

AVALON HOLDINGS CORP
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November 24, 2017

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 13D
Under the Securities Exchange Act of 1934
(Amendment (28))*

AVALON HOLDINGS CORPORATION

(Name of Issuer)

Class A Common Stock, \$0.01 par value

(Title of Class of Securities)

0534P109

(CUSIP Number)

Anil Choudary Nalluri

5500 Market Street, Suite 128

Youngstown, Ohio 44512

330-783-1147

(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)

November 24, 2017

(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition that is the subject of this Schedule 13D, and is filing this schedule because of §§240.13d-1(e), 240.13d-1(f) or 240.13d-1(g), check the following box.

Note: Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. See §240.13d-7 for other parties to whom copies are to be sent.

* The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

CUSIP No. 05343P109

13D

1. Names of Reporting Persons.

I.R.S. Identification Nos. of above persons (entities only).

Anil Choudary Nalluri

2. Check the Appropriate Box if a Member of a Group (See Instructions)

(a) (b)

3. SEC Use Only

4. Source of Funds (See Instructions)

PF

5. Check if Disclosure of Legal Proceedings Is Required Pursuant to Items 2(d) or 2(e)

6. Citizenship or Place of Organization

United States

Number of **7. Sole Voting Power**

Shares

Beneficially 719,234

8. Shared Voting Power

Owned by

Each

0

Reporting **9. Sole Dispositive Power**

Person

With 719,234

10. Shared Dispositive Power

0

11. Aggregate Amount Beneficially Owned by Each Reporting Person

719,234

12. Check if the Aggregate Amount in Row (11) Excludes Certain Shares (See Instructions)

13. Percent of Class Represented by Amount in Row (11)

22.53%

14. Type of Reporting Person (See Instructions)

IN

Instructions for Cover Page

- (1) *Names and I.R.S. Identification Numbers of Reporting Persons* Furnish the full legal name of each person for whom the report is filed - i.e., each person required to sign the schedule itself - including each member of a group. Do not include the name of a person required to be identified in the report but who is not a reporting person. Reporting persons that are entities are also requested to furnish their I.R.S. identification numbers, although disclosure of such numbers is voluntary, not mandatory (see SPECIAL INSTRUCTIONS FOR COMPLYING WITH SCHEDULE 13D below).
- (2) If any of the shares beneficially owned by a reporting person are held as a member of a group and the membership is expressly affirmed, please check row 2(a). If the reporting person disclaims membership in a group or describes a relationship with other persons but does not affirm the existence of a group, please check row 2(b) [unless it is a joint filing pursuant to Rule 13d-1(k)(1) in which case it may not be necessary to check row 2(b)].
- (3) The 3rd row is for SEC internal use; please leave blank.

- (4) Classify the source of funds or other consideration used or to be used in making purchases as required to be disclosed pursuant to Item 3 of Schedule 13D and insert the appropriate symbol (or symbols if more than one is necessary) in row (4):

<i>Category of Source</i>	<i>Symbol</i>
Subject Company (Company whose securities are being acquired)	SC
Bank	BK
Affiliate (of reporting person)	AF
Working Capital (of reporting person)	WC
Personal Funds (of reporting person)	PF
Other	OO

- (5) If disclosure of legal proceedings or actions is required pursuant to either Items 2(d) or 2(e) of Schedule 13D, row 5 should be checked.

- (6) *Citizenship or Place of Organization* - Furnish citizenship if the named reporting person is a natural person. Otherwise, furnish place of organization. (See Item 2 of Schedule 13D.)

(7)-(11), (13) *Aggregate Amount Beneficially Owned by Each Reporting Person, etc.* Rows (7) through (11) inclusive, and (13) are to be completed in accordance with the provisions of Item 5 of Schedule 13D. All percentages are to be rounded off to nearest tenth (one place after decimal point).

(12) Check if the aggregate amount reported as beneficially owned in row (11) does not include shares which the reporting person discloses in the report but as to which beneficial ownership is disclaimed pursuant to Rule 13d-4 [17 CFR 240.13d-4] under the Securities Exchange Act of 1934.

(14) *Type of Reporting Person* Please classify each reporting person according to the following breakdown and place the appropriate symbol (or symbols, i.e., if more than one is applicable, insert all applicable symbols) on the form:

<i>Category</i>	<i>Symbol</i>
Broker-Dealer	BD
Bank	BK
Insurance Company	IC
Investment Company	IV
Investment Adviser	IA
Employee Benefit Plan or Endowment Fund	EP
Parent Holding Company/Control Person	HC
Savings Association	SA
Church Plan	CP
Corporation	CO
Partnership	PN
Individual	IN
Other	OO

Notes:

Attach as many copies of the second part of the cover page as are needed, one reporting person per page.

Filing persons may, in order to avoid unnecessary duplication, answer items on the schedules (Schedule 13D, 13G or 14D-1) by appropriate cross references to an item or items on the cover page(s). This approach may only be used where the cover page item or items provide all the disclosure required by the schedule item. Moreover, such a use of a cover page item will result in the item becoming a part of the schedule and accordingly being considered as filed for purposes of Section 18 of the Securities Exchange Act or otherwise subject to the liabilities of that section of the Act.

Reporting persons may comply with their cover page filing requirements by filing either completed copies of the blank forms available from the Commission, printed or typed facsimiles, or computer printed facsimiles, provided the documents filed have identical formats to the forms prescribed in the Commission's regulations and meet existing Securities Exchange Act rules as to such matters as clarity and size (Securities Exchange Act Rule 12b-12).

SPECIAL INSTRUCTIONS FOR COMPLYING WITH SCHEDULE 13D

Under Sections 13(d) and 23 of the Securities Exchange Act of 1934 and the rules and regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this schedule by certain security holders of certain issuers.

Disclosure of the information specified in this schedule is mandatory, except for I.R.S. identification numbers, disclosure of which is voluntary. The information will be used for the primary purpose of determining and disclosing the holdings of certain beneficial owners of certain equity securities. This statement will be made a matter of public record. Therefore, any information given will be available for inspection by any member of the public.

Because of the public nature of the information, the Commission can utilize it for a variety of purposes, including referral to other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the Federal securities laws or other civil, criminal or regulatory statutes or provisions.

I.R.S. identification numbers, if furnished, will assist the Commission in identifying security holders and, therefore, in promptly processing statements of beneficial ownership of securities.

Failure to disclose the information requested by this schedule, except for I.R.S. identification numbers, may result in civil or criminal action against the persons involved for violation of the Federal securities laws and rules promulgated thereunder.

General Instructions

- A. The item numbers and captions of the items shall be included but the text of the items is to be omitted. The answers to the items shall be so prepared as to indicate clearly the coverage of the items without referring to the text of the items. Answer every item. If an item is inapplicable or the answer is in the negative, so state.
- B. Information contained in exhibits to the statements may be incorporated by reference in answer or partial answer to any item or sub-item of the statement unless it would render such answer misleading, incomplete, unclear or confusing. Material incorporated by reference shall be clearly identified in the reference by page, paragraph, caption or otherwise. An express statement that the specified matter is incorporated by reference shall be made at the particular place in the statement where the information is required. A copy of any information or a copy of the pertinent pages of a document containing such information which is incorporated by reference shall be submitted with this statement as an exhibit and shall be deemed to be filed with the Commission for all purposes of the Act.
- C. If the statement is filed by a general or limited partnership, syndicate, or other group, the information called for by Items 2-6, inclusive, shall be given with respect to (i) each partner of such general partnership; (ii) each partner who is denominated as a general partner or who functions as a general partner of such limited partnership; (iii) each member of such syndicate or group; and (iv) each person controlling such partner or member. If the statement is filed by a corporation or if a person referred to in (i), (ii), (iii) or (iv) of this Instruction is a corporation, the information called for by the above mentioned items shall be given with respect to (a) each executive officer and director of such corporation; (b) each person controlling such corporation; and (c) each executive officer and director of any corporation or other person ultimately in control of such corporation.

Item 1. Security and Issuer

This Statement on Schedule 13D (Schedule 13D) relates to the Class A Common Stock, \$0.01 par value (the Common Stock) of Avalon Holdings Corporation, an Ohio corporation (the Issuer), whose principal executive offices are located at One American Way, Warren, Ohio 44484.

Item 2. Identity and Background

This statement is filed by Anil Choudary Nalluri (Mr. Nalluri or the Reporting Person) on behalf of himself and his wife, Parvati Nalluri and various accounts controlled by them. Mr Nalluri s principal business address is 5500 Market Street, Suite 128, Youngstown, Ohio 44512. Mr. Nalluri s principal occupation is practicing in the field of child and adult psychiatry. During the past five years, Mr. Nalluri has not been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) and has not been a party to civil proceedings of a judicial or administrative body of competent jurisdiction, as a result of which Mr. Nalluri was or is subject to a judgment, decree, or final order enjoining future violations of, or prohibiting or mandating activities subject to, federal or state securities laws or finding any violation with respect to such laws. Mr. Nalluri is a United States citizen.

Item 3. Source and Amount of Funds or Other Consideration

Mr. Nalluri's purchases of shares of Common Stock have all been made with his personal funds.

Item 4. Purpose of Transaction

The purpose of this filing is to state that Mr. Nalluri is the beneficial owner of greater than 20% of the Common Stock of the issuer.

Mr. Nalluri does not currently have any specific plans or proposals that relate to or would result in any of the actions or events specified in clauses (a) through (j) of Item 4 of Schedule 13D. Mr. Nalluri reserves the right to change plans and take any and all actions that Mr. Nalluri may deem appropriate to maximize the value of his investments, including, among other things, purchasing or otherwise acquiring additional securities of the Issuer, selling or otherwise disposing of any securities of the Issuer beneficially owned by him, in each case in the open market or in privately negotiated transactions, or formulating other plans or proposals regarding the Issuer or its securities to the extent deemed advisable by Mr. Nalluri in light of his general investment policies, market conditions, subsequent developments affecting the Issuer and the general business and future prospects of the Issuer.

Item 5. Interest in Securities of the Issuer

(a) Mr. Nalluri beneficially owns 719,234 shares of Common Stock, which is equal to approximately 22.53% of the outstanding shares, based on information from the Issuer that 3,191,100 Class A shares of Common Stock are outstanding as of March 3, 2017.

(b) Mr. Nalluri has sole voting and dispositive power for all such shares of Common Stock held record by him.

Item 6. Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer

Not applicable

Item 7. Material to be Filed as Exhibits

Not applicable

Item 8. Submission of Shareholders Proposals for 2018 Proxy Statement

In accordance with Rule 14a-8 under the Securities Exchange Act of 1934, as amended, I hereby submit for presentation at the 2018 Annual Meeting of Shareholders (the Meeting) of Avalon Holdings Corporation (the Company) and inclusion in the proxy materials (i.e., the notice of meeting, proxy statement and proxy card) relating to the Meeting the following proposal and supporting statement:

1. Election of Class A Director Anil Choudary Nalluri, M.D. ABPN:
Enclosed is my resume

2. RESOLVED: That the shareholders of Avalon Holdings Corporation (the Company) authorize and direct the Company s Board of Directors to retain an investment bank to solicit offers for the purchase of the Company s stock or assets, and that the Board of Directors, within 120 days from the date of the approval of this resolution is directed to present the highest cash offer to purchase the Company s stock or assets to the shareholders for their acceptance or rejection of such offer.

Supporting Statement:

According to the publicly filed documents on December 31, 1998, the Company and cash equivalent of \$22,274,000, equal to approximately \$5.85 per share.

Mr. Klinge and the board of directors have not provided and lack visibility of providing a return justifying the use of approximately \$100 million dollars and borrowing an approximately additional \$20 million dollars at 6 percent interest. Corporate board members to whom I have spoken have stringent rates of return requirements for the approval of cash and cash investments. Judging from the results of the investment of \$100-\$130 million dollars in golf club renovations and the hotel& taking huge salaries bonuses this investment is wasted because the corporation has been losing money almost every year except 1 or 2 years.

I am the one and only outside Class A Shareholder who has attended all meetings with exception of 1 or 2. Mr. Klinge has repeatedly touted that he is making intelligent decisions contrary to that, I would say Mr. Klinge is doing the opposite evidenced by the stock has plummeted from \$8 a share to \$2 per share since April 30, 1998 to present. This is a clear evidence of Mr. Klinge's incompetency to run the board. Not only Mr. Klinge but the entire board is incompetent. Mr. Klinge should be ashamed of himself and resign immediately. I also believe a new CEO should be hired. If Mr. Klinge could have made rational decisions like Amazon, Apple Computer, and Tesla Motors the stock should have sky rocketed from \$8 a share to a much greater value.

