

DIXON TICONDEROGA CO  
Form 10-Q  
August 13, 2004

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

-----  
FORM 10-Q  
-----

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

For the quarterly period ended June 30, 2004

OR

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

-----  
Commission file number 1-8689

DIXON TICONDEROGA COMPANY  
Incorporated pursuant to the Laws of Delaware State

-----  
Internal Revenue Service-- Employer Identification No. 23-0973760

195 International Parkway, Heathrow, FL 32746  
(407) 829-9000  
-----

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

The total number of shares of the registrant's Common Stock, \$1 par value, outstanding on June 30, 2004, was 3,207,894.

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES  
-----

INDEX

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

-----

	Page
	-----
PART I. FINANCIAL INFORMATION	
Item 1. Financial Information	
Consolidated Balance Sheets -- June 30, 2004 and September 30, 2003	3
Consolidated Statements of Operations -- For The Three and Nine Months Ended June 30, 2004 and 2003	4
Consolidated Statements of Comprehensive Income -- For The Three and Nine Months Ended June 30, 2004 and 2003	5
Consolidated Statements of Cash Flows -- For The Nine Months Ended June 30, 2004 and 2003	6
Notes to Consolidated Financial Statements	7-10
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11-14
Item 3. Quantitative and Qualitative Disclosures About Market Risk	15
PART II. OTHER INFORMATION	
Item 6. Exhibits and Reports on Form 8-K	16-17
Signatures	18
Certifications	19-24

2

PART I - FINANCIAL INFORMATION

-----

Item 1.

-----

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

-----

CONSOLIDATED BALANCE SHEETS

-----

	June 30, 2004 (Unaudited)	September 30, 2003
	-----	-----
ASSETS		
-----		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,743,035	\$ 1,032,974
Receivables, less allowance for doubtful accounts of \$1,393,007 at June 30, 2004		

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

and \$1,429,222 at September 30, 2003	37,071,023	28,326,743
Inventories	32,192,464	26,439,361
Other current assets	2,353,742	2,350,813
	-----	-----
Total current assets	73,360,264	58,149,891
	-----	-----
PROPERTY, PLANT AND EQUIPMENT:		
Land and buildings	8,071,776	8,056,169
Machinery and equipment	11,594,554	11,158,157
Furniture and fixtures	1,400,016	1,385,857
	-----	-----
	21,066,346	20,600,183
	-----	-----
Less accumulated depreciation	(13,025,837)	(12,490,680)
	-----	-----
	8,040,509	8,109,503
	-----	-----
OTHER ASSETS	4,641,611	5,774,649
	-----	-----
	\$ 86,042,384	\$ 72,034,043
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
-----		
CURRENT LIABILITIES:		
Notes payable	\$ 12,943,738	\$ 6,382,065
Current maturities of long-term debt	21,193,333	13,227,965
Accounts payable	12,456,685	9,102,711
Accrued liabilities	6,697,460	8,496,182
	-----	-----
Total current liabilities	53,291,216	37,208,923
	-----	-----
LONG-TERM DEBT	10,341,075	12,510,860
	-----	-----
DEFERRED INCOME TAXES AND OTHER	782,429	894,601
	-----	-----
MINORITY INTEREST	584,590	578,530
	-----	-----
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, par \$1, authorized 100,000 shares, none issued	--	--
Common stock, par \$1, authorized 8,000,000 shares, issued 3,710,309 shares in 2003 and 2002	3,710,309	3,710,309
Capital in excess of par value	3,519,531	3,547,567
Retained earnings	24,498,648	23,679,772
Accumulated other comprehensive loss	(6,864,612)	(6,238,403)
	-----	-----
	24,863,876	24,699,245
Less shareholder loans	(557,721)	(557,721)
Less treasury stock, at cost (502,415 shares at June 30, 2004 and 508,160 shares at September 30, 2003)	(3,263,081)	(3,300,395)
	-----	-----
	21,043,074	20,841,129
	-----	-----
	\$ 86,042,384	\$ 72,034,043
	=====	=====

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES  
 -----  
 CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
 -----  
 FOR THE THREE AND NINE MONTHS ENDED JUNE 30, 2004 AND 2003  
 -----

