ADDVANTAGE TECHNOLOGIES GROUP INC
Form 10-Q
February 12, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED December 31, 2018

OR

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

FOR THE TRANSITION PERIOD FROM________________ TO ______________

Commission File number 1 10799

ADDvantage Technologies Group, Inc.
(Exact name of registrant as specified in its charter)

OKLAHOMA	73 1351610
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1221 E. Houston
Broken Arrow, Oklahoma 74012
(Address of principal executive office)
(918) 251-9121
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Shares outstanding of the issuer's $.01 par value common stock as of January 31, 2019 were 10,361,292.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
Form 10-Q
For the Period Ended December 31, 2018

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	December 31, 2018	September 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	$2,779,289	$3,129,280
Accounts receivable, net of allowance for doubtful accounts of $150,000	5,010,736	4,400,868
Income tax receivable	116,256	178,766
Inventories, net of allowance for excess and obsolete inventory of $4,993,000 and $4,965,000, respectively	18,572,493	18,888,042
Prepaid expenses	386,789	264,757
Assets held for sale		3,666,753
Total current assets	26,865,563	30,528,466
Property and equipment, at cost:		
Land and buildings	2,208,676	2,208,676
Machinery and equipment	3,882,878	3,884,859
Leasehold improvements	200,617	200,617
Total property and equipment, at cost	6,292,171	6,294,152
Less: Accumulated depreciation	(4,324,319)	(4,276,024)
Net property and equipment	1,967,852	2,018,128
Investment in and loans to equity method investee	12,000	49,000
Intangibles, net of accumulated amortization	6,577,623	6,844,398
Goodwill	4,820,185	4,820,185
Other assets	683,418	134,443
Total assets	$40,926,641	$44,394,620

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(UNAUDITED)

	December 31, 2018	September 30, 2018
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$3,876,056	$4,657,188
Accrued expenses	1,277,431	1,150,010
Notes payable – current portion		2,594,185
Deferred gain – current portion	138,380	
Other current liabilities	643,559	664,374
Total current liabilities	5,935,426	9,065,757
Deferred gain, less current portion	1,233,883	
Other liabilities	165,992	801,612
Total liabilities	7,335,301	9,867,369
Shareholders' equity:		
Common stock, $.01 par value; 30,000,000 shares authorized; 10,861,950 and 10,806,803 shares issued, respectively; 10,361,292 and 10,306,145 shares outstanding, respectively	108,620	108,068
Paid in capital	(4,495,825)	(4,598,343)
Retained earnings	38,978,559	40,017,540
Total shareholders' equity before treasury stock	34,591,354	35,527,265
Less: Treasury stock, 500,658 shares, at cost	(1,000,014)	(1,000,014)
Total shareholders' equity	33,591,340	34,527,251
Total liabilities and shareholders' equity	$40,926,641	$44,394,620

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31,	
	2018	2017
Sales	$11,272,286	$12,284,765
Cost of sales	8,430,724	8,903,610
Gross profit	2,841,562	3,381,155
Operating, selling, general and administrative expenses	3,796,680	3,646,823
Loss from operations	(955,118)	(265,668)
Interest expense	24,863	96,094
Loss before income taxes	(979,981)	(361,762)
Provision for income taxes	59,000	345,000
Net loss	$(1,038,981)	$(706,762)
Loss per share:		
Basic	$(0.10)	$(0.07)
Diluted	$(0.10)	$(0.07)
Shares used in per share calculation:		
Basic	10,361,292	10,225,995
Diluted	10,361,292	10,225,995

