(Address of Principal Executive Offices)

**(805) 581-4000**  
(Issuer's Telephone Number,  
Including Area Code)

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Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

As of October 31, 2004, there were 6,209,530 shares of Common Stock outstanding.

Transitional Small Business Disclosure Format:

Yes  No

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**PERFECTDATA CORPORATION**

## Balance Sheet

(Unaudited)

(Amounts in thousands except share amounts)

	<b>September 30, 2004</b>
<b>Assets</b>	
Current assets:	
Cash and cash equivalents	\$ 1,569
Accounts receivable, net of allowance of \$3	100
Prepaid expenses and other current assets	74
<b>Total current assets</b>	<b>1,743</b>
Property, plant and equipment, at cost, net	\$ 1,743
<b>Liabilities</b>	
Current liabilities:	
Accounts payable	\$ 354
Accrued compensation	28
Other accrued expenses	68
<b>Total current liabilities</b>	<b>450</b>
Shareholders' equity:	
Preferred Stock. Authorized 2,000,000 shares; none issued	
Common Stock, no par value. Authorized 10,000,000 shares; issued and outstanding 6,209,530 shares	11,258
Accumulated deficit	(9,965)
<b>Total shareholders' equity</b>	<b>1,293</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,743</b>

See accompanying notes to financial statements.

**PERFECTDATA CORPORATION**

## Statements of Operations

(Unaudited)

(Amounts in thousands, except per share information)

	Three Months Ended September 30,		Six Months Ended September 30,					
	2004	2003	2004	2003				
Net Sales	\$	\$	708	\$	326	\$	1,433	
Cost of goods sold			462		264		932	
Gross profit			246		62		501	
Selling, general, and administrative expenses		217	416		436		770	
Loss from operations		(217)	(170)		(374)		(269)	
Other income:								
Other, net		4	4		7		9	
Net loss		(213)	(166)		(367)		(260)	
Net loss per common share - basic and diluted	\$	(0.03)	\$	(0.03)	\$	(0.06)	\$	(0.04)
Weighted average shares outstanding - basic and diluted		6,209	6,193		6,209		6,176	

See accompanying notes to financial statements.

**PERFECTDATA CORPORATION**

## Statements of Cash Flows

(Unaudited)

(Amounts in thousands)

	<b>Six-Month Period Ended</b>	
	<b>September 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (367)	\$ (260)
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation and amortization		6
Stock issued for services		52
(Increase) decrease in accounts receivable	92	(151)
Decrease in inventory		97
Increase in prepaid expenses and other assets	(16)	(7)
Increase in accounts payable	29	170
Decrease in accrued expenses	(72)	(27)
Net cash used in operating activities	(334)	(120)
Net decrease in cash and cash equivalents	(334)	(120)
Cash and cash equivalents at beginning of period	1,903	2,173
Cash and cash equivalents at end of period	\$ 1,569	\$ 2,053

See accompanying notes to financial statements.

**PERFECTDATA CORPORATION**

Notes to Financial Statements

1. All adjustments included in the financial statements in this Report are of a normal recurring nature and are necessary to present fairly the Company's financial position as of September 30, 2004 and the results of its operations and cash flows for the six months ended September 30, 2004 and 2003. Results of operations for the interim periods are not necessarily indicative of results of operations for a full year due to external factors that are beyond the control of the Company. This Report should be read in conjunction with the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2004 ( Annual Report 2004 ).

**2. Proposed Sale of Business Operations**

On October 3, 2003, the Company entered into an Asset Purchase Agreement (the APA) with Spray Products Corporation ( Spray ), pursuant to which the Company agreed to sell to Spray (or a Spray affiliate) substantially all of the operating assets of the Company for a price equal to the sum of the value of the inventory, collectible accounts receivable and \$100,000, less the amount of trade payables which are being assumed by Spray.

Since November 1, 2003, Spray had, pursuant to the APA, been acting as a manager for the fulfillment of orders from the Company's customers. As compensation for Spray's services, Spray was receiving a fee of 7½% of net sales. As indicated in the next paragraph, as a result of Spray assuming, effective as of June 1, 2004, full responsibility for all customers, Spray is entitled to the full economic benefit of any sale to a customer of the Company in lieu of the foregoing fee.