If you invest approximately \$100 million dollars in the bank your return on that savings would amount to approximately \$3 million dollars per year.

However instead of Avalon Holdings Corporation making \$3 million in interest per year, the shareholders are losing approximately \$5 - \$6 million per year.

Allocation of capital by the company, the company's board of directors has been very disappointing. We believe it is essential that the board of directors focus its attention on maximizing shareholder value in order to preserve the diminished value that remains.

We believe this can be accomplished with the assistance of an investment bank retained by the company to solicit offers on behalf of the company for the purchase of the company's stock and/or assets. The highest cash offer would then be presented to the company's shareholders for their acceptance or rejection.

This proposal does not mandate the sale of the company but proposes a reasonable process to determine the true market value of the company and to give the shareholders the opportunity to determine the future course of the company. Strong support for this proposal would send a signal to the board of directors that shareholders are dissatisfied with its performance.

In my opinion the board of directors are rubberstamping Mr. Klinge's proposals. It seems to me like this is the blind leading the blind. Mr. Klinge is guarding the Avalon Holdings Corporation since its inception from 4-30-1998 to date for 19 years like a fox guarding a hen house.

We urge you to vote FOR this proposal.

The entire sale of Avalon Holdings 3.8 million share of the open stock exchange is only worth 8 million dollars. The stock is highly ill-liquid.

The outside Class A shareholders are losing money daily and the board of directors to include the CEO and the accountants are the only ones profiting from this venture.

you and your executive board do not deserve any bonuses, evidenced by the fact that in 1 years the stock value of Avalon Holdings has grossly plummeted from \$8 a share to \$2.00 trading range for the past 2-3 years. The book value of the stock price is \$9.98. How can you justify the stock being sold for $\frac{1}{4}$ - $\frac{1}{5}$ of the book value? I strongly recommend that all of your salaries must be frozen until you show profit and increase the shareholder value.

How can you justify the losses year after year for over 19 years? You have lost more money in the golf for the past 19 years. You never lost money in the garbage business.

You are making money in the garbage business and borrowing more money and you wasted approximately \$100 - \$130 million dollars in the golf related and hotel business. I was unable to have access to the records to know the exact amount. The \$100 - \$130 millions that includes:

1. Buying and leasing Country Clubs
2. Hughes salaries and bonuses to his self, his wife and all of the board members.
3. Building multiple swimming pools indoor and outdoor.
4. Indoor tennis courts.
5. Rebuilding old Avalon Inn Hotel by borrowing \$40 million-\$25 Million @ approximately 4-5% interest rate
6. I will add 3.4 million dollar investment for deep water injection wells.
7. Mr. Klinge collected 3.5 million dollars from outside investors for the deep water injection wells.
8. I will add this 6.9 million dollars into the originals \$100 -\$130 million dollars Mr. Klinge wasted.
9. From December 31, 1998 to November 18, 2002 in a period of just four years, Mr. Klinge wasted 18.4 million dollars in rebuilding golf clubs. No income or minimal income was generated from these 18.4 million dollars.
10. Mr. Klinge never gave a dime to outside shareholders from April 30, 1998 to date.
11. The Avalon Holdings Stock plummeted from \$8.00 a share to \$2.00.

The above is clear indication of your lack of due diligence, dereliction of fiduciary duty, and pure incompetence. In fact it is my opinion that you and the rest of the board should reevaluate your roles, which is why I am running for the Class A director because I could certainly do no worse and undoubtedly do a better job of investing the shareholders money.

None of you asked an independent agency to evaluate whether investing \$ 35-40 million dollars in the Avalon Hotel in a depressed, poor Mahoning and Trumbull counties was a lucrative endeavor. We are not in Florida, South Carolina, Las Vegas or anywhere in California where these types of luxury hotels are found.

For Proxy Card:

1. Authorize and direct Board of Directors to retain an investment bank to solicit offers for the Company s stock or assets and to present highest cash offer to shareholders within 120 days.

Item #1. FOR []	AGAINST []	ABSTAIN []
Item #2 FOR []	AGAINST []	ABSTAIN []

I currently own 719,234 shares of Common A stock of Avalon Holdings Corporation, which presently has a market value of \$1,438,468 at the market price of \$2.00 now.

I have included with this submission a letter from E-Trade Securities Corporation verifying that I own more than 20,000 shares as of the date of submission and that I have continuously held the shares for the past 19 years.

I intend to continue to hold these shares through the date of the Meeting. I either personally or through a representative also intends to attend the Meeting and present the proposal in this submission in accordance with Ohio law.

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I am sending this submission via Priority US Mail and will retain proof of delivery and I will also fax a copy to 330-856-8480 which will be no later than November 27, 2017.

Anil C. Nalluri, M.D.

Certified by American Board of Psychiatry and Neurology, June 1981, certificate no. 22542

Certified by the American Board of Forensic Psychiatry, 03/31/05, expired 12/31/15, certificate no. 1554 Re Certified April 3, 2017 Expires 04-03-2027 (one out of 2500 psychiatrists in the United States)

Certified by American Board of Independent Medical Examiners 10/06/98, expires 10/06/18, certificate no. 98-01228 (one out of 11 psychiatrists in the United States)

Lifetime Continuing Education Hours AMA Guides 4th, 5th, & 6th Editions and Forensic Psychiatry (over 2,000 hours)

Pennsylvania Independent Rating Evaluator for the Bureau of Workers Compensation, August 2001-02/20/2013

Assistant Professor of Psychiatry, NEOMED 07/19/82-12/31/12

Fellow, American Academy of Disability Evaluating Physicians 11/15/97 12/31/03

Fellow, American Psychiatric Association 12/19/97-12/31/02

Distinguished Fellow, American Psychiatric Association 01/01/03-01/26/10

Distinguished Life Fellow, American Psychiatric Association 01/27/10

Ohio Medical License # 35-040657 issued 05/19/77, expires 04/01/20

Pennsylvania Medical License# MD-037040-L issued 02/14/77, expires 12/31/18

ACN

CC/ Securities & Exchange Commission

100 F Street N.E.

Washington, DC 20549

Date: November 24, 2017

Signature /s/ Anil Choudary Nalluri
Name/Title: Anil Choudary Nalluri

The original statement shall be signed by each person on whose behalf the statement is filed or his authorized representative. If the statement is signed on behalf of a person by his authorized representative (other than an executive officer or general partner of the filing person), evidence of the representative's authority to sign on behalf of such person shall be filed with the statement: provided, however, that a power of attorney for this purpose which is already on file with the Commission may be incorporated by reference. The name and any title of each person who

signs the statement shall be typed or printed beneath his signature.

Attention: Intentional misstatements or omissions of fact constitute Federal criminal violations (See 18 U.S.C. 1001)

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arter of fiscal 2003.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information with respect to the executive officers of K-tel at June 30, 2003.

Name of Officer	Age	Positions and Offices Held
Philip Kives	74	Chairman of the Board, Chief Executive Officer, President and Director
Dennis Ward	57	Chief Financial Officer, Secretary and Director

The officers of K-tel are elected annually and serve at the discretion of the Board of Directors.

Philip Kives has held various offices and/or managerial positions with K-tel for more than thirty-five years. Mr. Kives is currently the Company's Chairman, Chief Executive Officer and President.

Dennis W. Ward was appointed Chief Financial Officer and Secretary of K-tel on December 29, 2000 and has served as Controller of K-5 Leisure Products, Inc. (K-tel's largest shareholder) for more than twelve years.

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

On September 22, 2003, there were 1,391 record holders of K-tel's common stock and 13,653,738 shares outstanding. The Company's common stock is traded on the Over-the-Counter Bulletin Board under the symbol KTEL.

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The following table shows the range of high and low closing prices per share of K-tel's common stock for the fiscal year periods indicated. Such over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	2003		2002	
	High	Low	High	Low
1st Quarter	\$.10	\$.05	\$.14	\$.10
2nd Quarter	\$.10	\$.04	\$.39	\$.12
3rd Quarter	\$.06	\$.04	\$.40	\$.13
4th Quarter	\$.18	\$.04	\$.15	\$.09

No cash dividends have been declared on K-tel's common stock during the past two fiscal years and K-tel does not expect to pay cash dividends in the foreseeable future. Management plans to use cash generated from operations for expansion of its business. The declaration or payment by K-tel of dividends, if any, on its common stock in the future is subject to the discretion of the Board of Directors and will depend on K-tel's earnings, financial condition, capital requirements and other relevant factors. The declaration or payment by K-tel of dividends is also subject to the terms of its credit facility.

Equity Compensation Plan Information

The following table provides information as of June 30, 2003 with respect to compensation plans under which the Company's equity securities are authorized for issuance.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	142,900(1) \$	5.93	2,387,989(2)
Equity compensation plans not approved by security holders	300,000(3) \$	0.05	NA
Total	442,900 \$	1.95	2,387,989

(1) Consists of 140,900 shares issuable pursuant to options granted under the Company's 1997 Stock Option Plan and 2,000 shares of common stock issuable pursuant to options granted under the Company's 1987 Stock Incentive Plan.

(2) Represents shares of common stock remaining available for future issuance under the Company's 1997 Stock Option Plan, as amended.

(3) Includes non-qualified stock options to purchase 95,000 shares of our common stock issued outside of the Company's 1997 Stock Option Plan to each of Jay William Smalley, Richard R. Marklund and Wesley C. Hayne in connection with such non-employee directors' appointment to the Company's Compensation/ Stock Option Committee and a non-qualified stock option to purchase 15,000 shares of our common stock issued outside the Company's 1997 Stock Option Plan to Jay William Smalley in consideration of his past and continued service on the Company's board of directors. (See Director Compensation on page 18.) Does not include an aggregate of 2,137,939 shares of common stock issuable pursuant to a stock option exchange program approved on March 18, 2003 by a committee of the Company's board of directors comprised solely of independent directors. Under the program, four optionees agreed to cancellation of previously awarded options under the Company's 1997 Stock Option Plan and the Company agreed to issue options to purchase an equal number of shares outside the Company's stock option plan not earlier than six months and one day after the date of cancellation of the previously awarded options. The replacement options will be issued at an exercise price per share equal to the fair market value of the Company's common stock on the date of grant and will expire ten years after the date of grant. The options previously awarded were cancelled on March 18, 2003 and replacement options had not yet been granted as of the date of the table.

ITEM 6: SELECTED FINANCIAL DATA

The following summary of consolidated operations and certain balance sheet information includes the consolidated results of operations of K-tel and its subsidiaries as of and for the five years ended June 30, 2003. This summary should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this filing. All share and per share amounts are based on the weighted average shares issued. All amounts are in thousands of dollars, except per share data.

	2003	2002	2001	2000	1999
Net sales	\$ 7,234	\$ 6,875	\$ 17,514	\$ 29,092	\$ 44,650
Operating income (loss)	\$ 53	\$ (332)	\$ (9,480)	\$ (12,980)	\$ (8,356)
Loss from discontinued operations	\$ (581)	\$ (180)	\$ (4,315)	\$ (5,541)	\$ (2,260)
Extraordinary item:					
Gain on bankruptcies	\$	\$ 894	\$ 16,185	\$	\$
Net income (loss)	\$ (988)	\$ 14	\$ 1,369	\$ (15,738)	\$ (11,547)
Net loss per share:					
Continuing operations	\$ (.03)	\$ (.05)	\$ (.77)	\$ (1.02)	\$ (1.01)
Total assets	\$ 4,757	\$ 4,250	\$ 3,832	\$ 17,941	\$ 32,249
Long-term debt	\$	\$	\$ 4,000	\$ 4,000	\$ 4,000

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Through its operating subsidiaries, K-tel licenses its music catalog internationally and markets entertainment products mainly derived from its catalog in the United States and Europe through retail and direct response marketing channels.

For this analysis, the following changes in the Company's business should be considered: K-tel closed the operations of its German subsidiary, Dominion Vertriebs GmbH, in June 2000; one of its subsidiaries in the United Kingdom, K-tel Marketing Ltd., in November 2000; and a United States subsidiary, K-tel Consumer Products, Inc., in February 2001. These three closings represent the discontinuation of the Company's consumer products division and accordingly have been presented in the accompanying financial statements as discontinued operations. In addition, in March 2001, the Company's music distribution subsidiary in the United States, K-tel (USA) ceased operations and filed for protection under Chapter 7 of the United States Bankruptcy Code.