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended December 31, 2018	2017
Operating Activities		
Net loss	$(1,038,981)	$(706,762)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	111,717	98,143
Amortization	266,775	313,311
Provision for excess and obsolete inventories	28,000	161,100
Charge for lower of cost or net realizable value for inventories		11,528
Gain on disposal of property and equipment	(20,906)	(6,862)
Deferred income tax provision		345,000
Share based compensation expense	54,320	38,578
Changes in assets and liabilities:		
Accounts receivable	(609,868)	267,469
Income tax receivable\payable	62,510	2,676
Inventories	287,549	(245,558)
Prepaid expenses	(73,282)	38,275
Other assets	(48,975)	3,250
Accounts payable	(781,132)	86,169
Accrued expenses	127,421	(243,271)
Other liabilities	10,565	20,087
Net cash provided by (used in) operating activities	(1,624,287)	183,133
Investing Activities		
Acquisition of net operating assets	(500,000)	–
Loan repayment from (investment in and loans to) equity method investee	37,000	(41,341)
Purchases of property and equipment	(1,519)	–
Disposals of property and equipment	–	23,113
Proceeds from sale of Broken Arrow, OK building	5,000,000	–
Net cash provided by (used in) investing activities	4,535,481	(18,228)
Financing Activities		
Guaranteed payments for acquisition of business	(667,000)	(667,000)
Payments on notes payable	(2,594,185)	(3,055,737)
Net cash used in financing activities	(3,261,185)	(3,722,737)
Net decrease in cash and cash equivalents	(349,991)	(3,557,832)
Cash and cash equivalents at beginning of period	3,129,280	3,972,723
Cash and cash equivalents at end of period	$2,779,289	$414,891
Supplemental cash flow information:		
Cash paid for interest	$57,178	$118,292
Cash paid for income taxes	$–	$–

See notes to unaudited consolidated condensed financial statements.

ADDVANTAGE TECHNOLOGIES GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation and Accounting Policies

Basis of presentation

The consolidated condensed financial statements include the accounts of ADDvantage Technologies Group, Inc. and its subsidiaries, all of which are wholly owned (collectively, the “Company” or “we”). Intercompany balances and transactions have been eliminated in consolidation. The Company’s reportable segments are Cable Television (“Cable TV”) and Telecommunications (“Telco”).

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, the information furnished reflects all adjustments, consisting only of normal recurring items which are, in the opinion of management, necessary in order to make the consolidated condensed financial statements not misleading. It is suggested that these consolidated condensed financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2018.

Reclassification

The Company adopted ASU 2016-15: “Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments.” on October 1, 2018. The $667,000 of guaranteed payments for acquisition of businesses have been reclassified from investing activities and are reported as a financing activity in the Consolidated Condensed Statement of Cash Flows for the three month period ended December 31, 2018. This reclassification had no effect on previously reported results of operations or retained earnings.

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02: “Leases (Topic 842)” which is intended to improve financial reporting about leasing transactions. This ASU will require organizations (“lessees”) that lease assets with lease terms of more than twelve months to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Organizations that own the assets leased by lessees (“lessors”) will remain largely unchanged from current GAAP. In addition, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective for annual periods beginning after December 15, 2018 and early adoption is permitted. Based on management’s initial assessment, ASU 2016-02 will have a material impact on the Company’s consolidated financial statements. Management reviewed its lease obligations and determined that the Company generally does not enter into long-term lease obligations with the exception of its real estate leases for its facilities. The Company is a lessee on certain real estate leases that will need to be reported as right of use assets and liabilities at an estimated amount of $3 million on the Company’s consolidated financial statements on the date of adoption.

In June 2016, the FASB issued ASU 2016-13: “Financial Instruments – Credit Losses (Topic 326) – Measurement of Credit Losses on Financial Instruments.” This ASU requires entities to measure all expected credit losses for most financial assets held at the reporting date based on an expected loss model which includes historical experience, current conditions, and reasonable and supportable forecasts. Entities will now use forward-looking information to better form their credit loss estimates. This ASU also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity’s portfolio. ASU 2016-13 is effective for annual periods beginning after December

15, 2019, including interim periods within those fiscal periods. Entities may adopt earlier as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years. We are currently in the process of evaluating this new standard update.

Note 2 – Revenue Recognition

On October 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606), using the modified retrospective transition method. Management determined that there was no cumulative effect adjustment to the consolidated financial statements and the adoption of the standard did not require any adjustments to the consolidated financial statements for prior periods. Under the guidance of the standard, revenue is recognized at the time a good or service is transferred to a customer and the customer obtains control of that good or receives the service performed. Substantially all of the Company's sales arrangements with customers are short-term in nature involving single performance obligations related to the delivery of goods or repair of equipment and generally provide for transfer of control at the time of shipment to the customer. The Company generally permits returns of product or repaired equipment due to defects; however, returns are historically insignificant.