	THREE MONTHS ENDED JUNE 30,		NINE MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
	\$	\$	\$	
REVENUES	\$ 27,367,166	\$ 26,940,174	\$ 61,796,736	\$ 61,702,854
COST AND EXPENSES:				
Cost of goods sold	16,093,878	15,535,113	37,488,302	37,039,958
Selling and administrative expenses	7,851,966	7,998,795	19,681,314	20,480,089
Provision for restructuring and related costs	--	183,178	--	486,866
Debt refinancing costs	--	--	--	624,662
Investment banking and related costs	128,283	--	468,593	--
	24,074,127	23,717,086	57,638,209	58,631,575
OPERATING INCOME	3,293,039	3,223,088	4,158,527	3,071,279
OTHER INCOME, NET	--	611,680	--	1,052,500
INTEREST EXPENSE	(912,476)	(990,806)	(2,519,481)	(2,652,880)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST				
	2,380,563	2,843,962	1,639,046	1,470,899
INCOME TAXES	(682,231)	(971,733)	(786,971)	(379,197)
MINORITY INTEREST	(26,268)	(21,948)	(33,199)	(28,829)
INCOME FROM CONTINUING OPERATIONS	1,672,064	1,850,281	818,876	1,062,873
DISCONTINUED OPERATIONS, NET OF INCOME TAXES				
	--	(59,723)	--	(311,161)
NET INCOME	\$ 1,672,064	\$ 1,790,558	\$ 818,876	\$ 751,712
EARNINGS (LOSS) PER COMMON SHARE (BASIC):				
Continuing operations	\$ 0.52	\$ 0.58	\$ 0.26	\$ 0.33
Discontinued operations	--	(0.02)	--	(0.09)

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

Net income	\$ 0.52	\$ 0.56	\$ 0.26	\$ 0.24
EARNINGS (LOSS) PER COMMON SHARE (DILUTED):				
Continuing operations	\$ 0.52	\$ 0.58	\$ 0.26	\$ 0.33
Discontinued operations	--	(0.02)	--	(0.09)
Net income	\$ 0.52	\$ 0.56	\$ 0.26	\$ 0.24
SHARES OUTSTANDING:				
Basic	3,205,979	3,199,043	3,203,107	3,194,902
Diluted	3,206,190	3,199,043	3,203,107	3,194,902

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

4

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
 FOR THE THREE AND NINE MONTHS ENDED JUNE 30, 2004 AND 2003

	THREE MONTHS ENDED JUNE 30,		NINE MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
NET INCOME	\$ 1,672,064	\$ 1,790,558	\$ 818,876	\$ 751,712
OTHER COMPREHENSIVE INCOME (LOSS):				
Current period adjustment to recognize fair value of cash flow hedges	193,188	14,673	378,172	52,320
Foreign currency translation adjustments	(1,050,741)	1,186,575	(1,004,381)	864,875
COMPREHENSIVE INCOME	\$ 814,511	\$ 2,991,806	\$ 192,667	\$ 1,668,907

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

5

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES  
 -----  
 CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
 -----  
 FOR THE NINE MONTHS ENDED JUNE 30, 2004 AND 2003  
 -----

	2004	2003
	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income from continuing operations	\$ 818,876	\$ 1,062,873
Net loss from discontinued operations	--	(311,161)
Gain on receipt of securities from insurance company demutualizations	--	(672,291)
Adjustment to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,570,230	1,815,576
Deferred taxes	308,102	13,875
Provision for doubtful accounts receivable	288,220	260,478
Gain attributable to foreign currency exchange	(346,153)	(67,721)
Income attributable to minority interest	33,199	28,829
Changes in assets and liabilities:		
Receivables	(9,629,052)	(8,552,684)
Inventories	(6,266,262)	(4,428,977)
Other current assets	(18,163)	(936,378)
Accounts payable and accrued liabilities	2,163,502	(2,344,096)
Other assets	517,362	1,421,865
	-----	-----
Net cash used in operations	\$ (10,560,139)	\$ (12,709,812)
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment, net	(1,185,695)	(747,931)
Proceeds on sale of securities received from insurance tualizations	--	607,262
	-----	-----
Net cash used in investing activities	\$ (1,185,695)	\$ (140,669)

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from notes payable	7,089,310	5,876,929
Net proceeds from long-term debt	5,795,583	5,585,430
Deferred financing costs	--	(549,193)
Sales of treasury stock	9,278	14,255
Other non-current liabilities	--	(99,745)
<hr/>		
Net cash provided by financing activities	12,894,171	10,827,676
<hr/>		
Effect of exchange rate changes on cash	(438,276)	63,255
<hr/>		
Net increase (decrease) in cash and cash equivalents	710,061	(1,959,550)
Cash and cash equivalents, beginning of period	1,032,974	2,589,493
<hr/>		
Cash and cash equivalents, end of period	\$ 1,743,035	\$ 629,943
<hr/>		
Supplemental Disclosures:		
Cash paid during the period:		
Interest	\$ 2,532,085	\$ 4,279,085
Income taxes	795,713	606,442

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

6

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION:

The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K. In the opinion of the Company, all adjustments (solely of a normal recurring nature) necessary for the fair presentation of the financial position of Dixon Ticonderoga Company and subsidiaries as of June 30, 2004, and the results of their operations and cash flows for the nine months ended June 30, 2004 and 2003, have been included. The results of operations for such interim periods are not necessarily indicative of the results for the entire year.

Certain other prior year amounts have been reclassified to conform with the

## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

current year classifications.

### 2. INVENTORIES:

Since amounts for inventories under the LIFO method are based on annual determinations of quantities and costs as of the end of the fiscal year, the inventories at June 30, 2004 (for which the LIFO method of accounting are used) are based on certain estimates relating to quantities and costs as of year end.

Inventories consist of (in thousands):

	June 30, 2004	September 30, 2003
	-----	-----
Raw materials	\$ 12,434	\$ 10,486
Work in process	3,471	2,198
Finished goods	16,287	13,755
	-----	-----
	\$ 32,192	\$ 26,439
	=====	=====

7

### 3. RECENT ACCOUNTING PRONOUNCEMENT:

In March 2004, the FASB issued a proposed statement, "Share-Based Payment - an amendment of Statements No. 123 and 95" that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees", and generally would require instead that such transactions be accounted for using a fair-value-based method. The Company would be required to adopt this proposed statement in its 2006 fiscal year, and its adoption is not expected to have a material impact in the Company's financial condition, results of operations or cash flows.

### 4. RESTRUCTURING AND RELATED COSTS:

In fiscal 2003, the Company completed its comprehensive Restructuring and Cost Reduction Program, including the final phase of consolidation of its manufacturing operations. The Company had reserved \$90,000 of employee severance and related costs as of September 30, 2003.

The restructuring costs reserve and utilization since September 30, 2003 are summarized below (in thousands):

Reserve balances at September 30, 2003	\$ 90
Payments in the nine months ended June 30, 2004	(78)
	-----
Reserve balances at June 30, 2004	\$ 12
	=====



## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

In the prior year period ended June 30, 2003, the Company incurred approximately \$487,000 for costs associated with the shutdown of a manufacturing facility, which were not accruable in advance.

### 5. LONG-TERM DEBT:

In connection with the completion of its debt restructuring in October 2002, the Company expensed approximately \$625,000 of deferred financing costs in the nine-month period ended June 30, 2003 associated with its previous senior debt arrangements with a consortium of lenders and its previous subordinated debt agreements.

### 6. OTHER INCOME:

Other income, net in the nine-month period ended June 30, 2003, includes \$672,000 of gains from the receipt of securities by the Company as a policyholder following the demutualization of certain insurance companies. Additionally, the Company received \$380,000 in import duty rebates in the 2003 period.

8

### 7. LINE OF BUSINESS REPORTING:

The Company's operations consist only of one principal business segment - its Consumer Group. The following information sets forth certain additional data pertaining to its operations for the three and nine-month periods ended June 30, 2004 and 2003 (in thousands).

	Three Months		Nine Months	
	Revenues	Operating Profit	Revenues	Operating Profit (Loss)
<b>2004:</b>				
United States	\$ 16,049	\$ 1,002	\$ 34,599	\$ 1,060
Canada	3,097	759	6,223	904
Mexico	7,558	1,329	19,655	1,932
United Kingdom	413	39	1,069	87
China	250	164	251	176
	\$ 27,367	\$ 3,293	\$ 61,797	\$ 4,159
<b>2003:</b>				
United States	\$ 16,064	\$ 789	\$ 35,569	\$ (830)
Canada	3,179	468	6,463	626
Mexico	7,291	1,734	18,575	2,774
United Kingdom	366	42	958	64
China	40	190	138	437
	\$ 26,940	\$ 3,223	\$ 61,703	\$ 3,071

The United States operating loss in each period includes unallocated corporate expenses.

### 8. STOCK OPTIONS - PRO FORMA DISCLOSURES:

## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

The Company has adopted the disclosure-only provisions of FASB Statements No. 123 and No. 148, and, accordingly, there is no compensation expense recognized for its stock option plans. Pro forma net income and income per share would have been as follows if the fair value estimates were used to record compensation expense:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Net income reported	\$1,672,064	\$1,790,558	\$ 818,876	\$ 751,712
Estimated stock compensation expense	9,446	22,747	52,026	68,241
Pro forma net income	\$1,662,618	\$1,767,811	\$ 766,850	\$ 683,471
Pro forma income per share:				
Basic	\$ .52	\$ .55	\$ .24	\$ .21
Diluted	\$ .52	\$ .55	\$ .24	\$ .21

9

### 9. INVESTMENT BANKING AND RELATED COSTS:

On January 9, 2004, the Company and Jarden Corporation (NYSE: JAH) signed an exclusivity agreement to allow Jarden to evaluate a potential transaction among the companies whereby Jarden or its affiliate would acquire all of the outstanding shares of the Company's common stock at a price of \$5 per share, subject to, among other things, due diligence and entering into definitive acquisition agreements. The exclusivity agreement was later amended several times to extend the expiration date. On March 29, 2004, the companies terminated their discussions.

The Company incurred approximately \$469,000 through June 30, 2004 associated with the aforementioned potential transaction and other investment banking and related costs which are classified accordingly in the accompanying financial statements.

10

Item 2.

-----  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
-----  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
-----

RESULTS OF OPERATIONS  
-----

REVENUES for the quarter ended June 30, 2004, increased \$427,000 from the same quarter last year. The changes are as follows:

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

	Increase (Decrease) (in thousands)	% Increase (Decrease)		
		Total	Volume	Price/Mix
U.S. Consumer	(13)	--	5	(5)
Foreign Consumer	440	4	8	(4)

U.S. Consumer revenue increases in the educational and commercial market reflecting a shift in buying patterns closer to the back-to-school season were offset by lower retail and superstore market sales. Volume increases in Mexico offset a reduction of \$630,000 due to the devaluation of the Mexican peso. Canada remained flat with small volume decreases offsetting a gain of \$80,000 due to the increasing value of the Canadian dollar. The Company expects to experience continued competitive pressures making it difficult for the Company to grow revenues substantially over the short-term.

Revenues for the nine months ended June 30, 2004, increased \$94,000 from the same period last year. The changes are as follows:

	Increase (Decrease) (in thousands)	% Increase (Decrease)		
		Total	Volume	Price/Mix
U.S. Consumer	(970)	(3)	-	(3)
Foreign Consumer	1,064	4	2	2

U.S. Consumer revenue decreased \$970,000 with the educational and retail markets experiencing a less favorable mix of products sold and certain competitive pricing pressures. Foreign consumer increased \$1,064,000 despite a reduction of \$1.1 million due to the devaluation of the Mexico peso. Volume and price increases in Mexico and increases in the value of the Canadian dollar of \$560,000 more than offset the peso decline.

While the Company has operations in Canada, Mexico and the U.K., historically only the operating results in Mexico have been materially impacted by currency fluctuations. There has been a significant devaluation of the Mexican peso at least once in each of the last three decades, the last one being in August 1998. In the short term after such devaluation, consumer confidence has been shaken, leading to an immediate reduction in revenues in the months following the devaluation. Then, after the immediate shock, and as the peso stabilizes, revenues tend to grow. Selling prices tend to rise over the long term to offset any inflationary increases in costs. The peso, as well as any currency value, depends on many factors including international trade, investor confidence, and government policy, to name a few. These factors are impossible for the Company to predict, and thus, an estimate of potential effect on results of operations for the future cannot be made. This currency risk in Mexico is presently managed through occasional foreign currency hedges, local currency financing and by export sales denominated in U.S. dollars.

OPERATING INCOME in the quarter ended June 30, 2004 increased \$70,000 over the same quarter last year. U.S. operating profits increased \$213,000. The current quarter's U.S. operating profit reflects \$128,000 in investment banking costs, while the prior year quarter included \$183,000 in restructuring costs. Reductions in U.S. administrative expenses due to previous cost reduction initiatives also contributed to the U.S. increase. Foreign operating profits decreased \$143,000. Canada increased \$290,000 due to lower costs associated with certain imported products and the favorable impact of the Canadian dollar. Mexico decreased \$405,000 due principally to the effects of pricing pressures following the peso devaluation and mix of products sold during the period. China operating profits declined somewhat due to higher material costs impacting its profit on wood slats.

## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

Operating income for the nine months ended June 30, 2004 increased \$1,088,000 over the prior year. U.S. operating income increased \$1,890,000. Excluding investment banking costs incurred this year and debt refinancing costs and restructuring costs incurred in the prior year period, operating income increased \$1,288,000. The Company's consolidation and cost reduction programs significantly improved U.S. gross margins despite the decline in revenues. Lower U.S. commissions, advertising, distribution and personnel costs contributed to a decrease in consolidated selling and administrative costs (31.8% of revenue as compared to 33.2% of revenue in the prior year). Foreign operating income decreased \$802,000 primarily in Mexico, due to the aforementioned factors. The Mexico decrease in operating income was partially offset by higher profits in Canada due to the effects of higher margins on certain imported products and favorable currency effects. China decreased due to higher material costs, as discussed above.

OTHER INCOME, net of \$612,000 in the prior year quarter represents gains from securities received by the Company as a policyholder following the demutualization of certain insurance companies. Other income of \$1,052,000 in the nine months ended June 30, 2003, includes the aforementioned gains from the receipt of securities from insurance company demutualizations as well as import duty rebates received.

INTEREST EXPENSE decreased \$78,000 and \$133,000 in the quarter and nine months ended June 30, 2004, respectively (net of interest allocated to discontinued operations in the corresponding prior year periods). The decreases are primarily due to lower average borrowing levels during the current year periods.

INCOME TAX decreased \$290,000 and increased \$408,000 for the quarter and nine months ended June 30, 2004, respectively. Income tax expense in each period represents foreign income tax only. For the quarter ended June 30, 2004, any tax on U.S. income was offset by tax benefits from available loss carry-forwards. Despite the improvement in U.S. operating results, no tax benefit was recognized for U.S. tax losses in the nine-month period as the Company recorded further valuation reserves to offset any U.S. deferred tax assets created.

MINORITY INTEREST represents approximately 3% of the results of operations of the Company's Mexico subsidiary.

### LIQUIDITY AND CAPITAL RESOURCES

-----

The Company's cash flows used in operations improved \$2.15 million in the nine months ended June 30, 2004. Somewhat higher U.S. inventory levels (due to the shift in buying patterns of certain of its major customers as well as higher in-transit imported products) and higher Mexico trade and other receivables adversely affected cash flows during the period. However, this was more than offset by enhanced accounts payable management and by lower cash flows needed to extinguish trade payables, interest and restructuring liabilities during the current year period.

The Company's fiscal 2004 investing activities included approximately \$1,186,000 in net purchases of property and equipment, compared to \$748,000 in the prior year period. The increase is due to the purchase of computer software enhancements designed to improve logistics and inventory management, as well as certain strategic manufacturing equipment in Mexico. Generally, all major capital projects are discretionary in nature. Capital expenditures are usually funded from operations and existing financing or new leasing arrangements.

The Company's financing agreements with its senior lender and subordinated lenders run through fiscal 2005. Wells Fargo Foothill provides a three-year \$28 million senior debt facility.

The senior debt facility includes a \$25 million revolving loan, which bears interest at either the prime rate, plus 0.75%, or the prevailing LIBOR rate, plus 3.5%. Borrowings under the revolving loan are based upon 85% of eligible U.S. and Canada accounts receivable, as defined; 50% of certain accounts receivable having extended payment terms; and varying advance rates for U.S. and

## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

Canada raw materials and finished goods inventories. The facility also includes term loans originally aggregating \$3 million, which bear interest at either the prime rate, plus 1.5%, or the prevailing LIBOR rate, plus 4.25%. These loans are payable in monthly installments of \$50,000, plus interest, with the balance due in a balloon payment in October 2005. The loan agreement also contains restrictions regarding the payment of dividends as well as subordinated debt payments (discussed below), a requirement to maintain a minimum level of earnings before interest, taxes, depreciation and amortization and net worth and

12

a limitation on the amount of annual capital expenditures. In an attempt to better balance and manage overall interest rate exposure, the Company previously executed an interest rate swap agreement that effectively fixed the rate of interest on \$8 million of its variable rate debt at 8.98% through August 2005.

These financing arrangements are collateralized by the tangible and intangible assets of the U.S. and Canada operations (including accounts receivable, inventories, property, plant and equipment, patents and trademarks) and a guarantee by and pledge of capital stock of the Company's subsidiaries. As of June 30, 2004, the Company had approximately \$8 million of unused lines of credit available under the senior debt facility.

The Company also has \$16.5 million of Senior Subordinated Notes with a maturity date to 2005. The Company had only been required to pay monthly installments of \$50,000 through December 2003 and \$150,000 per month, commencing January 2004 through the maturity date. However, the Company has paid a total of \$5.2 million in principal through June 30, 2004 and expects to make additional excess payments to its subordinated lenders through the maturity date in October 2005. Payments to the subordinated lenders are subject to certain restrictions imposed under the senior debt facility. Interest on the balance of subordinated debt is paid quarterly. If the Company is unable to make scheduled and excess payments totaling at least an additional \$3.8 million by 2005 (due to restrictions imposed under the senior debt facility or otherwise) contingent warrants issued to the noteholders equivalent to up to approximately 1.2% of the diluted common shares outstanding for each \$1 million in remaining unpaid additional principal will become exercisable at an exercise price of \$.01 per share. The Company made sufficient payments through May 31, 2004 so that contingent warrants to purchase 2.5% of diluted common shares outstanding were cancelled May 31, 2004, before ever vesting. Under the subordinated note agreement, as amended, the next date at which a portion of the contingent warrants issued to the subordinated noteholders would become exercisable is March 31, 2005, when contingent warrants to purchase up to 2.5% of the diluted common shares outstanding will become exercisable if aggregate payments to the subordinated noteholders are less than \$8 million through that date. The agreement also grants the subordinated lenders a lien on Company assets (junior in all aspects to the senior debt collateral agreements described above). The interest rate on the subordinated notes is 12.5% through maturity in October 2005. The subordinated note agreement includes certain other provisions, including restrictions as to the payment of dividends and the elimination or adjustment of financial covenants contained in the original agreement to conform to those contained in the senior debt agreements.

In addition, the Company's Mexico subsidiary had approximately \$16 million in bank lines of credit (\$3 million unused) as of June 30, 2004, expiring at various dates from September 2004 through March 2005, which bear interest at a rate based upon either a floating U.S. bank rate or the rate of certain Mexico government securities. The Company relies heavily upon the availability of the lines of credit in the U.S. and Mexico for liquidity in its operations.

The Company believes that amounts available from its lines of credit under its senior debt and under lines of credit available to its Mexican subsidiary are sufficient to fulfill all current and anticipated operating requirements of its business through 2005. The Company's Mexico subsidiary cannot assure that

## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

each of its lines of credit will continue to be available after their respective expiration dates, or that replacement lines of credit will be secured. However, the Company believes there should be sufficient amounts available under its present or future facilities or lines of credit to cover any potential shortfalls due to any expiring lines of credit.

The Company has recently been assisted by investment bankers and certain other outside consultants to advise and assist it in evaluating certain strategic alternatives, including capital restructuring, mergers and acquisitions, and/or other measures designed to maximize shareholder value. The Company continues to pursue strategic alternatives, including a potential sale. The costs associated with these initiatives (including the potential transaction discussed below) are reflected as investment banking and related costs in the accompanying financial statements. Management expects to continue to incur certain expenses in the future related to these activities.

On January 9, 2004, the Company and Jarden Corporation (NYSE: JAH) signed an exclusivity agreement to allow Jarden to evaluate a potential transaction among the companies whereby Jarden or its affiliate would acquire all of the outstanding shares of the Company's common stock at a price of \$5 per share, subject to, among other things, due diligence and entering into definitive acquisition agreements. The exclusivity agreement was later amended several times to extend the expiration date. On March 29, 2004, the companies terminated

13

their discussions and all costs related to the proposed transaction have been expensed.

### RECENT ACCOUNTING PRONOUNCEMENT

-----

In March 2004, the FASB issued a proposed statement, "Share-Based Payment - an amendment of Statements No. 123 and 95" that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees", and generally would require instead that such transactions be accounted for using a fair-value-based method. The Company would be required to adopt this proposed statement in its 2006 fiscal year, and its adoption is not expected to have a material impact in the Company's financial condition, results of operations or cash flows.

### FORWARD-LOOKING STATEMENTS

-----

The statements in this Quarterly Report on Form 10-Q that are not purely historical are "forward-looking statements" within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934, including statements about the Company's expectations, beliefs, intentions or strategies regarding the future. Forward-looking statements include statements regarding, among other things, the effects of the devaluation of the Mexican peso; the sufficiency and continued availability of the Company's lines of credit and its ability to meet its current and anticipated obligations, including payments due under its subordinated debt; management's expectation for savings from the restructuring and cost-reduction program; the Company's ability to increase sales in its core businesses; its expectations regarding the Company's ability to utilize certain tax benefits in the future; the avoidance of the exercisability of part or all of the warrants issued to the Company's subordinated noteholders; and management's expectation that the Company will

incur additional costs related to certain investment banking activities. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those expressed or implied by such forward-looking statements. Such risks include (but are not limited to) the risk that the shareholders' ownership will be diluted by the issuance of common stock to the Company's subordinated lenders; the Company's lenders will not continue to fund the Company in the future; the cancellation of the lines of credit available to the Company's Mexico subsidiary; the inability to maintain and/or secure new sources of capital and the costs associated with pursuing new sources of capital; manufacturing inefficiencies; difficulties encountered with the consolidation and cost-reduction program; increased competition; decrease in revenues; U.S. and foreign economic factors; foreign currency exchange risk; and interest rate fluctuation risk, among others.

14

Item 3.

-----

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

-----

As discussed elsewhere, the Company is exposed to the following principal market risks (i.e. risks of loss arising from adverse changes in market rates): foreign exchange rates and interest rates on debt.

The Company's exposure to foreign currency exchange rate risk in its international operations is principally limited to Mexico and, to a lesser degree, Canada. Approximately 39% of the Company's fiscal 2003 net revenues were derived in Mexico and Canada, combined (exclusive of intercompany activities). Foreign exchange transaction gains and losses arise from monetary assets and liabilities denominated in currencies other than the business unit's functional local currency. It is estimated that a 10% change in both the Mexican peso and Canadian dollar exchange rates would impact reported operating profit by approximately \$500,000. This quantitative measure has inherent limitations because it does not take into account the changes in customer purchasing patterns or any adjustment to the Company's financing or operating strategies in response to such a change in rates. Moreover, this measure does not take into account the possibility that these currency rates can move in opposite directions, such that gains from one may offset losses from another.

In addition, the Company's cash flows and earnings are subject to changes in interest rates. As of June 30, 2004, approximately 50% of total short and long-term debt is fixed, at rates between 4% and 12.5%. The balance of the Company debt is variable, principally based upon the prevailing U.S. bank prime rate, the rate of Mexico government securities or the LIBOR rate. An interest rate swap, which expires in 2005, fixes the rate of interest on \$8 million of this debt at 8.98%. A change in the average prevailing interest rates of the remaining debt of 1% would have an estimated annual impact of \$150,000 upon the Company's pre-tax results of operations and cash flows. This quantitative measure does not take into account the possibility that the prevailing rates can move in opposite directions and that the Company has, in most cases, the option to elect the determining interest rate factor.

Item 4.

-----

CONTROLS AND PROCEDURES

-----

Within the 90-day period prior to the date of this report, the Company's Co-Chief Executive Officers, Chief Financial Officer and Chief Accounting Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures and concluded that such disclosure controls and procedures are effective. There have been no significant changes in internal controls or in other factors, which could significantly affect internal controls subsequent to the date that the officers carried out their evaluations.

15

PART II. OTHER INFORMATION

-----

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

-----

(a) Documents filed as part of this report:

-----

1. Financial statements

-----

See index under Item 1. Financial Information.

2. Exhibits

-----

The following exhibits are required to be filed as part of this Quarterly Report on Form 10-Q:

- (2) c. Asset Purchase Agreement dated December 23, 2002, between Dixon Ticonderoga Company, as Seller and New Castle Refractories Company, Inc., Inc., as Buyer with addenda. 7
- (3) (i) Restated Certificate of Incorporation 2
- (3) (ii) Amended and Restated Bylaws 1
- (4) a. Specimen Certificate of Company Common Stock 2
- (4) b. Amended and Restated Stock Option Plan 3
- (10) b. 12.00% Senior Subordinated Notes, Due 2003, Note and Warrant Purchase Agreement 1
- (10) c. 12.00% Senior Subordinated Notes, Due 2003, Common Stock Purchase Warrant Agreement 1
- (10) j. Amendment No. 1 to 12.00% Senior Subordinated Notes, Due 2003, Note and Warrant Purchase Agreement. 4
- (10) m. Amendment No. 2 to Note and Warrant Purchase Agreement. 5
- (10) n. Loan and Security Agreement by and among Dixon Ticonderoga Company and its Subsidiaries and Foothill Capital Corporation. 6
- (10) o. Dixon Ticonderoga Company Amended and Restated Note and



## Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

Warrant Purchase Agreement, 12.5% Senior Subordinated Notes, due October 3, 2005. 6

- (10) p. Warrant Amendment Agreement 9
- (21) Subsidiaries of the Company. 7
- (31.1) Chairman of the Board and Co-Chief Executive Officer Certification pursuant to Exchange Act Rule 13a-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

16

- (31.2) Vice Chairman of the Board and Co-Chief Executive Officer Certification pursuant to Exchange Act Rule 13a-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (31.3) Executive Vice President of Finance and Chief Financial Officer Certification pursuant to Exchange Act Rule 13a-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- (32.1) Chairman of the Board and Co-Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (32.2) Vice Chairman of the Board and Co-Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (32.3) Executive Vice President of Finance and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (99.A11) Code of Ethics 8

1Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 1996, file number 0-2655, filed in Washington, D.C.

2Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 1997, file number 0-2655, filed in Washington, D.C.

3Incorporated by reference to Appendix 3 to the Company's Proxy Statement dated January 27, 1997, file number 0-2655, filed in Washington, D.C.

4Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 1999, file number 0-2655, filed in Washington, D.C.

5Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 2002, file number 0-2655, filed in Washington, D.C.

6Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended December 31 2002, file number 0-2655, filed in Washington, D.C.

7Incorporated by reference to the Company's Annual Report on Form 10-K for the

Edgar Filing: DIXON TICONDEROGA CO - Form 10-Q

year ended September 30, 2003, file number 0-2655 filed in Washington, D.C.

8Incorporated by reference to the Company's report on Form 10-K/A, Amendment No. 1, for the year ended September 30, 2003, file number 0-2655, filed in Washington, D.C.

9Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, file number 0-2655, filed in Washington, D.C.

17

(b) Reports on Form 8-K:

On May 13, 2004, the Company filed a Form 8-K which included as an exhibit its press release, also dated May 13, 2004, regarding its second fiscal quarter results.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DIXON TICONDEROGA COMPANY

Date: August 13, 2004  
-----

By: /s/ GINO N. PALA  
-----  
Gino N. Pala  
Chairman of Board, Co-Chief Executive  
Officer and Director

Date: August 13, 2004  
-----

By: /s/ RICHARD A. ASTA  
-----  
Richard A. Asta  
Executive Vice President of Finance,  
Chief Financial Officer and Director

Date: August 13, 2004  
-----

By: /s/ JOHN ADORNETTO  
-----  
John Adornetto  
Vice President, Corporate Controller and  
Chief Accounting Officer

18