Because the Company's largest customer had threatened to seek another supplier because of a supplier's offer of lower prices, and because of the long delay in closing the transaction, thereby causing uncertainty for customers and Spray, the Company and Spray had agreed in principle, and subsequently finalized the agreement in writing by the Second Amendment dated as of August 12, 2004, to the following revisions to the APA: (1) effective June 1, 2004, Spray assumed full responsibility for all of the Company's customers in order to prevent possible losses of customer business, resulting in Spray receiving, thereafter, the full economic benefits of any sales to customers of the Company; (2) the aforementioned payment of \$100,000 was reduced to \$80,000; and (3) the Company may put the assets to Spray for the purchase price on the earlier of (a) September 30, 2004 or (b) the Company receiving shareholder consent to the sale of Spray.

The Board of Directors, after consultation with certain major shareholders, had elected in June 2003, to sell the operating business assets of the Company because, despite efforts by the Company during the prior fiscal years which had increased sales and reduced expenses, the Company continued to operate at a loss, thereby diluting the Company's cash, which is its major asset. The Board concluded that a sale or liquidation of the operating assets was in the best interests of the Company and its shareholders even if no acquisition or merger was effected.

The Company is seeking shareholders' approval by consents in lieu of holding a meeting, to permit the sale of its operating assets to Spray and to reincorporate the Company in the State of Delaware. As a result of the new arrangement with Spray effective June 1, 2004, the Company has no operations and will receive no revenues until an acquisition or merger is



effected.

The Board of Directors of the Company does not intend to liquidate the Company, but instead, with the Company having cash or cash equivalents currently in excess of \$1,500,000, the Board intends to continue its search for a suitable merger or acquisition candidate. Even though the Company has no operations, the Company believes its status as a publicly-traded company is valuable and therefore makes it a viable merger candidate. During the past four fiscal years, the Company had been seeking acquisitions which have not been related to its current business. The Board was of the opinion that profitability on a continuous basis would not be achieved absent an acquisition of a new business or businesses and/or new products. However, the Board can not determine when any such acquisition will be consummated, if at all. During recent years, three potential acquisitions were actively pursued; however, all terminated for different reasons and the Company incurred expenses in connection therewith.

No adjustments have been made to the financial statements as a result of these uncertainties.

### 3. Revenue Recognition

Until June 1, 2004 the Company recognized revenue on a gross basis when products were shipped and the customers took ownership and assumed risk of loss, collection of relevant receivables was probable, pervasive evidence of an arrangement existed and the sales price was fixed or determinable. As a result of the provisions to the APA with Spray, the Company no longer meets the criteria necessary to recognize revenue as a principal and instead recognizes revenue net as an agent, which is in conformity with generally accepted accounting principles.

### 4. Inventories

Pursuant to the APA, the Company transferred its inventory on hand at October 31, 2003 to Spray. Pursuant to this agreement, Spray will pay the Company for the inventory at the time of the close of the transaction. The Company reclassified its inventory, with a net book value of \$28,000, to other current assets.

### 5. Property and Equipment

Property and equipment at September 30, 2004 consist of (in thousands):

Machinery and equipment	\$ 296
Furniture and fixtures	7



	303
Less accumulated depreciation and amortization	(303)
	\$

**6. Loss Per Common Share**

Basic net loss per share is based on the weighted average number of shares

outstanding during each of the respective periods. Diluted net loss per share includes the dilutive impact of all Common Stock equivalents such as options and warrants to purchase the Company's Common Stock. During the respective periods, the impact of the Common Stock equivalents, such as stock options, was antidilutive; therefore, they have been excluded from the calculation of diluted loss per share.

## 7. Stock-Based Compensation

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123 *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair-value for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

In accordance with provisions of SFAS No. 123, the Company applies Accounting Principles Board (APB) Opinion No. 25 and related interpretations in accounting for its stock options plans and accordingly, does not recognize compensation costs for grants to employees and directors whose exercise prices equals the market price of the stock on the date of grant.

Due to the reduction of the exercise price of fixed stock options through the cancellation of stock option awards and the granting of replacement awards, per FIN No. 44, *Accounting for Certain Transaction Involving Stock Compensation*, the Company has adopted variable accounting for the replacement awards, per FIN No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below. The fair value of these options was estimated at the date of grant using a Black-Scholes option-pricing model, assuming a risk-free interest rate of 3.26% - 6.26%, three to ten-year terms, 50% volatility, and \$0 expected dividend rate.

(000's except per share amounts)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net loss, as reported	\$ (213)	(166)	(367)	(260)
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of tax	(9)	(8)	(14)	(12)
Pro forma net loss	\$ (222)	(174)	(381)	(272)
Basic and diluted net loss per common share:				
As reported	\$ (0.03)	(0.03)	(0.06)	(0.04)
Pro forma	(0.04)	(0.03)	(0.06)	(0.04)

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

**Proposed Sale of Business Operations**

As previously reported, on October 3, 2003, the Company entered into an Asset Purchase Agreement (the "APA") with Spray Products Corporation ("Spray"), pursuant to which the Company agreed to sell to Spray (or a Spray affiliate) substantially all of the operating assets of the Company for a price equal to the sum of the value of the inventory, collectible accounts receivable and \$100,000, less the amount of trade payables which are being assumed by Spray.

Also as previously reported, since November 1, 2003, Spray had, pursuant to the APA, been acting as a manager for the fulfillment of orders from the Company's customers. As compensation for Spray's services, Spray was receiving a fee of 7½% of net sales. As indicated in the next paragraph, as a result of Spray assuming, effective as of June 1, 2004, full responsibility for all customers, Spray is entitled to the full economic benefit of any sale to a customer of the Company in lieu of the foregoing fee. As a result of the management arrangement with Spray, the Company had moved to a smaller facility and reduced its staff, thereby reducing its ongoing overhead expenses.

Also as previously reported, because the Company's largest customer had threatened to seek another supplier because of a supplier's offer of lower prices, and because of the long delay in closing the transaction, thereby causing uncertainty for customers and Spray, the Company and Spray have agreed in principle and subsequently finalized the agreement in writing by the Second Amendment dated as of August 12, 2004, to the following revisions to the APA: (1) effective June 1, 2004, Spray assumed full responsibility for all of the Company's customers in order to prevent possible losses of customer business, resulting in Spray receiving, thereafter, the full economic benefits of any sales to customers of the Company; (2) the aforementioned payment of \$100,000 was reduced to \$80,000; and (3) the Company may put the assets to Spray for the purchase price on the earlier of (a) September 30, 2004 or (b) the Company receiving shareholder consent to the sale of Spray. As a result of these revisions, effective June 1, 2004, the Company began recognizing revenue from sales to customers on a net basis as an agent in accordance with EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," because it no longer meets the criteria necessary to recognize revenue as a principal.

Also as previously reported, the Board of Directors, after consultation with certain major shareholders, had elected in June 2003, to sell the operating business assets of the Company because, despite efforts by the Company during the prior fiscal years which had increased sales and reduced expenses, the Company continued to operate at a loss, thereby diluting the Company's cash, which is its major asset. The Board concluded that a sale or liquidation of the operating assets was in the best interests of the Company and its shareholders even if no acquisition or merger was effected.

The Company is seeking shareholders' approval, by consents in lieu of holding a meeting, to permit the sale of its operating assets to Spray and to reincorporate the Company in

the State of Delaware.

As a result of the transaction, as amended, with Spray, effective June 1, 2004, the Company has no operations and will receive no revenues until an acquisition or merger is effected, as to which and when there can be no assurance.

#### **Efforts to Seek Another Merger or Acquisition Candidate**

The Board of Directors of the Company does not intend to liquidate the Company but instead, with the Company having cash or cash equivalents currently in excess of \$1,500,000, the Board intends to continue its search for a suitable merger or acquisition candidate. Even though the Company has no operations, the Company believes its status as a publicly-traded company is valuable and therefore makes it a viable merger candidate. During the past four fiscal years, the Company had been seeking acquisitions which have not been related to its current business. The Board was of the opinion that profitability on a continuous basis would not be achieved absent an acquisition of a new business or businesses and/or new products. However, the Board can not determine when any such acquisition will be consummated, if at all. During recent years, three potential acquisitions were actively pursued; however, all terminated for different reasons and the Company incurred expenses in connection therewith.

#### **Critical Accounting Policies**

Management believes that the following discussion addresses the Company's most critical accounting policies, which are those that are most important to the portrayal of the Company's financial condition and results, and require the most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Prior to November 1, 2003, the date on which Spray assumed responsibility for fulfillment of customer orders, management also included a discussion of its evaluation of inventory as a critical accounting policy on an on-going basis.

#### **Revenue Recognition:**

Until June 1, 2004 the Company recognized revenue on a gross basis when products were shipped and the customers took ownership and assumed risk of loss, collection of relevant receivables was probable, pervasive evidence of an arrangement existed and the sales price was fixed or determinable. As a result of the provisions to the APA with Spray, the Company no longer meets the criteria necessary to recognize revenue as a principal and instead recognizes revenue net as an agent.

#### **Allowance for Doubtful Accounts:**

The Company evaluates the collectibility of its accounts receivable and provides an allowance for estimated losses that may result from customers' inability to pay. The amount of the reserve is determined by analyzing known uncollectible accounts, aged receivables and customers' credit-worthiness. Amounts later determined and specifically identified to be uncollectible are written off against the allowance.

**Results of Operations**

Net sales for the second fiscal quarter ended September 30, 2004 ( current quarter ) were nil, as compared to \$708,000 in the year-earlier period. Net sales for the six months

ended September 30, 2004 ( current six-month period ) were \$326,000, as compared to \$1,433,000 in the year-earlier period.

As previously reported, commencing June 1, 2004, Spray assumed full responsibility for all the Company's customers and realized the full economic benefit pursuant to the APA Second Amendment. Consequently, for the current quarter and current six-month period, the Company did not report the sales of \$585,000 and \$891,000, respectively.

Cost of Goods Sold ( Costs ) as a percentage of net sales for the current quarter and current six-month period was nil and 81% respectively, as compared to 65% in each of the respective year-earlier periods. There were no Costs in the current quarter because, as discussed in the preceding paragraph, commencing June 1, 2004, the Company did not report any sales. The increase in Costs in the current six-month period was directly related to a price increase from Spray in the months of April and May 2004.

Selling, General and Administrative Expenses ( Expenses ) for the current quarter were \$217,000 as compared to \$416,000 in the year-earlier period. Expenses for the current six-month period were \$436,000 as compared to \$770,000 in the year-earlier period. As previously discussed, the Company transferred its order fulfillment to Spray on November 1, 2003 and moved to a smaller facility. The decrease in Expenses from the year-earlier period related to a reduction in facility expenses as well as a reduction in payroll and related Costs. There was also a reduction in Expenses from the year earlier periods related to freight, sales commissions and customer rebates which Spray became responsible for when they assumed full responsibility for all the customers on June 1, 2004. In addition, the Company recorded compensation expense of \$51,500 in the year-earlier period related to the 50,000 shares of the Company's Common Stock issued to the then Chairman of the Audit Committee for his services as such.

Other Income for the current quarter was dividend income of \$4,000, consistent with the year-earlier period. Other Income for the current six-month period was dividend income of \$7,000 as compared to dividend income of \$9,000 in the year-earlier period.

The increased net loss in the current quarter and current six-month period directly related to the decrease in sales as described above.

### **Liquidity and Capital Resources**

The Company's cash and cash equivalents decreased \$334,000 from \$1,903,000 at March 31, 2004 to \$1,569,000 at September 30, 2004. The decrease resulted from cash used in operating activities of \$334,000. The cash used in operating activities was primarily the result of the net loss of \$367,000, partially offset by an increase in accounts payable.

As a result of the continuing negative cash flows from operations, the Company is dependent on the proceeds from its March 2000 private placement in order to meet its payable requirements. On March 31, 2000, certain investors (including two of the current directors) purchased from the Company an aggregate of 1,333,333 shares of the Common Stock at \$2.25 per share or an aggregate purchase price of \$2,999,999. The net proceeds approximated to \$2,895,000. Because all of such funds were not required for operations, the funds deemed excess were invested in a working capital management account with Merrill Lynch, Pierce, Fenner & Smith Incorporated ( Merrill Lynch ). As of September 30, 2004, the Company had approximately \$1,569,000 of cash equivalents in two financial institutions, which exposes the



Company to a concentration of credit risk. The Company had, as of that date, approximately \$1,537,000 invested in highly liquid money market instruments with Merrill Lynch, which are not federally insured. The remaining \$32,000 was deposited at a bank, which is federally insured up to \$100,000.

The Company believes that, as a result of the cash described in the preceding paragraph, the Company's working capital is adequate to fund its operations and its requirements for the fiscal year ending March 31, 2005 while seeking a suitable merger and acquisition candidate.

### **Forward-Looking and Cautionary Statements**

With the exception of historical information, the matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations include certain forward-looking statements that involve risks and uncertainties. The Company is hereby identifying information that is forward-looking and, accordingly, involves risks and uncertainties, including, without limitation, statements regarding the Company's future financial condition and the success of the Company's efforts to seek a merger or acquisition partner and the proposed sale to Spray. Other risks are discussed in the Annual Report 2004. As a result, actual results may differ materially from those described in the forward-looking statement. The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement in this Report.

### **Item 3. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company has a CEO and a CFO/CAO, constituting all of management, and, during the reporting period, two employees to conduct operations. The CEO and CFO/CAO performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2004. Because of its small size and limited number of personnel, the Company does not currently have elaborate written procedures, nor does management believe that such elaborate written procedures are currently necessary to ensure accurate reporting in the Company's periodic reports. In making their evaluation, the CEO and CFO/CAO consulted with the Company's outside counsel. Based on that evaluation, the two officers concluded that the Company's disclosure controls and procedures were adequate and effective, as of September 30, 2004, to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this Report was being prepared. Their evaluation was reported to the Audit Committee in connection with its review of this Report prior to its filing.

#### **Changes in Internal Controls**

There was no significant change during the quarter ended September 30, 2004 in the Company's internal controls over financial reporting identified in connection with the officers' evaluation reported above that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.





**PART II . OTHER INFORMATION**

**Item 5. Other Information**

In order to keep expenses at a minimum the Board currently intends to call the Annual Meeting of Shareholders for the fiscal year ending March 31, 2004 ( fiscal 2004 ) on Friday, January 14, 2005. Shareholders proposals for inclusion in the Company s proxy statement for the Annual Meeting of Shareholders for fiscal 2004 must be received no later than a reasonable time before the Company prints and mails its proxy material for such Annual Meeting. If a shareholder intends to submit a proposal for consideration at such Annual Meeting by means other than the inclusion of the proposal in the Company s proxy statement for such Annual Meeting, the shareholder must notify the Company of such intention no later than a reasonable time before the Company prints and mails its proxy material for such Annual Meeting, or risk management exercising discretionary voting authority with respect to the management proxies to defeat such proposal when and if presented at such Annual Meeting. The Company currently anticipates mailing the proxy material for such Annual Meeting on or before Thursday, December 23, 2004. The Company shall advise its shareholders of any change in the contemplated mailing date for its proxy material for the Annual Meeting of Shareholders for fiscal 2004 by notice in its earliest possible Quarterly Report on Form 10-QSB or by other appropriate notice.

**Item 6. Exhibits and Reports on Form 8-K**

**(a) Exhibits**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
10.1	Asset Purchase Agreement entered into as of October 3, 2003 by and between PerfectData Corporation and Spray Products Corporation(1)
10.2	First Amendment, dated as of February 26, 2004, to the Asset Purchase Agreement, dated as of October 3, 2003, filed as Exhibit 10.1(2)
10.3	Second Amendment, dated as of August 12, 2004, to the Asset Purchase Agreement, dated as of October 3, 2003(3)
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934(4)
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934(4)
32	Certification Pursuant to Section 906 of Sarbanes-Oxley Act of 2002(5)

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(1) Incorporated by reference to the Company s Report on Form 8-K filed on October 8, 2003.

(2) Incorporated by reference to the Company s Annual Report on Form 10-KSB for its fiscal year ended March 31, 2004.



(3) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2004.

(4) Filed herewith.

(5) Furnished herewith.

(b) **Reports on Form 8-K**

There were no reports on Form 8-K filed by the Company during the quarter ended September 30, 2004.

**SIGNATURE**

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.

PERFECTDATA CORPORATION

By: /s/ Irene J. Marino  
Irene J. Marino  
Authorized Officer and Principal Financial  
and Accounting Officer

Date: November 12, 2004

**PerfectData Corporation  
Index to Exhibits Filed with  
Quarterly Report on Form 10-QSB**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>	<b>Page</b>
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934	E-2
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934	E-4
32	Certification Pursuant to Section 906 of Sarbanes-Oxley Act of 2002	E-6

E-1

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