The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for its products or repair services. The following steps are applied in determining the amount and timing of revenue recognition:

1. Identification of a contract with a customer is a sales arrangement involving a purchase order issued by the customer stating the goods to be transferred. Payment terms are generally net due in 30 days. Discounts on sales arrangements are generally not provided. Credit worthiness is determined by the Company based on payment experience and financial information available on the customer.

2. Identification of performance obligations in the sales arrangement which is predominantly the promise to transfer goods, repair services or recycled items to the customer.

3. Determination of the transaction price which is specified in the purchase order based on product pricing negotiated between the Company and the customer.

4. Allocate the transaction price to performance obligations. Substantially all the contracts are single performance obligations and the allocated purchase price is the transaction price.

5. Recognition of revenue which predominantly occurs upon completion of the performance obligation and transfer of control. Transfer of control generally occurs at the point the Company ships the sold or repaired product from its warehouse locations.

The Company's principal revenues are from sales of Cable TV and Telco equipment, Cable TV repair services and Telco recycled equipment. Sales are primarily to customers in the United States. International sales are made to customers in Central America, South America and, to a substantially lesser extent, other international regions that utilize the same technology which totaled approximately $0.9 million and $1.2 million in the three months ended December 31, 2018 and 2017, respectively.

The Company's customers include multiple system operators, resellers and direct sales to end-user customers. Sales to the Company's largest customer totaled approximately 5% of consolidated revenues.

Our revenues by type were as follows:

	Three Months Ended December 31,	
	2018	2017
Equipment sales		
Cable TV	$4,052,140	$5,114,291
Telco	6,609,642	5,691,320
Intersegment	(40,242)	(180)
Recycle revenue		
Cable TV		
Telco	240,697	767,221
Repair revenue		
Cable TV	410,049	712,113
Telco		
	$11,272,286	$12,284,765

Note 3 – Sale and Leaseback of Assets

In October 2018, the Company entered into an agreement with David Chymiak to sell the Broken Arrow, Oklahoma facility. Mr. Chymiak is the Chief Technology Officer, President of Tulsat LLC ("Tulsat"), director, and substantial shareholder of the Company. The sale agreement provided for a purchase price of $5,000,000 payable in cash at closing. The sale closed on November 29, 2018, which generated a pretax gain of approximately $1.4 million.

In connection with the sale of the Broken Arrow, Oklahoma facility, Tulsat, which is one of the subsidiaries contained in the Cable TV segment, entered into a ten-year lease with Mr. Chymiak for a monthly rent of $44,000, or $528,000 per year. Tulsat, as tenant, will be responsible for most ongoing expenses related to the facility, including property tax, insurance and maintenance. As a result of the leaseback, the pretax gain of $1.4 million was deferred over the lease period and is reported in Deferred gain in the Consolidated Condensed Balance Sheet.

Note 4 – Disposition of Assets

In December 2018, the Company entered into an agreement for the sale of our Cable TV segment business to a company controlled by David Chymiak for $10.3 million. This sale is subject to shareholder approval, which the Company anticipates occurring in our third fiscal quarter of 2019. The purchase price will consist of $3.9 million of cash and a $6.4 million promissory note to be paid in semi-annual installments over five years with an interest rate of 6.0%. If the sale receives shareholder approval, the Company estimates that this sale will result in a pretax loss of approximately $2.8 million. In addition, if the sale receives shareholder approval, the Company will accelerate the remaining deferred gain of $1.4 million from the sale of the Broken Arrow, Oklahoma facility (see Note 3 – Sale and Leaseback of Assets).

Note 5 – Inventories

Inventories at December 31, 2018 and September 30, 2018 are as follows:

	December 31, 2018	September 30, 2018
New:		
Cable TV	$12,056,677	$12,594,138
Telco	1,612,763	1,371,545
Refurbished and used:		
Cable TV	2,968,626	2,981,413
Telco	6,927,427	6,905,946
Allowance for excess and obsolete inventory:		
Cable TV	(4,150,000)	(4,150,000)
Telco	(843,000)	(815,000)
	$18,572,493	$18,888,042

New inventory includes products purchased from manufacturers plus "surplus-new", which are unused products purchased from other distributors or multiple system operators. Refurbished inventory includes factory refurbished, Company refurbished and used products. Generally, the Company does not refurbish its used inventory until there is a sale of that product or to keep a certain quantity on hand.