Through another subsidiary, K-tel Entertainment, Inc., K-tel has a focused method of distribution that targets the strengths of fewer individual retailers and supplies products suited to each retailer's specific needs. These new products are derived from the Company's master recordings music catalog with the objective of realizing more competitive profit margins. As well, the Company seeks to license its name and marks to other businesses for a royalty or fee.

A. RESULTS OF OPERATIONS

The following sections discuss the results of operations by business segment. See Note 8 to the consolidated financial statements for additional segment information. General corporate expenses of \$860,000 in the year ended June 30, 2003, \$1,049,000 in the year ended June 30, 2002 and \$2,689,000 in the year ended June 30, 2001 have been allocated to the segments.

FISCAL 2003 VERSUS FISCAL 2002

Net sales for the year ended June 30, 2003 were \$7,234,000, an increase of 5.2% from fiscal 2002 sales of \$6,875,000. This sales increase was attributed to increased domestic music sales partially offset by a decrease in licensing revenue. The net loss for fiscal 2003 was \$988,000, or \$.07 per share, compared to a net income of \$14,000, or \$.00 per share (after an extraordinary gain of \$894,000 related to the K-tel Marketing liquidation), in fiscal 2002.

The following sections discuss the results of continuing operations by business segment.

BUSINESS SEGMENT RESULTS

Music

Sales in the music segment were \$4,454,000 for the year ended June 30, 2003 compared to \$3,757,000 for the year ended June 30, 2002, an increase of 18.6%. The increase was primarily related to increased sales to Handleman who became a customer late in the prior year and to an increased number of products available for sale during the most recently completed year.

Cost of goods sold in the music segment increased to 63.2% of sales for the year ended June 30, 2003 compared to 54.2% of sales for the year ended June 30, 2002. Advertising expenses within the segment, which consists primarily of co-operative advertising payments, trade advertising and promotions, increased to \$200,000 for the year ended June 30, 2003 compared to \$172,000 for the year ended June 30, 2002.

Selling, general and administrative expenses for the segment decreased \$669,000, or 20.5%, to \$2,600,000 for the year ended June 30, 2003 compared to \$3,269,000 for the year ended June 30, 2002. The primary reasons for the decrease were related the closing of the Company's office in Germany in 2002 and efforts to reduce overhead costs in the Company's office in England. As a result, the music segment incurred an operating loss of \$1,106,000 for the year ended June 30, 2003 compared to an operating loss of \$1,725,000 for the year ended June 30, 2002.

Licensing

Licensing revenues were \$2,780,000 for fiscal 2003 compared to \$3,118,000 for fiscal 2002, a decrease of 10.8%. While European revenue decreased \$405,000, domestic revenue from licensing activity increased \$67,000. The decrease in Europe reflected a reduced level of licensing in the music industry. While domestic licensing experienced this as well, licensing revenue from the Company's main licensee increased significantly. In mid-2002, the Company undertook a program to audit licensees of the music catalog in order to verify compliance with the terms of license agreements. One of the audits undertaken determined that a significant amount of revenue had not been reported to the Company. During the year ended June 30, 2003 the licensee subject to this audit made the royalty payments that are required under the license, and the Company's revenue has increased accordingly. While the Company expects other licensing activity to continue at a reduced level into the next fiscal year, the Company is hopeful that current efforts will help reverse this trend for the Company during the year. Operating income in the licensing segment was \$1,159,000 for the year ended June 30, 2003 and \$1,393,000 for the year ended June 30, 2002, a decrease of 16.8%.

FISCAL 2002 VERSUS FISCAL 2001

Net sales for the year ended June 30, 2002 were \$6,875,000, a decrease of 61% from the year ended June 30, 2001 sales of \$17,514,000. The sales decrease was primarily attributed to the cessation of operations of the Company's domestic music distribution subsidiary, K-tel (USA), which had sales of \$11,948,000 during 2001. For the fiscal year ended June 30, 2002, approximately 43% of the Company's net sales were derived in Europe. Net income for the year ended June 30, 2002 was \$14,000, or \$.00 per share (after an extraordinary gain of \$894,000 related to the K-tel Marketing liquidation), compared to a net income of \$1,369,000, or \$.10 per share (after an extraordinary gain of \$16,185,000 related to the K-tel (USA) bankruptcy filing) in the year ended June 30, 2001.

The following sections discuss the results of continuing operations by business segment.

BUSINESS SEGMENT RESULTS

Music

Sales in the music segment were \$3,757,000 for the year ended June 30, 2002 compared to \$14,202,000 for the year ended June 30, 2001, a decline of 74%. European sales decreased \$674,000 and domestic music sales decreased \$9,965,000. The domestic business had been comprised primarily of sales of music compilations produced by K-tel and the sales and distribution of other record labels. Sales declined as K-tel (USA) ceased operations and filed for bankruptcy in March 2001. Sales during the year ended June 30, 2002 were in another domestic subsidiary (K-tel Entertainment, Inc.) that markets products derived from the Company's proprietary master music catalog.

Cost of goods sold in the music segment decreased to 55% of sales for the year ended June 30, 2002 compared to 106.9% of sales for the year ended June 30, 2001. The cost of goods in excess of net sales for the year ended June 30, 2001 reflected the disposal of slow-moving and obsolete inventory at prices less than cost during the period. Advertising expenses within the segment, which consist primarily of co-operative advertising payments, trade advertising and promotions, decreased to \$183,000 for the year ended June 30, 2002 compared to \$513,000 for the year ended June 30, 2001. The decrease in advertising spending was primarily the result of reduced levels of advertising during the year ended

June 30, 2002.

Selling, general and administrative expenses for the segment decreased \$3,070,000, or 49%, to \$3,269,000 for the year ended June 30, 2002 compared to \$6,261,000 for the year ended June 30, 2001. The primary reasons for the decrease were related to general overall spending reductions and nine months of operations of the domestic music distribution subsidiary in the year ended June 30, 2001. As a result, the music segment incurred an operating loss of \$1,725,000 for the year ended June 30, 2002 compared to an operating loss of \$7,749,000 for the year ended June 30, 2001.

In connection with the K-tel Marketing Ltd. creditors liquidation in the year ended June 30, 2002, the assets and liabilities of the subsidiary have been removed from the books of the Company and the remaining net liability has been shown as a gain on liquidation. During the fiscal year ended June 30, 2002, this subsidiary was not operating. During the fiscal year ended June 30, 2001, this subsidiary had net sales of \$3,179,000 and sustained an operating loss of \$3,220,000. Management believes the Company will have no ongoing liability related to this subsidiary as a result of the filing and the outcome of the liquidation proceeding.

In connection with the K-tel (USA) bankruptcy filing in the year ended June 30, 2001, the assets and liabilities of the subsidiary were removed from the books of the Company and the remaining net liability has been shown as a gain on liquidation. During the fiscal year ended June 30, 2002, this subsidiary was not operating. During the fiscal year ended June 30, 2001, this subsidiary had net sales of \$11,948,000 and sustained an operating loss \$5,229,000. Management believes

the Company will have no ongoing liability related to this subsidiary as a result of the filing and the outcome of the bankruptcy proceeding.

Licensing

Licensing revenues were \$3,118,000 for the year ended June 30, 2002 compared to \$3,710,000 for the year ended June 30, 2001, a decrease of 15.9%. Included in the segment revenue in the year ended June 30, 2001 was approximately \$763,000 of inter-company revenue, which was eliminated on the accompanying consolidated financial statements. Operating income in the licensing segment was \$1,393,000 for the year ended June 30, 2002 and \$425,000 for the year ended June 30, 2001, an increase of 228%, which was a result of operational productivity improvements.

Other

The Other segment of the business was comprised of the e-commerce business, which was closed in the fourth quarter of 2001. The Company had neither revenue nor losses from this segment in the years ended June 30, 2002 and 2003. Revenue from this segment was \$365,000 in the year ended June 30, 2001. Operating losses from this segment were \$2,156,000 in the year ended June 30, 2001.

Critical Accounting Policies

Revenue Recognition The Company derives its revenue mainly from two sources: the sale of music compilations (predominately compact discs) produced by the Company, and license revenue from the licensing of Company-owned masters. Revenue from music sales is recognized at the time of shipment to the customer, while license revenue is recognized when payment is received from customers or when known amounts are receivable, as prior to that date collection is not considered probable. Most music sales are made with a right of return of unsold goods. Estimated reserves for returns are established by management based upon historical experience and product mix and are subject to ongoing review and adjustment by the Company. These reserves are recorded at the time of sale and are reflected as a reduction in revenues. The Company's reserve for returns was \$213,000 at June 30, 2003 and \$40,000 at June 30, 2002.

Rights to Use Music Product - Certain of the Company's compilation products are master recordings under license from record companies and publishers. In most instances, minimum guarantees or non-refundable advances are required to obtain the licenses and are realized through future sales of the product. The amounts paid for minimum guarantees or non-refundable advances are capitalized and charged to expense as sales are made. The unrealized portion of guarantees and advances is included in royalty advances in the accompanying consolidated balance sheets. Licenses are subject to audit by licensors. When anticipated sales appear to be insufficient to fully recover the minimum guarantees or non-refundable advances, a provision against current operations is made for anticipated losses.

Royalties - The Company has entered into license agreements with various record companies and publishers under which it pays royalties on units sold. The Company accrues royalties using contractual rates and certain estimated rates on applicable units sold. The contractual royalty liability is computed quarterly and the accrued royalty balance is adjusted accordingly. The royalty agreements are subject to audit by licensors.

Recent Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 146 (SFAS 146), *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 146 provides financial accounting and reporting guidance for costs associated with exit or disposal activities, including one-time termination benefits, contract termination costs other than for a capital lease, and costs to consolidate facilities or relocate employees. This statement is effective for exit or disposal activities that are initiated after December 31, 2002. Management does not believe this pronouncement will have a material effect on the Company's consolidated financial position and results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 addresses the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. FIN 45 also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN 45 were effective for the Company for its quarter ended December 31, 2002. The liability recognition requirement is applicable prospectively to all guarantees issued or modified after December 31, 2002. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In December 2002, the FASB issued Statement 148 (FAS 148), *Accounting for Stock-Based Compensation Transition and Disclosure*. FAS 148 amends the disclosure and certain transition provisions of Statement 123, *Accounting for Stock-Based Compensation*. Its disclosure provisions, which apply to all entities with employee stock-based compensation, are effective for fiscal years ending after December 15, 2002. New interim period disclosures were required in financial statements for interim periods beginning after December 15, 2002. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In January 2003, the FASB issued Interpretation (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 is an interpretation of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, and addresses consolidation by business enterprises of variable interest entities. FIN 46 applies immediately to variable interest entities created or obtained after January 31, 2003 and it applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that is acquired before February 1, 2003. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In May 2003, the FASB issued Statement 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. Statement 150 changes the classifications in the statement of financial position of certain common financial instruments from either equity or mezzanine presentation to liabilities and requires an issuer of those financial statements to recognize changes in fair value or redemption amount, as applicable, in earnings. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of Statement 150 is not anticipated to have an impact on the Company's consolidated financial position or results of operations.

B. LIQUIDITY AND CAPITAL RESOURCES

K-tel has a Line of Credit Agreement with K-5 Leisure Products, Inc. (K-5), the Company's largest shareholder controlled by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel. Under the terms of the agreement (the K-5 Facility), K-5 has agreed to make available up to \$8,000,000 to K-tel on a revolving basis. The loan bears interest at a variable rate based upon the base rate of a nationally recognized lending institution (4.0% at June 30, 2003), expires July 20, 2005, and is subordinated to the Foothill loan (see below). The K-5 Facility contains the same covenants as the Foothill loan agreement. K-tel has pledged the stock of its foreign subsidiaries as collateral for the loan, and the loan carries a subordinated position to the Foothill loan on all other assets of the Company. K-tel had outstanding balances of \$7,282,000 and \$6,026,000 as of June 30, 2003 and 2002 respectively under the K-5 Facility. At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

In addition, K-tel has a second loan agreement with K-5, under which K-5 assumed rights and obligations under a loan from the Company's former banker (Foothill Capital Corporation) pursuant to an Assignment and Acceptance Agreement dated February 27, 2001. This Foothill loan, which has been extended through July 20, 2005, provides for a \$10,000,000 credit facility consisting of a \$4,000,000 term loan due upon expiration, and a \$6,000,000 revolving facility under which borrowings are limited to a percent of eligible receivables. Borrowings under the facility bear interest at a variable rate based on a base rate of a nationally recognized lending institution plus 1% (5.0% at June 30, 2003) and are collateralized by the assets of certain Company subsidiaries in the United States, including accounts receivable, inventories, equipment, music library and general intangibles. The loan agreement contains certain financial and other covenants or restrictions, including the maintenance of a minimum shareholders' equity by K-tel, limitations on capital expenditures, restrictions on music library acquisitions, limitations on other indebtedness and restrictions on dividends paid by K-tel. As of June 30, 2003 and 2002, \$4,000,000 was outstanding under the term loan and there were no borrowings under the revolving facility. At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

K-tel has an overdraft privilege borrowing facility with The Royal Bank of Scotland in the United Kingdom. This facility is secured by a standby letter of credit for \$260,000 provided by K-tel International Ltd., a Canadian company controlled by Philip Kives and is payable on demand in accordance with normal banking practices. Borrowings bear interest of 2.0% per annum over the base rate (a total of 5.75% at June 30, 2003) but are subject to a minimum of 6% per annum. K-tel had outstanding balances of \$233,000 and \$227,000 as of June 30, 2003 and 2002 respectively.

K-tel has primarily funded its operations to date through internally generated capital, proceeds from stock option exercises and secured loans from K-5. Management currently believes that K-tel has sufficient cash and borrowing capacity to ensure the Company will continue operations in the near term. In part, this is a result of improvement in operating results in fiscal 2003 as well as the two existing lines of credit with K-5. Although K-5 continues to advance funds sufficient to meet the

Company's needs at this time, there can be no assurance that this will be adequate or continue in the future or that K-tel will be able to obtain additional financing upon favorable terms when required.

The Company's ability to continue its present operations and implement future expansion plans successfully is contingent mainly upon its ability to maintain its line of credit arrangements with K-5, increase its revenues and profit margins, and ultimately attain and sustain profitable operations. Without increased revenues and sustained profitability beyond the near term, the cash generated from the Company's current operations will likely be inadequate to fund operations and service its indebtedness on an ongoing basis. Management is focusing its efforts on music licensing and limited music distribution. However, there can be no assurance that the Company will achieve profitable operations through these efforts. In the event the Company is unable to fund its operations and implement its current business plan properly, it may be unable to continue operations. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. The report of the Company's independent certified public accountants as of June 30, 2003 and 2002 and for the three years in the period ended June 30, 2003 included an explanatory paragraph expressing doubt about our ability to continue as a going concern.

CAUTIONARY STATEMENT

Certain information of a non-historical nature contained in Items 1, 2, 3 and 7 of this Form 10-K include forward-looking statements. Words such as anticipates, believes, expects, intends, future, and similar expressions identify forward-looking statements. Any such forward-looking statements reflect the Company's current views with respect to future events and financial performance, and are subject to a variety of factors that could cause the actual results or performance to differ materially from historical results or from the anticipated results or performance expressed or implied by such forward-looking statements. Because of such factors, the Company cannot assure you that the actual results or developments that it anticipates will be realized or, even if substantially realized, that they will have the anticipated results.

The risks and uncertainties that may affect the Company's business include, but are not limited to, those set forth below. The risks and uncertainties set forth below incorporate both historical and forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. You should not place undue reliance on such forward-looking statements, which speak only as of the date hereof. You should also be aware that, except as the law may otherwise require, the Company undertakes no obligation to publicly revise any such forward-looking statements to reflect events or circumstances that may arise after the date of this report. The following information is not intended to limit in any way the characterization of other statements or information under other captions as cautionary statements for such purpose. The order in which such factors appear below should not be construed to indicate their relative importance or priority.

The Company incurred losses in the fiscal years ended June 30, 2003 and June 30, 2002 and expects to continue incurring losses in the near future.

Continuation and expansion of the Company's operations will require additional working capital and continued access to financing to meet working capital requirements and develop new business opportunities.

The Company has primarily funded its operations to date through internally generated capital, proceeds from stock option exercises and secured loans from K-5 Leisure Products, Inc. (K-5), the Company's largest shareholder controlled by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel, and there can be no assurance that K-5 will continue to advance funds

sufficient to meet the Company's needs or that the Company will be able to obtain additional financing upon favorable terms when required.

Approximately 30.1% of the Company's revenue for the year ended June 30, 2003, was derived from two major customers, and the loss of any such customer could have a material adverse effect on the Company.

The music business is highly competitive and dominated by several major record companies that dominate the market for pre-recorded music, have greater financial resources than the Company and have a larger depth and breadth of catalog, distribution capabilities and current repertoire than the Company, making it difficult to compete in this market.

The major pre-recorded music companies, either directly or through subsidiaries, now manufacture or distribute pre-recorded music compilations in direct competition with the Company's music compilation products.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

K-tel is exposed to various market risks, including changes in interest rates and foreign currency exchange rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. K-tel does not enter into derivatives or other financial instruments for trading or speculative purposes.

K-tel's exposure to market risk for changes in interest rates relates to K-tel's short-term borrowings. K-tel's short-term credit facilities carry a variable interest rate that does have an impact on future earnings and cash flows. At June 30, 2003, K-tel had variable rate debt of \$11,515,000. If the interest rate were to change 100 basis points or 1% while K-tel was borrowing under the credit facilities, interest expense would change by \$115,000.

Approximately 32% of K-tel's revenues during the year ended June 30, 2003 were derived from operations in Europe. The results of operations and financial position of K-tel's operations in Europe were principally measured in their respective currencies and translated into U.S. dollars. The effect of foreign currency fluctuations in these European countries is somewhat mitigated by the fact that expenses are generally incurred in the same currencies in which the revenue is generated. The reported income of these subsidiaries will be higher or lower depending on the weakening or strengthening of the U.S. dollar against the respective foreign currency. If the U.S. dollar foreign currency rate were to change by 1%, the effect on income would be \$4,000. Additionally, approximately 18% of K-tel's assets at June 30, 2003 were based in its foreign operations and were translated into U.S. dollars at foreign currency exchange rate in effect as of the end of each accounting period, with the effect of such translation reflected as a separate component of consolidated shareholders' equity (deficit). Accordingly, K-tel's consolidated shareholders' equity (deficit) will fluctuate depending on the weakening or strengthening of the U.S. dollar against the respective foreign currency.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and related notes and schedules required by this Item are set forth in Part IV, Item 15, and identified in the index on page 23.

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There were no changes in or disagreements with accountants during the years ended June 30, 2003 and June 30, 2002.

ITEM 9A: CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are adequately designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in applicable rules and forms.

During the Company's most recent fiscal quarter, there has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following describes the business, the business experience and background of each director and executive officer of K-tel.

Wesley C. Hayne, age 56, was elected a director in November 2002. Since 2000, Mr. Hayne has been Chief Executive Officer of Biorefining, Inc., a company that develops, commercializes and licenses patented technologies capable of converting residual plant material into high-end, value-added products. From 1999 to 2000, Mr. Hayne was President of Cybrix Corporation, Inc., a company that provides solutions and leases staffing for computer security and disaster planning. From 1997 to 2000, Mr. Hayne was Chief Executive Officer of International Concept Development, Inc., a company that develops fast food restaurants in Europe. Mr. Hayne filed a petition under Chapter 7 of the Bankruptcy Code before the U.S. Bankruptcy Court for the District of Minnesota on February 16, 1999, resulting in the discharge of personal debts effective May 10, 1999.

Philip Kives, age 74, founded K-tel in 1968 and has served as its Chairman of the Board since K-tel's inception. In addition, Mr. Kives has been the Chief Executive Officer for more than five years.

Richard Marklund, age 58, was elected a director in November 2002. Since 2002, Mr. Marklund has been Chairman and Chief Executive Officer of Phoenix Newcastle Holdings, Inc., a management consulting company. From 2000 until 2002, Mr. Marklund served as Executive Vice President of Wamnet Inc., a data communication company. From 1998 until 2000, Mr. Marklund served as Chief Executive Officer of Hyperport International, Inc., a real estate development company.

Jay William Smalley, age 69, was elected a director in January 1999. Since 1970, Mr. Smalley has been Chief Executive Officer of JWS, Inc., a privately owned real estate development and sales company specializing in hotel, motel, industrial and residential properties.

Dennis W. Ward, age 57, was elected a director in January 1999 and the Company's Secretary and Chief Financial Officer in December 2000. Since 1990, Mr. Ward has been the Controller of K-tel International, Ltd., a Canadian corporation owned by Philip Kives and engaged in the marketing and distribution of consumer products, and of K-5 Leisure Products, Inc. (K-tel's largest shareholder).

During the Company's most recent fiscal quarter, there has been no change in the Company's internal control over

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires K-tel's officers, directors and persons who own more than 10% of a registered class of K-tel's equity securities to file reports of ownership on Form 3 and changes in ownership on Form 4 or 5 with the Securities and Exchange Commission. Such officers, directors and 10% shareholders also are required by Securities and Exchange Commission's rules to furnish K-tel with copies of all Section 16(a) reports they file. Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons, the Company believes that during the last fiscal year, its officers, directors and 10% shareholders filed all reports on a timely basis, except as set forth herein.

Reports on Form 3 for Richard Marklund and Wesley Hayne due following their election to the board of directors effective November 27, 2002 were not filed on a timely basis. A report on Form 4 relating to the grant of options to purchase an aggregate of 110,000 shares of common stock outside our 1997 Stock Option Plan to Jay William Smalley on November 27, 2002 was not filed on a timely basis. A report on Form 4 disclosing the cancellation of options to purchase common stock pursuant to the Company's Stock Option Exchange Program effective March 18, 2003 was not filed in a timely manner by each of Philip Kives and Dennis Ward.

ITEM 11: EXECUTIVE COMPENSATION

The following table sets forth the aggregate cash compensation paid to or accrued by each of K-tel's executive officers for services rendered to K-tel during the fiscal years ended June 30, 2003, 2002 and 2001. K-tel has no written employment agreements with its executive officers.

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation		Long-Term Compensation Awards Securities Underlying Options	All Other Compensation
		Salary	Bonus		
Philip Kives Chief Executive Officer	2003	\$	\$		\$
	2002	\$	\$		\$
	2001	\$	\$	80,000	\$
Dennis Ward Chief Financial Officer	2003	\$	\$		\$
	2002	\$	\$		\$
	2001	\$	\$	190,000	\$

No options were granted during the fiscal year ended June 30, 2003, to any of K-tel's executive officers.

No options were exercised by the executive officers during the last fiscal year and no unexercised options were held by the executive officers as of the end of the last fiscal year.

Director Compensation

Directors who are employees of our Company receive no compensation for their services as director. Non-employee directors receive cash compensation of \$10,000 per year (paid quarterly) and are entitled to receive non-qualified stock options for the purchase of 5,000 shares of our common stock at an exercise price equal to the fair market value of our common stock on the date of initial election and upon each re-election by the shareholders at an annual or special meeting. In connection with their appointment to the Company's Compensation/Stock Option Committee during the fiscal year ended June 30, 2003, Jay William Smalley, Richard R. Marklund and Wesley C. Hayne each also received a non-qualified stock option to purchase 95,000 shares of our common stock issued outside the Company's 1997 Stock Option Plan. During the fiscal year ended June 30, 2003, Mr. Smalley also received a non-qualified stock option to purchase 15,000 shares of common stock outside the Company's 1997 Stock Option Plan in consideration of his past and continued service on the Company's board of directors. All stock options issued to non-employee directors during the fiscal year ended June 30, 2003 are exercisable for a period of ten years from the date of grant and bear an exercise price equal to the last sale price of our common stock as quoted by the OTC Bulletin Board for the five trading days immediately ending after the close of the market on November 27, 2002, the date the board of directors resolved to grant such options.

During the Company's most recent fiscal quarter, there has been no change in the Company's internal control over

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table contains certain information as of September 22, 2003, regarding the beneficial ownership of the Common Stock by (i) each person known to K-tel to own beneficially five percent or more of the Common Stock, (ii) each director of K-tel, (iii) each executive officer of K-tel and (iv) the directors and executive officers as a group. The percentage of beneficial ownership is based on 13,653,738 shares outstanding as of September 22, 2003. Any shares which are subject to an option or a warrant exercisable within 60 days are reflected in the following table and are deemed to be outstanding for the purpose of computing the percentage of Common Stock owned by the option or warrant holder but are not deemed to be outstanding for the purpose of computing the percentage of Common Stock owned by any other person. Unless otherwise indicated, each person in the table has sole voting and investment power as to the shares shown. Unless otherwise indicated, the address for each listed shareholder is c/o K-tel International, Inc., 2655 Cheshire Lane North, Suite 100, Plymouth, Minnesota 55447.

	Amount and Nature of Beneficial Ownership(1)	Percentage of Outstanding Stock
Philip Kives 220 Saulteaux Crescent Winnipeg, Manitoba R3J 3W3 Canada	7,799,614(2)	57.1%
Dennis Ward	(3)	
Jay William Smalley	120,000(4)	*
Wesley C. Hayne	100,000(4)	*
Richard Marklund	100,000(4)	*
All directors and officers as a group (5 persons)	8,119,614(5)	59.5%

* Indicates ownership of less than 1% of the outstanding shares of Common Stock.

(1) The securities beneficially owned by a person are determined in accordance with the definition of beneficial ownership set forth in the regulations of the Securities and Exchange Commission and accordingly, may include securities owned by or for, among others, the spouse, children or certain other relatives of such person as well as other securities as to which the person has or shares voting or investment power or has the right to acquire within 60 days. More than one person may beneficially own the same shares.

(2) Consists of 7,474,278 shares held directly by K-5 Leisure Products Inc. (an affiliate of the Company controlled by Mr. Kives), and 325,336 shares held by a wholly-owned subsidiary of K-5. Does not include 1,702,939 shares purchasable upon the exercise of options proposed to be granted pursuant to the terms of a Stock Option Exchange Program . (See footnote 2 to Equity Compensation Plan Information table on page 8.)

(3) Does not include 255,000 shares purchasable upon exercise of options proposed to be granted pursuant to the terms of a Stock Option Exchange Program . (See footnote 2 to Equity Compensation Plan Information table on page 8.)

(4) Represents shares purchasable upon the exercise of options.

(5) Includes 320,000 shares purchasable upon the exercise of options.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

K-tel has a Line of Credit Agreement with K-5 Leisure Products, Inc. (K-5), the Company's largest shareholder controlled by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel. Under the terms of the agreement (the K-5 Facility), K-5 has agreed to make available up to \$8,000,000 to K-tel on a revolving basis. The loan bears interest at a variable rate based upon the base rate of a nationally recognized lending institution (4.0% at June 30, 2003), expires July 20, 2005, and is subordinated to the Foothill loan (see below). The K-5 Facility contains the same covenants as the Foothill loan agreement. K-tel has pledged the stock of its foreign subsidiaries as collateral for the loan, and the loan carries a subordinated position to the Foothill loan on all other assets of the Company. K-tel had outstanding balances of \$7,282,000 and \$6,026,000 as of June 30, 2003 and 2002 respectively under the K-5 Facility. At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

During the Company's most recent fiscal quarter, there has been no change in the Company's internal control over

In addition, K-tel has a second loan agreement with K-5, under which K-5 assumed rights and obligations under a loan from the Company's former banker (Foothill Capital Corporation) pursuant to an Assignment and Acceptance Agreement dated February 27, 2001. This Foothill loan, which has been extended through July 20, 2005, provides for a \$10,000,000 credit facility consisting of a \$4,000,000 term loan due upon expiration, and a \$6,000,000 revolving facility under which borrowings are limited to a percent of eligible receivables. Borrowings under the facility bear interest at a variable rate based on a base rate of a nationally recognized lending institution plus 1% (5.0% at June 30, 2003) and are collateralized by the assets of certain Company subsidiaries in the United States, including accounts receivable, inventories, equipment, music library and general intangibles. The loan agreement contains certain financial and other covenants or restrictions, including the maintenance of a minimum shareholders' equity by K-tel, limitations on capital expenditures, restrictions on music library acquisitions, limitations on other indebtedness and restrictions on dividends paid by K-tel. As of June 30, 2003 and 2002, \$4,000,000 was outstanding under the term loan and there were no borrowings under the revolving facility.

At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

K-tel has an overdraft privilege borrowing facility with The Royal Bank of Scotland in the United Kingdom. This facility is secured by a standby letter of credit for \$260,000 provided by K-tel International Ltd., a Canadian company controlled by Philip Kives and is payable on demand in accordance with normal banking practices. Borrowings bear interest of 2.0% per annum over the base rate (a total of 5.75% at June 30, 2003) but are subject to a minimum of 6.0% per annum. K-tel had outstanding balances of \$233,000 and \$227,000 as of June 30, 2003 and 2002 respectively.

The Company purchased approximately \$463,000 in the year ended June 30, 2003, \$366,000 in the year ended June 30, 2002 and \$574,000 in the year ended June 30, 2001 of music entertainment and consumer convenience products from K-5, which represented 14.6%, 14.7% and 3.7% of cost of goods sold, respectively. There were trade payables to K-5 of \$371,000 at June 30, 2003, \$ 291,000 at June 30, 2002 and \$285,000 at June 30, 2001, or 31.9%, 23.0% and 22.2% of total trade payables, respectively.

The Company had no sales of consumer convenience products to K-5 during fiscal years 2003 and 2002 and sales of \$13,000 during fiscal 2001. There was a balance receivable from K-5 at June 30, 2003 of \$73,000, June 30, 2002 of \$129,000 and June 30, 2001 of \$109,000. No interest was charged on the related outstanding balances during fiscal years 2003, 2002 and 2001.

During the fiscal year ended June 30, 2003, the Company licensed certain marks to K-tel Drug Mart Ltd., a Canadian direct marketer of prescription drugs owned by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel. The terms of the license agreement between the Company and K-tel Drug Mart have not been finalized, but will involve payment of a royalty to the Company by K-tel Drug Mart for use of the trademark. The agreement is currently under consideration by the Company, and will be subject to approval by the Company's independent directors.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Pursuant to SEC Release No. 33-8183 (as amended by Release No. 33-8183A), the disclosure requirements of this Item are not effective until the Annual Report on Form 10-K for the first fiscal year ending after December 15, 2003.

PART IV

ITEM 15: EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements and Schedules

The consolidated statements and schedules listed in the accompanying Index to Consolidated Financial Statements and Schedules on page 23 hereof are filed as part of this report.

(b) Reports on 8-K

There were no reports filed under Form 8-K by the Company for the quarter ended June 30, 2003.

(c) Exhibits

Reference is made to the Exhibit Index on Page 41.

(d) Excluded Financial Statements

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf on October 14, 2003, by the undersigned, thereunto duly authorized.

K-TEL INTERNATIONAL, INC.

By /s/ Philip Kives
 (Philip Kives - Chairman of the Board,
 Chief Executive Officer and President)

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated and on the dates indicated.

Signatures	Title	Date
/s/ Philip Kives Philip Kives	Chairman, Chief Executive Officer, (Principal Executive Officer) President and Director	October 14, 2003
/s/ Dennis Ward Dennis Ward	Chief Financial Officer (Principal Accounting Office Director	October 14, 2003
/s/ Jay William Smalley Jay William Smalley	Director	October 14, 2003
/s/ Wesley C. Hayne Wesley C. Hayne	Director	October 14, 2003
/s/ Richard Marklund Richard Marklund	Director	October 14, 2003

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Certified Public Accountants

Consolidated Balance Sheets as of June 30, 2003 and 2002

Consolidated Statements of Operations for each of the three years in the period ended June 30, 2003

Consolidated Statements of Shareholders' Equity (Deficit) for each of the three years in the period ended June 30, 2003

Consolidated Statements of Cash Flows for each of the three years in the period ended June 30, 2003

Notes to Consolidated Financial Statements

Supplemental Schedule to Consolidated Financial Statements:

Schedule II - Valuation and Qualifying Accounts for each of the three years in the period ended June 30, 2003

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted as not required, not applicable or the information required has been included elsewhere in the consolidated financial statements and notes thereto.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders of K-tel International, Inc.

We have audited the accompanying consolidated balance sheets of K-tel International, Inc. (a Minnesota corporation) and subsidiaries as of June 30, 2003 and 2002 and the related consolidated statements of operations, shareholders' equity (deficit), and cash flows for each of the three years in the period ended June 30, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of K-tel International, Inc. and subsidiaries as of June 30, 2003 and 2002 and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2003 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has incurred significant recurring losses from operations and has a net working capital deficit that raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We have also audited Schedule II for each of the three years in the period ended June 30, 2003. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

/S/ GRANT THORNTON LLP

Minneapolis, Minnesota,
August 7, 2003

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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JUNE 30,

(in thousands - except share data)

	2003	2002
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 1,219	\$ 75
Accounts receivable, net of allowance for doubtful accounts of \$25 and \$68	1,559	1,656
Inventories	520	637
Royalty advances	235	282
Prepaid expenses and other	304	378
Total Current Assets	3,837	3,028
Property and equipment, net of accumulated depreciation and amortization of \$1,506 and \$1,418	101	162
Owned catalog masters, net of accumulated amortization of \$2,755 and \$2,829	819	1,060
	\$ 4,757	\$ 4,250
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current Liabilities:		
Notes payable to affiliate and other	\$ 11,515	\$ 10,253
Accounts payable	1,162	1,264
Accrued royalties	2,333	2,245
Reserve for returns	213	40
Net liabilities of discontinued operations	116	92
Total Current Liabilities	15,339	13,894
Shareholders' Deficit:		
Common Stock 50,000,000 shares authorized, par value \$.01; 13,653,738 issued and outstanding	136	136
Additional paid-in capital	21,292	21,292
Accumulated deficit	(31,759)	(30,771)
Accumulated other comprehensive loss	(251)	(301)
Total Shareholders' Deficit	(10,582)	(9,644)
	\$ 4,757	\$ 4,250

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

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED JUNE 30,

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(in thousands - except per share data)

	2003	2002	2001
Net Sales	\$ 7,234	\$ 6,875	\$ 17,514
Costs and Expenses:			
Cost of goods sold	3,181	2,485	15,658
Advertising	200	172	618
Selling, general and administrative	3,800	4,550	10,718
Total Costs and Expenses	7,181	7,207	26,994
Operating Income (Loss)	53	(332)	(9,480)
Other Income (Expense):			
Interest income			155
Interest expense	(534)	(472)	(912)
Foreign currency transaction loss			(360)
Other income (expense)	74	(37)	
Total Other Income (Expense)	(460)	(509)	(1,117)
Loss from Continuing Operations Before Income Taxes	(407)	(841)	(10,597)
Benefit for Income Taxes		141	96
Loss from Continuing Operations	(407)	(700)	(10,501)
Discontinued Operations:			
Loss from Discontinued Operations	(581)	(180)	(4,315)
Loss before Extraordinary Item	(988)	(880)	(14,816)
Extraordinary Item:			
Gain on Subsidiary Liquidations		894	16,185
Net Income (Loss)	\$ (988)	\$ 14	\$ 1,369
Income (Loss) per Share Basic and Diluted:			
Continuing Operations	\$ (.03)	\$ (.05)	\$ (.77)
Discontinued Operations	(.04)	(.01)	(.32)
Extraordinary Item		.06	1.19
Net Income (Loss)	\$ (.07)	\$.00	\$.10
Shares used in the calculation of loss per share Basic and Diluted:	13,654	13,654	13,654
Comprehensive Income (Loss)			
Net income (loss)	\$ (988)	\$ 14	\$ 1,369
Unrealized pension cost	(55)		

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Translation adjustment		105	(18)	476
Comprehensive Income (Loss)	\$	(938)	\$ (4)	\$ 1,845

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

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIT)
YEARS ENDED JUNE 30, 2003, 2002 AND 2001
(in thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	Total
	Shares	Amount				
Balance at June 30, 2000	10,321	\$ 103	\$ 20,213	\$ (32,154)	\$ (759)	(12,597)
Net income				1,369		1,369
Conversion of debt to equity	3,333	33	467			500
Translation adjustment					476	476
Balance at June 30, 2001	13,654	136	20,680	(30,785)	(283)	(10,252)
Net income				14		14
Reduction of notes payable to affiliate			612			612
Translation adjustment					(18)	(18)
Balance at June 30, 2002	13,654	136	21,292	(30,771)	(301)	(9,644)
Net income				(988)		(988)
Unrealized pension cost					(55)	(55)
Translation adjustment					105	105
Balance at June 30, 2003	13,654	\$ 136	\$ 21,292	\$ (31,759)	\$ (251)	(10,582)

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

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS****YEARS ENDED JUNE 30,***(in thousands)*

	2003	2002	2001
Operating Activities:			
Net income (loss)	\$ (988)	\$ 14	\$ 1,369
Adjustment to reconcile net income (loss) to cash used in operating activities:			
Depreciation and amortization	315	380	408
Loss on disposal of property and equipment	1	3	349
Gain on liquidation		(894)	(16,185)
Discontinued operations	7	(109)	3,630
Write down of long lived asset			417
Changes in operating assets and liabilities:			
Accounts receivable, net	10	(689)	3,217
Inventories	137	(199)	2,378
Royalty advances	68	(84)	(82)
Prepaid expenses and other current assets	89	295	(225)
Accounts payable	(62)	(699)	2,421
Accrued royalties	87	157	230
Income taxes		(130)	
Reserve for returns	173	(12)	(370)
Cash used in operating activities	(163)	(1,967)	(2,443)
Investing Activities:			
Purchases of property and equipment	(18)	(124)	(62)
Music catalog additions			(63)
Other	15	27	27
Cash used in investing activities	(3)	(97)	(98)
Financing Activities:			
Borrowings on notes payable	2,278	3,676	13,946
Payments on notes payable	(1,033)	(1,629)	(12,508)
Cash provided by financing activities	1,245	2,047	1,438
Effect of exchange rates on cash	65	(81)	478
Net increase (decrease) in cash equivalents	1,144	(98)	(625)
Cash and equivalents at beginning of period	75	173	798

YEARS ENDED JUNE 30,

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Cash and equivalents at end of period	\$	1,219	\$	75	\$	173
Supplemental Cash Flow Information						
Cash Paid For -						
Interest	\$	396	\$	598	\$	483
Income Taxes	\$		\$		\$	4
Non-cash Information						
Reduction of notes payable to affiliate through debt forgiveness, recorded as a capital contribution	\$		\$	612	\$	
Music Catalogs reclassified to prepaid assets	\$		\$	173	\$	

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

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2003, 2002 AND 2001

1. BUSINESS AND LIQUIDITY

K-tel International, Inc. (the Company or K-tel) was incorporated in 1968 and currently has its corporate offices located in Plymouth, Minnesota. Through its operating subsidiaries, K-tel licenses its music catalog internationally and markets entertainment products mainly derived from its catalog through retail and direct response marketing channels in the United States and Europe. The Company has a focused method of distribution that targets the strengths of fewer individual retailers and supplies products suited to each retailer's needs. These new products are derived mainly from the Company's master recordings music catalog with the objective of realizing more competitive profit margins. K-tel seeks to license its trademarks to other companies in businesses unrelated to K-tel's current operations. Licenses are granted for a royalty or fee, with no cost to the Company. The Company has licensed certain marks to K-tel Drug Mart Ltd., a Canadian direct marketer of prescription drugs beneficially owned by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel. K-tel Drug Mart, which recently began operations, offers prescription drugs from its pharmacy in Canada to persons in the United States. K-tel is merely a licensor of its mark to K-tel Drug Mart. To date, K-tel Drug Mart's operations have not generated any significant licensing revenues for the Company.

Subsidiaries Bankruptcy and Liquidation

In March 2001, the Company's music distribution subsidiary in the United States, K-tel International (USA), Inc. ceased operations and filed for protection under Chapter 7 of the U. S. bankruptcy code. In connection with this filing, the assets and liabilities of this subsidiary were removed from the books of the Company as control of the subsidiary was transferred to the bankruptcy trustee. The net liability at the time of this filing was shown as a gain on the Chapter 7 liquidation. Management believes the Company will have no ongoing liability related to this subsidiary as a result of the filing and the outcome of the bankruptcy proceeding. During the fiscal year ended June 30, 2001, this subsidiary had net sales of \$11,948,000 and an operating loss of \$5,299,000.

In November 2000, the Company's consumer products subsidiary in the United Kingdom, K-tel Marketing Ltd., ceased operations and began voluntary liquidation proceedings. At the initial meeting of the creditors on November 24, 2000, the creditors voted for the liquidation to become a creditors' liquidation under English law. The Company has not been informed by the liquidators or their counsel of any plan to attempt to hold it or any of its subsidiaries liable for any of the commitments of K-tel Marketing Ltd. Management believes the Company will have no ongoing material liability related to K-tel Marketing Ltd. as a result of the liquidation proceeding. K-tel Marketing Ltd. had no operations during the fiscal years ended June 30, 2003 and 2002. During fiscal 2001, this subsidiary had net sales of \$3,179,000 and an operating loss of \$3,220,000. Losses in the year ended June 30, 2003 of \$581,000 and \$180,000 in the year ended June 30, 2002 related mainly to legal fees incurred in the Tristar litigation (See Note 6.)

Discontinued Operations

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The Company's consumer products business, which was concentrated in Europe, consisted primarily of housewares, consumer convenience items and exercise equipment. The Company discontinued its consumer products operations in Germany, the United Kingdom and the United States in June 2000, November 2000 and January 2001, respectively. Accordingly, these activities have been presented in the accompanying financial statements as discontinued operations. Net sales for these operations were \$3,818,000 for the fiscal year ended June 30, 2001. The accompanying consolidated financial statements have been prepared to reflect the consumer products division as a discontinued operation. The net liabilities of discontinued operations at June 30, 2003 and 2002 consist of assets of \$19,000 and \$14,000 and liabilities of \$135,000 and \$106,000.

Going Concern

During the years ended June 30, 2003, 2002 and 2001, the Company incurred net losses from continuing operations of \$407,000, \$700,000 and \$10,501,000, respectively, and used \$163,000, \$1,967,000, and \$2,443,000 of cash in operating activities. Additionally, the Company had a working capital deficit of \$11,502,000 at June 30, 2003.

The Company's ability to continue its present operations and implement future expansion plans successfully is contingent mainly upon its ability to maintain its line of credit arrangements with K-5 Leisure Products, Inc. (See Note 3), increase its revenues and profit margins, and ultimately attain and sustain profitable operations. Without increased revenues and

sustained profitability, the cash generated from the Company's current operations will likely be inadequate to fund operations and service its indebtedness on an ongoing basis. Management is focusing its efforts on music licensing and limited music distribution. However, there can be no assurance that the Company will achieve profitable operations through these efforts. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The accompanying consolidated financial statements include the accounts of K-tel International, Inc. and its domestic and foreign subsidiaries, all of which are wholly owned. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition - The Company derives its revenue mainly from two sources: the sale of music compilations (predominately compact discs) produced by the Company, and license revenue from the licensing of Company-owned masters. Revenue from music sales is recognized at the time of shipment to the customer, while license revenue is recognized when payment is received from customers or when known amounts are receivable, as prior to that date collection is not considered probable. Most music sales are made with a right of return of unsold goods. Estimated reserves for returns are established by management based upon historical experience and product mix and are subject to ongoing review and adjustment by the Company. These reserves are recorded at the time of sale and are reflected as a reduction in revenues. The Company's reserve for returns was \$213,000 at June 30, 2003 and \$40,000 at June 30, 2002.

Cost of Goods Sold - The Company expenses all product manufacturing, distribution and royalty costs associated with music sales as cost of goods sold. The Company also expenses royalties, commissions and amortization of its owned master recordings associated with its license revenue as costs of goods sold.

Shipping and Handling Costs - The Company expenses within cost of goods sold all shipping and handling costs incurred in the shipment of goods.

Cash and Equivalents - Cash and equivalents consist principally of cash and short-term, highly liquid investments with original maturities of less than ninety days.

Inventories - Inventories, which consists of finished goods that include all direct product costs, are valued at the lower of cost, determined on a first-in, first-out basis, or net realizable value.

Owned Catalog Masters The Company capitalizes the costs to purchase owned master recordings at the time of acquisition. These costs are amortized over the estimated useful life of these master recordings, which is generally seven years and represents management's best estimate of the average period of value.

Rights to Use Music Product - Certain of the Company's compilation products are master recordings under license from record companies and publishers. In most instances, minimum guarantees or non-refundable advances are required to obtain the licenses and are realized through future sales of the product. The amounts paid for minimum guarantees or non-refundable advances are capitalized and charged to expense as sales are made. The unrealized portion of guarantees and advances is included in royalty advances in the accompanying consolidated balance sheets. Licenses are subject to audit by licensors. When anticipated sales appear to be insufficient to fully recover the minimum guarantees or non-refundable advances, a provision against current operations is made for anticipated losses.

Property and Equipment - Property and equipment are stated at cost. Depreciation and amortization is provided using straight line or declining balance methods over the estimated useful lives of the assets, which range from three to nine years.

Long Lived-Assets The Company evaluates its long-lived assets quarterly, or earlier if a triggering event occurs, to determine potential impairment by comparing the carrying value of those assets to the related undiscounted future cash flows of the assets. If an asset is determined to be impaired, it is written down to its estimated fair value. During the quarter ended March 31, 2001, the Company suspended its online business to relocate these operations to the Company's offices in Minnesota and update the website to reflect the Company's continuing operations. The Company wrote down the assets of that business to its estimated fair value, resulting in a charge during the quarter ended March 31, 2001 of approximately \$240,000. In addition, during the quarter ended June 30, 2001, the Company wrote down approximately \$177,000 of trademarks related to its European operations, which were determined to have no remaining value as the Company is no longer marketing the products benefited by those trademarks. These charges were included within general

and administrative expense.

Royalties - The Company has entered into license agreements with various record companies and publishers under which it pays royalties on units sold. The Company accrues royalties using contractual rates and certain estimated rates on applicable units sold. The contractual royalty liability is computed quarterly and the accrued royalty balance is adjusted accordingly. The royalty agreements are subject to audit by licensors.

Advertising - The Company expenses the costs of advertising when the advertising takes place, except for direct response advertising, which is capitalized and amortized over its expected period of future benefits (usually the period remaining under a related contract, which is generally less than one year). Direct response advertising consists primarily of television advertising whereby customers respond specifically to the advertising and where the Company can identify the advertising that elicited the response. Advertising expenses were \$200,000, \$172,000, and \$618,000 for the years ended June 30, 2003, 2002 and 2001, respectively.

Foreign Currency - The operations of foreign subsidiaries are measured in local currencies. Assets and liabilities are translated into U.S. dollars at period-end exchange rates. Revenues and expenses are translated at the average exchange rates prevailing during the period. Adjustments resulting from translating the financial statements of foreign entities into U.S. dollars are recorded as a component of accumulated other comprehensive income or loss.

Stock-based Compensation The Company accounts for stock-based awards to employees using the intrinsic value method prescribed in APB No. 25, Accounting for Stock Issued to Employees, whereby the options are granted at market price, and therefore no compensation costs are recognized. The Company has elected to retain its current method of accounting as described above and has adopted the SFAS Nos. 123 and 148 disclosure requirements. If compensation expense for the Company's various stock option plans had been determined based upon the projected fair values at the grant dates for awards under those plans in accordance with SFAS No. 123, the Company's pro-forma net earnings, basic and diluted earnings per common share would have been as follows:

	Fiscal Year Ended June 30,		
	2003	2002	2001
Net income (loss) (in thousands):			
As reported	\$ (988)	\$ 14	\$ 1,369
Pro forma	\$ (1,003)	\$ (458)	\$ (496)
Basic and Diluted EPS:			
As reported	\$ (.07)	\$ (.00)	\$.10
Pro forma	\$ (.07)	\$ (.04)	\$ (.04)

Income Taxes - Deferred income taxes are provided for temporary differences between the financial reporting basis and tax basis of the Company's assets and liabilities at currently enacted tax rates. A valuation allowance equal to the aggregate amount of deferred tax assets is established when realization is not likely.

Net Income (Loss) Per Share - Basic and diluted net income (loss) per share have been computed by dividing net income (loss) by the weighted average number of shares outstanding during the period. For all periods presented, common stock equivalents were excluded from the per share calculation as the net effect would be antidilutive. For the fiscal years ended June 30, 2003, 2002 and 2001, weighted average options to purchase 442,900, 2,273,839, and 2,336,889 shares of common stock, with weighted average exercise prices of \$1.95, \$5.89, and \$5.77 were excluded from the computation of common share equivalents for the respective periods as they were antidilutive.

Use of Estimates - Preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Principal estimates include allowances for bad debt, inventory valuation, return reserves, royalty obligations, purchase commitments and product replacement costs. Actual results could differ from those estimates used by management.

3. LOANS PAYABLE TO AFFILIATE

K-tel has a Line of Credit Agreement with K-5 Leisure Products, Inc. (K-5), the Company's largest shareholder controlled by Philip Kives, the Chairman of the Board, President and Chief Executive Officer of K-tel. Under the terms of the agreement (the K-5 Facility), K-5 has agreed to make available up to \$8,000,000 to K-tel on a revolving basis. The loan bears interest at a variable rate based upon the base rate of a nationally recognized lending institution (4.0% at June 30, 2003), expires July 20, 2005, and is subordinated to the Foothill loan (see below). The K-5 Facility contains the same covenants as the Foothill loan agreement. K-tel has pledged the stock of its foreign subsidiaries as collateral for the loan, and the loan carries a subordinated position to the Foothill loan on all other assets of the Company. K-tel had outstanding balances of \$7,282,000 and \$6,026,000 as of June 30, 2003 and 2002 respectively under the K-5 Facility. At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

In addition, K-tel has a second loan agreement with K-5, under which K-5 assumed rights and obligations under a loan from the Company's former banker (Foothill Capital Corporation) pursuant to an Assignment and Acceptance Agreement dated February 27, 2001. This Foothill loan, which has been extended through July 20, 2005, provides for a \$10,000,000 credit facility consisting of a \$4,000,000 term loan due upon expiration, and a \$6,000,000 revolving facility under which borrowings are limited to a percent of eligible receivables. Borrowings under the facility bear interest at a variable rate based on a base rate of a nationally recognized lending institution plus 1% (5.0% at June 30, 2003) and are collateralized by the assets of certain Company subsidiaries in the United States, including accounts receivable, inventories, equipment, music library and general intangibles. The loan agreement contains certain financial and other covenants or restrictions, including the maintenance of a minimum shareholders' equity by K-tel, limitations on capital expenditures, restrictions on music library acquisitions, limitations on other indebtedness and restrictions on dividends paid by K-tel. As of June 30, 2003 and 2002, \$4,000,000 was outstanding under the term loan and there were no borrowings under the revolving facility. At June 30, 2003, K-tel obtained a waiver from K-5 for its non-compliance under the covenants, limitations and restrictions of the credit agreement.

K-tel has an overdraft privilege borrowing facility with The Royal Bank of Scotland in the United Kingdom. This facility is secured by a standby letter of credit for \$260,000 provided by K-tel International Ltd., a Canadian company controlled by Philip Kives and is payable on demand in accordance with normal banking practices. Borrowings bear interest of 2.0% per annum over the base rate (a total of 5.75% at June 30, 2003) but are subject to a minimum of 6.0% per annum. K-tel had outstanding balances of \$233,000 and \$227,000 as of June 30, 2003 and 2002 respectively.

4. INCOME TAXES

The Company operates in several countries and is subject to various tax regulations and tax rates. The provisions for income taxes are computed based on income reported for financial statement purposes in accordance with the tax rules and regulations of the taxing authorities where the income is earned.

The provision (benefit) for income taxes consists of the following for the years ended June 30 (in thousands):

	2003	2002	2001
Income (loss) before provision (benefit) for income taxes:			
United States	\$ 196	\$ (295)	\$ 2,871
Foreign	(1,184)	168	(1,598)
Total	\$ (988)	\$ (127)	\$ 1,273
Provision (benefit) for income taxes:			
Current			
United States	\$	\$ (141)	\$ (100)
Foreign			4
Total provision (benefit) for income taxes	\$	\$ (141)	\$ (96)

A reconciliation of the U.S. Federal statutory rate to the effective tax rate for the years ended June 30 was as follows:

	2003	2002	2001
Federal statutory rate	34%	34%	34%
State Taxes, net of Federal benefit	0	2	2
Valuation allowance	(34)	(36)	(36)

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Temporary differences, which are all deferred tax assets, were as follows (in thousands):

	June 30, 2003	June 30, 2002
Net operating loss carryforwards	\$ 20,875	\$ 17,661
Alternative minimum tax credits	432	432
Foreign tax credit	325	325
Reserve for returns	852	761
Depreciation and amortization	199	238
Royalty reserves	145	105
Inventory reserves	36	40
Nondeductible accruals	286	310
Allowance for bad debts	19	29
Valuation allowance	(23,169)	(19,901)

\$ \$

A valuation allowance equal to the aggregate amount of deferred tax assets has been established until such time as realizability is more likely than not.

For U.S. tax reporting purposes, the Company has net operating loss carryforwards (NOL) of approximately \$58,000,000. However, of the amount available through 2013 and 2020, \$20,100,000 of the NOL relates to deductions associated with the exercise of stock options. The tax benefit of approximately \$7,236,000 associated with this stock option deduction will be recorded as additional paid-in capital when realized. The NOL carryforwards may be reduced in future years, without financial statement benefit, to the extent of intercompany dividends received from foreign subsidiaries. Also, the NOL carryforwards are subject to review and possible adjustment by taxing authorities. In addition, the Company has approximately \$432,000 in U.S. federal alternative minimum tax credits and \$325,000 in foreign tax credits, which may be utilized in the future to offset any regular corporate income tax liability.

5. **CAPITAL TRANSACTIONS**

Stock Option Plan

The Company has a Stock Option Plan for officers, directors, and employees of the Company. Under the terms of this plan the Board of Directors has the sole authority to determine the employees to whom options and awards are granted, the type, size and terms of the awards, the timing of the grants, the duration of the exercise period and any other matters arising under the plan. The common stock incentives may take the form of incentive stock options and nonqualified stock options. The Company's 1987 plan, which has expired, covered a maximum of 700,000 shares of common stock, of which options for the purchase of 2,000 shares remain outstanding and exercisable. In February 1997, the Company's Board of Directors approved a new stock option plan covering a maximum of 600,000 shares of common stock, which was subsequently amended to 5,000,000 through shareholder amendments in February 1999, January 2000 and November 2000. There were options on 2,613,011 net shares granted under this plan as of June 30, 2003. Of these options granted, 2,472,111 have been exercised. Any options cancelled are available for future grants. No options granted have expired.

Stock Option Exchange

On March 18, 2003, a committee of the Company's board of directors comprised solely of independent directors, approved a Stock Option Exchange Program. The program provides for a small number of optionees who were previously awarded options to purchase shares of common stock under the Company's 1997 Stock Option Plan to exchange them for options to purchase an equal number of shares outside the Company's Stock Option Plan. The options to purchase an aggregate 2,137,939 shares of common stock have a weighted average price per share of \$5.95. Replacement options are proposed to be issued six months and one day after the date of cancellation of the existing options and shall be at an exercise price per share equal to the fair market value of the Company's common stock as quoted on the OTC Bulletin Board on the date of grant and shall expire ten years after the date of grant. It is anticipated that there will be no compensation expense recognized as a result of this exchange.

Restricted and Non-Qualified Stock Options

In addition to stock options granted under the terms of the Stock Option Plan, the Board of Directors has the sole authority to grant employees, officers and directors incentive stock options and non-qualified stock options outside the Stock Option Plan. The Board of Directors determines the type, size and terms of the grants, timing of the grants, the duration of the exercise period and any other matters pertaining to options or awards granted outside of the Stock Option Plan. There were options on 355,000 net shares granted outside the Stock Option Plan as of June 30, 2003.

The share information for all plans is summarized below:

**Incentive Stock
Options**

**Non-Qualified
Stock Options**

**Weighted
Average
Exercise Price**

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Outstanding June 30, 2000	2,210,556	497,000	\$	6.72
Granted	310,000	75,000		1.06
Cancelled	(228,167)	(527,500)		6.49
Outstanding June 30, 2001	2,292,389	44,500	\$	5.77
Adjustment (1)	(2,105,045)	2,105,045		
Cancelled	(36,050)	(27,000)		5.86
Outstanding June 30, 2002	151,294	2,122,545	\$	5.89
Granted	10,000	300,000		.05
Cancelled	(73,394)	(2,067,545)		5.86
Outstanding June 30, 2003	87,900	355,000	\$	1.95

(1) Adjustment reflects options disclosed previously as incentive that should have been recorded as non-qualified.

The following tables summarize information concerning currently outstanding and exercisable stock options at June 30, 2003:

Options Outstanding				
Exercise Prices		Weighted Average	Number of Shares	Weighted Average Remaining Contractual Life
Range				
\$	0.05	\$ 0.05	310,000	9.4 years
\$	1.75	\$ 1.75	1,000	3.3 years
\$	3.06 - 3.38	\$ 3.29	1,400	3.6 years
\$	5.51 - 6.00	\$ 5.66	97,500	6.6 years
\$	8.73	\$ 8.73	33,000	5.7 years
			442,900	

Options Exercisable			
Exercise Prices		Weighted Average	Number of Shares
Range			
\$	0.05	\$ 0.05	310,000
\$	1.75	\$ 1.75	1,000
\$	3.06 - 3.38	\$ 3.29	1,400
\$	5.51 - 6.00	\$ 5.66	97,500
\$	8.73	\$ 8.73	33,000
			442,900

The weighted average fair value of options granted in fiscal 2003 was \$.05 and fiscal 2001 was \$1.06. No options were granted in fiscal 2002. Because the fair value provisions have not been applied to options granted prior to June 30, 1995, the resulting pro forma compensation cost (See Note 1) may not be representative of that to be expected in future years.

The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used to estimate the fair value of options:

	2003	2002	2001
Risk-free interest rate	4.00%	5.00%	5.00%
Expected life	10 years	5 years	5 years
Expected volatility	220%	150%	150%
Expected dividend yield	None	None	None

6. COMMITMENTS AND CONTINGENCIES

Class Action Lawsuit

K-tel and certain of its current and former officers and directors were named as defendants in *In re K-tel International, Inc. Securities Litigation*, No. 98-CV-2480. This action consolidated twenty-three purported class actions that were initially filed in various United States District Courts in November 1998, and were subsequently transferred to, and consolidated in, the United States District Court for the District of Minnesota. On July 19, 1999, the plaintiffs filed an amended consolidated class action complaint that challenged the accuracy of certain public disclosures made by K-tel regarding its financial condition during the period from May 1998 through November 1998. The plaintiffs asserted claims under the federal securities laws and sought damages in an unspecified amount as well as costs, including attorneys' fees and any other relief the Court deemed just and proper. K-tel moved to dismiss the complaint, and on July 31, 2000, the United States District Court granted the Company's motion to dismiss. The Court also barred further actions by the plaintiffs and denied plaintiffs' request to amend the complaint in order to refile the complaint in the future. The plaintiffs appealed to the United States Court of Appeals for the Eighth Circuit, and the Court of Appeals heard the matter in October 2001. On August 7, 2002 the Court of Appeals, in a two to one decision, denied the plaintiffs' appeal. On August 20, 2002 the plaintiffs applied for a rehearing by the full Court of Appeals. K-tel filed a response on September 15, 2002 to the plaintiffs' petition for rehearing at the request of the Court. On October 2, 2002, the Court denied the petition for rehearing. The plaintiffs had until January 1, 2003 to seek a writ of certiorari (a petition asking the Court for a discretionary review of a lower court decision) from the United States Supreme Court, but did not seek this writ. There having been no appeal filed, the case has been dismissed with no further recourse available.

RTL Shopping S.A.

The Company has been named in a lawsuit filed in France brought by RTL9, a French cable TV station. The action seeks damages in the approximate amount of 20 million French Francs, or approximately \$2.8 million. Initially, RTL9 was named as a defendant in a suit brought by a competitor of K-tel Marketing Ltd. alleging that RTL9 ran a commercial for K-tel Marketing which presented a product under brand names alleged to infringe on the competitor's own trademarks and also translated an English language script indicating that the product was "just like or as good as others into better than" in French, contrary to French law. The suit alleged trademark infringement, unfair competition, illicit comparative advertising and passing off. RTL9 then sued K-tel Marketing on October 4, 2000, pursuant to an indemnification provision the parties had entered into. Subsequently, K-tel Marketing went into liquidation and RTL9 filed a suit in December 2000 against K-tel International, Inc. under its agreement to guarantee payment for the commercial time. On May 28, 2001, RTL9 presented documents in court identifying K-tel International (USA), Inc. as a target of its claim. On September 3, 2001, the Company filed documents disputing the claim and advising the court of K-tel (USA)'s Chapter 7 bankruptcy filing.

The Company believes that RTL9 has no basis for a complaint against the Company. As the result of information supplied by the parties to the Court, RTL9 has proposed to drop the lawsuit.

K-tel International, Inc. vs. Tristar Products, Inc.

On March 14, 2000, K-tel and its subsidiary in Germany commenced an action for breach of express and implied warranties against Defendant Tristar Products, Inc. This action is venued in the United States District Court for the District of Minnesota. This action arises out of Tristar's sale to K-tel of a defective home exercise product called the BunBlaster for resale in Germany, Austria and Switzerland. By written contract, Tristar

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has agreed to indemnify K-tel for injuries and damages arising out of the resale of those goods. K-tel is seeking approximately \$2 million in consequential damages. Tristar is vigorously defending this claim. Discovery has been completed. Tristar has filed a Motion for Summary Judgment, to which the Company filed a Memorandum in Opposition. This motion was heard in U.S. District Court in Minneapolis on August 25, 2003. The Court has yet to rule on this motion.

On April 30, 2001, Tristar also asserted a patent and trademark/ trade-dress counterclaim against K-tel for allegedly passing off a product called the K-tel Hook and Hang while allegedly a distributor of the original patented Tristar Hook and Hang product. The Company denies the allegation because it never was a distributor of this or any similar product and intends to defend this action vigorously. Tristar has not identified the amount of damages it seeks with respect to this counterclaim. The United States District Court for the District of Minnesota issued an order on August 14, 2001 severing this action from the Company's action. This action is at an early stage and no discovery or other actions have occurred.

Litigation and Disputes

K-tel and its subsidiaries are also involved in other legal actions in the ordinary course of its business. With all litigation matters, management considers the likelihood of loss based on the facts and circumstances. If management determines that a loss is probable and the amount of loss can be reasonably estimated, such amount is recorded as a liability. Although the outcome of any such legal actions cannot be predicted, in the opinion of management there is currently no legal proceeding pending or asserted against or involving K-tel for which the outcome is likely to have a material adverse effect upon the consolidated financial position or results of operations of K-tel.

Subsidiaries Bankruptcy and Liquidation

In March 2001, the Company's music distribution subsidiary in the United States, K-tel International (USA), Inc. ceased operations and filed for protection under Chapter 7 of the United States Bankruptcy Code. Pursuant to an agreement between the bankruptcy trustee and K-5 Leisure Products, Inc. (K-tel's secured creditor and controlling shareholder) entered into on March 3, 2003, the trustee released K-5 Leisure Products, Inc., K-tel and its subsidiaries and affiliates from any claims and actions with respect to the bankruptcy filing. The trustee filed a Limited Notice of Abandonment relative to K-5's security interest in K-tel's assets. The Bankruptcy Court approved the abandonment as of June 13, 2003.

In November 2000, the Company's consumer products subsidiary in the United Kingdom, K-tel Marketing Ltd., ceased operations and began voluntary liquidation proceedings. At the initial meeting of the creditors on November 24, 2000, the creditors voted for the liquidation to become a creditors' liquidation under English law. The Company has not been informed by the liquidators or their counsel of any plan to attempt to hold it or any of its subsidiaries liable for any of the commitments of K-tel Marketing Ltd. Management believes the Company will have no ongoing material liability related to K-tel Marketing Ltd. as a result of the liquidation proceeding.

Leases

The Company has entered into several office and warehouse leases which expire through 2005. Commitments under these leases are \$210,576 in 2004, and \$46,490 in 2005. Rental expense was \$253,523 in 2003, \$216,327 in 2002, and \$654,000 in 2001.

7. SIGNIFICANT CUSTOMERS AND RELATED PARTY TRANSACTIONS

Two customers, Anderson Merchandisers and Handleman Company accounted for approximately 17.0% and 13.1% respectively of K-tel's revenue for the year ended June 30, 2003. The loss of, or a substantial reduction in, business from any of these customers would have a material adverse effect on the Company.

See Note 3 for information regarding debt transactions with related parties.

The Company purchased approximately \$463,000 in the year ended June 30, 2003, \$366,000 in the year ended June 30, 2002 and \$574,000 in the year ended June 30, 2001 of music entertainment and consumer convenience products from K-5, the Company's largest shareholder controlled by Philip Kives, Chairman of the Board, President and Chief Executive Officer of K-tel. There were trade payables to K-5 of \$371,000 at June 30, 2003, \$291,000 at June 30, 2002 and \$285,000 at June 30, 2001.

The Company had no sales of consumer convenience products to K-5 during the years ended June 30, 2003 and 2002, and sales of \$13,000 during the year ended June 30, 2001. There was a balance receivable from K-5 at June 30, 2003 of \$73,000, June 30, 2002 of \$129,000, and June 30, 2001 of \$109,000. No interest was charged on the related outstanding balances during fiscal years 2003, 2002 and 2001.

8. BUSINESS SEGMENT AND GEOGRAPHIC AREA DATA

The Company markets and distributes entertainment products internationally and through its operating subsidiaries. K-tel's businesses are organized, managed and internally reported as three segments: retail music sales, music licensing and other, which consists primarily of e-commerce (which was closed in the fourth quarter of fiscal 2002). These segments are based on differences in products, customer type and sales and distribution methods. The Company's consumer product operations have been discontinued and are presented in the accompanying financial statements as discontinued operations and are therefore not included in the segment information.

The retail music segment consists primarily of the sales of pre-recorded music both from the Company's music master catalog and under licenses obtained from other record companies. The Company sells compact discs and DVD's directly to retailers, wholesalers and rack service distributors which stock and manage inventory within music departments for retail stores.

In the licensing segment, the Company licenses the rights to its master music catalog, consisting of original recordings and re-recordings of music from the 1950's through today, to third parties world-wide for use in albums, films, television programs, and commercials, for either a flat fee or a royalty based on the number of units sold.

Operating profits or losses of these segments include an allocation of general corporate expenses. Depreciation and amortization and capital additions are not significant and have therefore been excluded from presentation.

Certain financial information on the Company's continuing operating segments is as follows:

BUSINESS SEGMENT INFORMATION

Fiscal Years Ended June 30,	Music	Licensing	Other	Corporate Eliminations	Total Company
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(in thousands)

Net Sales	2003	\$	4,454	\$	2,780	\$	7,234
	2002		3,757		3,118		6,875
	2001		14,202		3,710	365 (763)	17,514
Operating Income (Loss)	2003	\$	(1,106)	\$	1,159	\$	53
	2002		(1,725)		1,393		(332)
	2001		(7,749)		425	(2,156)	(9,480)
Assets	2003	\$	2,356	\$	2,128	\$	4,757
	2002		2,319		1,668	142	4,250
	2001		1,501		1,650	443 238	3,832

GEOGRAPHIC INFORMATION

**Fiscal Years Ended
June 30,**
(in thousands)

			United States		Europe		Total
Net Sales	2003	\$	4,949	\$	2,285	\$	7,234
	2002		3,949		2,926		6,875
	2001		13,914		3,600		17,514
Assets	2003	\$	3,889	\$	868	\$	4,757
	2002		2,792		1,458		4,250
	2001		2,042		1,790		3,832

9. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Interpretation (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 is an interpretation of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, and addresses consolidation by business enterprises of variable interest entities. FIN 46 applies immediately to variable interest entities created or obtained after January 31, 2003 and it applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that is acquired before February 1, 2003. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In December 2002, the FASB issued Statement 148 (FAS 148), *Accounting for Stock-Based Compensation Transition and Disclosure*. FAS 148 amends the disclosure and certain transition provisions of Statement 123, *Accounting for Stock-Based Compensation*. Its disclosure provisions, which apply to all entities with employee stock-based compensation, are effective for fiscal years ending after December 15, 2002. New interim period disclosures are required in financial statements for interim periods beginning after December 15, 2002. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 addresses the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. FIN 45 also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN 45 are effective for the Company for its quarter ended December 31, 2002. The liability recognition requirement is applicable prospectively to all guarantees issued or modified after December 31, 2002. This pronouncement is not anticipated to have a material effect on the Company's consolidated financial position or results of operations.

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 146 (SFAS 146), *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 146 provides financial accounting and reporting guidance for costs associated with exit or disposal activities, including one-time termination benefits, contract termination costs other than for a capital lease, and costs to consolidate facilities or relocate employees. This statement is effective for exit or disposal activities that are initiated after December 31, 2002. Management does not believe this pronouncement will have a material effect on the Company's consolidated financial position and results of operations.

In May 2003, the FASB issued Statement 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. Statement 150 changes the classifications in the statement of financial position of certain common financial instruments from either equity or mezzanine presentation to liabilities and requires an issuer of those financial statements to recognize changes in fair value or redemption amount, as applicable, in earnings. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of Statement 150 is not anticipated to have an impact on the Company's consolidated financial position or results of operations.

SCHEDULE II

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

Years ended June 30,

(In thousands)

	Balance at Beginning of Period	Charged to Costs and Expenses or Net Sales	Charged to Other Accounts (1)	Deductions	Balance at End of Period
<u>Allowance for Doubtful Accounts</u>					
2003	\$ 68	\$ 62	\$ 9	\$ (114)(2)	\$ 25
2002	\$ 33	\$ 50	\$ 5	\$ (20)(2)	\$ 68
2001	\$ 1,416	\$ (41)	\$ (4)	\$ (1,338)(2)	\$ 33
<u>Reserve for Returns</u>					
2003	\$ 40	\$ 446	\$	\$ (273)	\$ 213
2002	\$ 50	\$ 49	\$ 6	\$ (65)	\$ 40
2001	\$ 4,623	\$ 45	\$ (3)	\$ (4,615)	\$ 50

(1) Exchange rate change

(2) Uncollectible accounts written off, net of recoveries

EXHIBIT INDEX

Exhibit No.	Description of Exhibit
3.1	Restated Articles of Incorporation, as amended.
3.2	Restated By-Laws (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1985 (File No. 1-07115)).
4	See Exhibits 3.1 and 3.2.
10.1	1987 Stock Incentive Plan (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1987 (File No. 1-07115)).
10.2	1997 Stock Option Plan (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1997 (File No. 1-07115)).
10.3	Form of Incentive Stock Option Agreement under the Company's 1997 Stock Option Plan (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000 (File No. 1-07115)).
10.4	Form of Non-Qualified Stock Option Agreement under the Company's 1997 Stock Option Plan (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000 (File No. 1-07115)).
10.5	Form of Non-Qualified Stock Option Agreement between the registrant and certain non-employee directors of the registrant, authorized effective November 27, 2002 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2003 (File No. 1-07115)).
10.6	Loan and Security Agreement between the Company and Foothill Capital Corporation dated November 19, 1997 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1997 (File No. 1-07115)).
10.7	Amendment Number One to the Loan and Security Agreement between the Company and Foothill Capital Corporation dated March 30, 1998 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1998 (File No. 1-07115)).
10.8	Amendment Number Two to the Loan and Security Agreement between the Company and Foothill Capital Corporation dated September 23, 1998 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1998 (File No. 1-07115)).
10.9	Restated Amendment Number Two to the Loan and Security Agreement between the Company and Foothill Capital Corporation dated September 30, 1998 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1998 (File No. 1-07115)).
10.10	Amendment Number Three to the Loan and Security Agreement between the Company and Foothill Capital Corporation dated September 22, 1999 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000 (File No. 1-07115)).
10.11	Amendment Number Four to the Loan and Security Agreement between the Company and Foothill Capital Corporation dated May 15, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000 (File No. 1-07115)).

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- 10.12 Amendment to Loan Agreement and Security Agreement between the Company and K-5 Leisure Products, Inc., as assignee of Foothill Capital Corporation dated February 12, 2002 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001 (File No. 1-07115)).

- 10.13 Credit Agreement between the Company and K-5 Leisure Products, Inc. dated September 27, 1999.
- 10.14 \$8,000,000 principal amount Note between the Company and K-5 Leisure Products, Inc. dated September 27, 1999.
- 10.15 Amendment to Credit Agreement and Note between the Company and K-5 Leisure Products, Inc. dated February 12, 2002 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001 (File No. 1-07115)).
- 21 Subsidiaries of the Registrant.
- 23.1 Consent of Independent Certified Public Accountants.
- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14.
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14.
- 32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.