The Company regularly reviews the Cable TV segment inventory quantities on hand, and an adjustment to cost is recognized when the loss of usefulness of an item or other factors, such as obsolete and excess inventories, indicate that cost will not be recovered when an item is sold. The Company recorded charges in the Cable TV segment to allow for obsolete inventory, which increased the cost of sales by zero and $0.2 million during the three months ended December 31, 2018 and 2017, respectively, to an allowance of $4.2 million at December 31, 2018.

In the three months ended December 31, 2018 and 2017, the Telco segment identified certain inventory that more than likely will not be sold or that the cost will not be recovered when it is processed through its recycling program. Therefore, the Company has a $0.8 million allowance at December 31, 2018. In the three months ended December 31, 2018, the Company increased the allowance by $30 thousand. The Company also reviewed the cost of inventories against estimated net realizable value and recorded a lower of cost or net realizable value charge for the three months ended December 31, 2018 and December 31, 2017 of zero and $12 thousand, respectively, for inventories that have a cost in excess of estimated net realizable value.

Note 6 – Intangible Assets

The intangible assets with their associated accumulated amortization amounts at December 31, 2018 and September 30, 2018 are as follows:

	December 31, 2018		
	Gross	Accumulated Amortization	Net
Intangible assets:			
Customer relationships – 10 years	$8,152,000	$(2,917,689)	$5,234,311
Trade name – 10 years	2,119,000	(807,355)	1,311,645
Non-compete agreements – 3 years	374,000	(342,333)	31,667

Total intangible assets	$10,645,000	$(4,067,377)	$6,577,623

	September 30, 2018		
	Gross	Accumulated Amortization	Net
Intangible assets:			
Customer relationships – 10 years	$8,152,000	$(2,713,890)	$5,438,110
Trade name – 10 years	2,119,000	(754,380)	1,364,620
Non-compete agreements – 3 years	374,000	(332,332)	41,668
Total intangible assets	$10,645,000	$(3,800,602)	$6,844,398

Note 7 – Notes Payable and Line of Credit

Forbearance Agreement

On May 31, 2018, the Company entered into a forbearance agreement with BOKF, NA dba Bank of Oklahoma ("Lender") relating to the Company's Amended and Restated Credit and Term Loan Agreement ("Credit and Term Loan Agreement").

Under the forbearance agreement, which is Amendment Ten to the Credit and Term Loan Agreement, Lender agreed to delete the fixed charge ratio covenant from the Credit and Term Loan Agreement and to forbear from exercising its rights and remedies under the Credit and Term Loan Agreement through October 31, 2018 subject to, among other things, the following terms:

- Reducing the revolving line commitment from $5.0 million to $3.0 million;
- Terminating the Lender's obligation to lend or make advances under the revolving line of credit;
- Limiting the Company's capital expenditure to $100,000 during the forbearance period;
- Requiring semi-monthly reporting of its borrowing base calculation; and
- Requiring the Company to remain in compliance with the terms of the amended Credit and Term Loan Agreement.

Revolving credit and term loans created under the Credit and Term Loan Agreement were collateralized by inventory, accounts receivable, equipment and fixtures, general intangibles and a mortgage on certain property. Among other financial covenants, the Credit and Term Loan Agreement provided that the Company maintain a leverage ratio (total funded debt to EBITDA) of not more than 2.50 to 1.0.

The Company had two term loans outstanding under the Credit and Term Loan Agreement. The first outstanding term loan had an outstanding balance of $0.6 million and was due on October 31, 2018, with monthly principal payments of $15,334 plus accrued interest. The interest rate was the prevailing 30-day LIBOR rate plus 1.4% (3.66% at October 31, 2018).

The second outstanding term loan had an outstanding balance of $1.5 million and was due October 31, 2018, with monthly principal and interest payments of $118,809. The interest rate on the term loan was a fixed interest rate of 4.40%.

In November 2018, the Company extinguished its two outstanding term loans under the forbearance agreement by paying the outstanding balances of $2.1 million.

The forbearance agreement reduced its line of credit to $3.0 million from $5.0 million, while other terms of its line of credit remained essentially the same. Any future borrowings under the line of credit were due on October 31, 2018.

In October 2018, the Company extinguished its line of credit under the forbearance agreement by paying the outstanding balance of $0.5 million.

Since the Company extinguished all of its outstanding term loans and line of credit outstanding under the forbearance agreement in the first quarter of 2019, the Company is no longer subject to the terms of the forbearance agreement and has been released from the Credit and Term Loan Agreement.

New Credit Agreement

In December 2018, the Company entered into a new credit agreement with a different lender. This credit agreement contains a $2.5 million revolving line of credit and matures on December 17, 2019. The line of credit requires quarterly interest payments based on the prevailing Wall Street Journal Prime Rate plus 0.75% (6.25% at December 31, 2018), and the interest rate is reset monthly. The new credit agreement provides that the Company maintain a fixed charge coverage ratio (net cash flow to total fixed charges) of not less than 1.25 to 1.0. Future borrowings under the line of credit are limited to the lesser of $2.5 million or the sum of 80% of eligible accounts receivable and 25% of eligible Telco segment inventory. Under these limitations, the Company's total available line of credit borrowing base was $2.5 million at December 31, 2018.

Fair Value of Debt

The carrying value of the Company's variable-rate line of credit approximates its fair value since the interest rate fluctuates periodically based on a floating interest rate.

Note 8 – Earnings Per Share

Basic earnings per share are based on the sum of the average number of common shares outstanding and issuable, restricted and deferred shares. Diluted earnings per share include any dilutive effect of stock options and restricted stock. In computing the diluted weighted average shares, the average share price for the period is used in determining the number of shares assumed to be reacquired under the treasury stock method from the exercise of options.

Basic and diluted earnings per share for the three months ended December 31, 2018 and 2017 are:

	Three Months Ended December 31, 2018	2017
Net loss attributable to common shareholders	$(1,038,981)	$(706,762)
Basic weighted average shares	10,361,292	10,225,995
Effect of dilutive securities:		
Stock options		–
Diluted weighted average shares	10,361,292	10,225,995
Loss per common share:		
Basic	$(0.10)	$(0.07)
Diluted	$(0.10)	$(0.07)

The table below includes information related to stock options that were outstanding at the end of each respective three-month period ended December 31, but have been excluded from the computation of weighted-average stock options for dilutive securities because their effect would be anti-dilutive. The stock options were anti-dilutive because the Company had a net loss for the periods presented. Additionally, for certain stock options, the exercise price exceeded the average market price per share of our common stock for the three months ended December 31, 2018 and 2017.

	Three Months Ended December 31, 2018	2017
Stock options excluded	620,000	700,000

Weighted average exercise price of stock options	$1.83	$2.54
Average market price of common stock	$1.34	$1.46

11

Note 9 – Stock-Based Compensation
Plan Information

The 2015 Incentive Stock Plan (the "Plan") provides for awards of stock options and restricted stock to officers, directors, key employees and consultants. Under the Plan, option prices will be set by the Compensation Committee and may not be less than the fair market value of the stock on the grant date.

At December 31, 2018, 1,100,415 shares of common stock were reserved for stock award grants under the Plan. Of these reserved shares, 157,154 shares were available for future grants.
Stock Options
All share-based payments to employees, including grants of employee stock options, are recognized in the financial statements based on their grant date fair value over the requisite service period. Compensation expense for share-based awards is included in the operating, selling, general and administrative expense section of the Company's consolidated condensed statements of operations.

Stock options are valued at the date of the award, which does not precede the approval date, and compensation cost is recognized on a straight-line basis over the vesting period. Stock options granted to employees generally become exercisable over a three, four or five-year period from the date of grant and generally expire ten years after the date of grant. Stock options granted to the Board of Directors generally become exercisable on the date of grant and generally expire ten years after the grant.

A summary of the status of the Company's stock options at December 31, 2018 and changes during the three months then ended is presented below: