GENERAL KINETICS INC
Form 10-Q
January 16, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report under Section 13 or 15(d)

of the Securities Exchange Act of 1934

For Quarter Ended November 30, 2000 — Commission File Number 0-1738

GENERAL KINETICS INCORPORATED
(Exact Name of Registrant as Specified in its Charter)

Virginia	54-0594435
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
14130-A Sullyfield Circle, Chantilly, VA	20151
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, including Area Code 703-802-4848

Indicate by checkmark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

The number of shares of Registrant's Common Stock outstanding as of January 5, 2001 — 6,718,925 Shares

INDEX

Cautionary Statement Under the Private Securities Litigation Reform Act of

Part I - Financial Information

Item I - Consolidated Financial Statements

Condensed Consolidated Balance Sheets -

November 30, 2000 and May 31, 2000.......................................

Condensed Consolidated Statements of Operations -
Three Months and Six Months Ended November 30, 2000 and November 30, 1999,
respectively...

Condensed Consolidated Statements of Cash Flows -
Six Months Ended November 30, 2000 and
November 30, 1999, respectively..

Notes to Condensed Consolidated Financial Statements.......................

Item 2 - Management's Discussion and Analysis of Financial

Condition and Results of Operations.......................................

Part 2 - Other Information

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

CAUTIONARY STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Statements in this Quarterly Report on Form 10-Q under the caption "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations", as well as oral statements that may be made by the Company or by officers, directors or employees of the Company acting on the Company's behalf, that are not historical fact constitute "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. These forward-looking statements involve risks and uncertainties, including, but not limited to, the risk that the Company may not be able to obtain additional financing if necessary; the risk that the Company may not be able to continue the necessary development of its operations, including maintaining or increasing sales and production levels, on a profitable basis; the risk the Company may in the future have to comply with more stringent environmental laws or regulations, or more vigorous enforcement policies of regulatory agencies, and that such compliance could require substantial expenditures by the Company; the risk that U.S. defense spending may be substantially reduced; and the risk that the Company's Common Stock will not continue to be quoted on the NASD OTC Bulletin Board services. In addition, the Company's business, operations and financial condition are subject to substantial risks which are described in the Company's reports and statements filed from time to time with the Securities and Exchange Commission, including this Report.

PART I FINANCIAL INFORMATION

Item 1 - Consolidated Financial Statements

The unaudited consolidated financial statements of General Kinetics Incorporated ("GKI" or the "Company") set forth below have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading.

In the opinion of management of the Company, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for a fair presentation of results for the periods presented. It is suggested that these consolidated financial statements be read in conjunction with the audited financial statements for the fiscal years ended May 31, 2000 and 1999 set forth in the Company's Annual Report on Form 10-K, as amended, for the fiscal year ended May 31, 2000.

3

General Kinetics Incorporated
Balance Sheets
November 30, 2000 and
May 31, 2000

	November 2000 (Unaudite
Assets	
Current Assets:	
Cash and cash equivalents	$ 358
Accounts receivable, net of allowance of $75,000 and $75,000	1,734
Inventories	773
Prepaid expenses and other	33
Total Current Assets	2,899
Property, Plant and Equipment	2,760
Less: Accumulated Depreciation	(1,906
	853
Other Assets	44
Total Assets	$ 3,797
Liabilities and Stockholders' Deficit	
Current Liabilities:	
Advances from Factor	$
Current maturities of long-term debt	69
Accounts payable, trade	893
Accrued expenses and other payables	497
Total Current Liabilities	1,460
Long-Term Debt - less current maturities (including $8,716,600 and $8,654,700 of convertible debentures)	9,298
Other long-term liabilities	249

Total Long-Term Liabilities	9,547
Total Liabilities	11,008
Stockholders' Deficit:	
Common Stock, $0.25 par value, 50,000,000 shares authorized, 7,245,557 shares issued, 6,718,925 shares outstanding	1,811
Additional Contributed Capital	7,239
Accumulated Deficit	(15,811
	(6,760
Less: Treasury Stock, at cost (526,632 shares)	(450
Total Stockholders' Deficit	(7,210
Total Liabilities and Stockholders' Deficit	$ 3,797

The accompanying notes are an integral part of the above statements.

General Kinetics Incorporated
Statements of Operations
(Unaudited)

	Six Months Ended November 30, 2000	Six Months Ended November 30, 1999
Net Sales	$ 4,713,900	$ 5,051,500
Cost of Sales	3,765,900	4,303,400
Gross Profit	948,000	748,100
Selling, General & Administrative	844,700	838,600
Product Research, Development & Improvement	37,700	-
Total Operating Expenses	882,400	838,600
Operating Income (loss)	65,600	(90,500)
Interest Expense	(110,200)	(176,100)
Net Income (loss)	(44,600)	(266,600)
Basic Earnings per Share:		
Basic Earnings (loss) per Share	($0.01)	($0.04)
Weighted Average Number of Common Shares		

Outstanding	6,718,925	6,718,925
Diluted Earnings per Share:		
Diluted Earnings (loss) per share	($0.01)	($0.04)
Weighted Average Number of Common Shares and Dilutive Equivalents Outstanding	6,718,925	6,718,925

The accompanying notes are an integral part of the above statements.

General Kinetics Incorporated
Statements of Cash Flows
(Unaudited)

	Six Months En November 30, 2000	N
Cash Flows From Operating Activities:		
Net Income/(Loss)	$ (44,600)	$
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	79,800	
Amortization of bond discount	31,000	
(Increase) Decrease in Assets:		
Accounts Receivable	(603,600)	
Inventories	209,500	
Prepaid Expenses	3,100	
Other assets	52,800	
Increase (Decrease) in Liabilities:		
Accounts Payable - Trade	19,400	
Accrued Expenses	(241,500)	
Other Long Term Liabilities	(19,200)	
Net cash provided by/(used in) Operating Activites	(513,300)	
Cash Flows from Investing Activities:		
Acquisition of property, plant and equipment	(8,100)	
Payment received on Notes Receivable	-	
Net cash provided by/(used in) Investing Activities	(8,100)	
Cash Flows from Financing Activities:		
Advances from Factor/Borrowings on Demand Notes Payable	70,500	
Repayments of advances from Factor/ Demand Notes Payable	(114,600)	
Notes Payable		
Repayments on Long Term Debt	(33,900)	
Net cash provided by/(used in) Financing Activities	(78,000)	
Net (decrease) increase in cash and cash equivalents	(599,400)	

Cash and Cash Equivalents: Beginning of Period	958,100	
Cash and Cash Equivalents: End of Period	$ 358,700	$
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the year for:		
Interest	$ 116,900	$
Income Taxes	800	

The accompanying notes are an integral part of the above statements.

Page 6

GENERAL KINETICS INCORPORATED
Notes to Condensed Financial Statements
(Unaudited)

Note 1 - Basis of Presentation

The condensed financial statements at November 30, 2000 and May 31, 2000, and for the three months and six months ended November 30, 2000, and November 30, 1999, respectively, include the accounts of General Kinetics Incorporated ("GKI").

The financial information included herein is unaudited. In addition, the financial information does not include all disclosures required under generally accepted accounting principles in that certain note information included in the Company's Annual Report has been omitted; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary to a fair presentation of the results of the interim periods.

The results of operations for the three month and six month periods ended November 30, 2000, are not necessarily indicative of the results to be expected for the full year.

Note 2 - Net Income/(Loss)Per Share

The Company implemented Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share", at May 31, 1998. SFAS 128 replaces the presentation of primary and fully diluted earnings per share with basic and diluted earnings per share and requires a reconciliation of the numerator and denominator of basic earnings per share to diluted earnings per share. Earnings per share have been computed using the weighted average number of common shares outstanding. The Company has excluded the effects of outstanding options and convertible securities as the effect would have been anti-dilutive.

Note 3 - Notes Payable

At November 30, 2000 and May 31, 2000, convertible debentures initially issued to clients of Gutzwiller & Partner, A.G. ("Gutzwiller") have an aggregate principal amount of approximately $9.0 million, mature in August 2004, are convertible into common stock at a conversion price of 50 cents per share, and bear interest at 1% per annum, which is payable annually.

Shares issuable upon conversion are also subject to certain rights to registration under the Securities Act of 1933, as amended.

Note 4 - Income Taxes

The Company's estimated effective tax rate for fiscal 2001 is 0%. This estimated effective tax rate is lower than the statutory rate due to the existence of net operating loss carryforwards.

GENERAL KINETICS INCORPORATED

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

Three Months Ended November 30, 2000 Compared to Three Months Ended November 30, 1999

Net sales for the three months ended November 30, 2000 were approximately $2.45 million compared to net sales of approximately $2.60 million for the quarter ended November 30, 1999. The small decrease in sales was due primarily to what are believed to be normal fluctuations in demand for the Company's products and services.

The gross margin percentage increased from 20.1% for the quarter ended November 30, 1999 to 24.6% for the quarter ended November 30, 2000. The primary reasons for the increase in gross profit margins were the steps taken to address production issues identified during fiscal 2000 as the Company faced large increases and decreases in shipping volume.

Sales, General & Administrative costs were essentially unchanged at approximately $415,700 in the second quarter of fiscal 2001 as compared to approximately $412,500 in the corresponding quarter of the prior fiscal year. During the quarter ended November 30, 2000, the Company incurred $37,700 in Product Research, Development & Improvement costs related to the initial development work on a new enclosure product.

For the three months ended November 30, 2000, the Company had operating income of $147,800 compared to operating income of $110,200 for the comparable quarter of the prior fiscal year. The increase was due primarily to the increase in gross profit margins described above.

Interest expense decreased from $80,400 in the second quarter of fiscal 2000 to $60,400 in the second quarter of fiscal 2001. This decrease occurred principally because in fiscal 2001 the Company used less accounts receivable financing to alleviate short-term cash requirements than in the prior fiscal year.

The Company's estimated effective tax rate for fiscal 2001 is 0%. This estimated effective tax rate is lower than the statutory rate due to the existence of net operating loss carryforwards.

Six Months Ended November 30, 2000, Compared to Six Months Ended November 30,

----
1999

Net sales for the six months ended November 30, 2000 were approximately $4.7 million compared to net sales of approximately $5.1 million for the six months ended November 30, 1999. The decrease in sales was due primarily to what are believed to be normal fluctuations in demand for the Company's products and services. However, the decrease in demand reflected in the first half of fiscal 2000 is not necessarily indicative of the results to be expected for the full year. The Company's contract backlog was approximately $3.7 million at November 30, 2000 as compared to approximately $2.9 million at November 30, 1999.

The gross margin percentage increased from 14.8% for the six months ended November 30, 1999 to 20.1% for the six months ended November 30, 2000. The primary reasons for the increase in gross profit margins were the steps taken to address production issues identified during fiscal 2000 as the Company faced large increases and decreases in shipping volume.

Sales, General & Administrative costs were essentially unchanged at approximately $844,700 in the first six months of fiscal 2001 as compared to approximately $838,600 in the first six months of the prior fiscal year. During the six months ended November 30, 2000, the Company incurred $37,700 in Product Research, Development & Improvement costs related to the initial development work on a new enclosure product.

For the six months ended November 30, 2000, the Company had operating income of $65,600 compared to an operating loss of $90,500 for the comparable six months of the prior fiscal year. The improvement was due principally to the increase in gross profit margins described above.

Interest expense decreased from $176,100 in the first six months of fiscal 2000 to $110,200 in the first six months of fiscal 2001. This decrease occurred principally because in fiscal 2001 the Company used less accounts receivable financing to alleviate short-term cash requirements than in the prior fiscal year.

10

Liquidity and Capital Resources

The Company has relied upon internally generated funds and accounts receivable financing, plus cash from sales of two of its operating companies, to finance its operations. During the first half of fiscal 2001, operating income totaled $65,600, after incurring significant operating losses during the prior two fiscal years. In order to generate the working capital required for operations, the Company must continue to generate orders, stabilize its level of shipments, and operate profitably during the remainder of fiscal 2001.

The Company must continue to market electronic enclosure products to government and commercial markets, enter into contracts which the Company can complete with favorable profit margins, ship the orders in a timely manner, and control its costs in order to recover from its liquidity problems and seek to operate profitably in the second half of fiscal 2001.

As of November 30, 2000, the Company had cash of $358,700. The Company has faced production issues that have contributed to losses from operations. The Company has taken and is continuing to take steps to address these production issues through changes and additions to plant supervision and by adding new scheduling and planning procedures. The Company is trying to stabilize the level of shipments at a profitable level through these changes and an increased sales effort. The backlog at November 30, 2000 was $3.7 million.

Management believes that cash on hand, borrowings from the factoring of accounts receivable, and careful management of operating costs and cash disbursements can enable the Company to meet its cash requirements through May 31, 2001. The Company may also seek additional funding sources to provide a cushion to handle variances in cash requirements if sales, gross profits and shipment levels fluctuate throughout the fiscal year. However, there is no assurance the Company will be successful in pursuing its plans or in obtaining additional financing to meet those cash requirements. The Company must continue to maintain its level of sales, consistently make timely shipments and produce its products at adequate profit margins, or the Company will continue to face liquidity problems, and may be left without sufficient cash to meet its ongoing requirements.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As explained above, the Company sustained significant operating losses in fiscal 2000. In addition, the Company has significant short-term cash commitments, the funding of which is limited to cash flow from operations and the factoring of certain accounts receivable. These factors raise significant doubt about the Company's ability to continue as a going concern. The financial statements do not contain any adjustment that might result from the outcome of these uncertainties.

The Company is party to a factoring agreement with Reservoir Capital Corporation ("Reservoir") in which Reservoir agreed to purchase eligible accounts receivable from the Company at an assignment price equal to 80% of the outstanding amount of such accounts receivable. At November 30, 2000 there were no advances due to Reservoir. The Company expects to draw on this facility through fiscal 2001 as necessary to alleviate cash requirements, although, as discussed above, the Company will also need to control expenses, maintain the sales backlog at appropriate levels, and keep shipment levels in line with booked orders in order to meet these requirements.

The Company had significant amounts payable to trade creditors at November 30, 2000. In addition, commitments under operating leases, net of sublessee income, amount to $90,500 in fiscal 2001. Current maturities of long-term debt amount to $69,600 in fiscal 2001.

The Company has outstanding debentures originally issued to clients of Gutzwiller totaling approximately $9.0 million. The debentures mature in August 2004, are convertible into common stock at a conversion price of 50 cents per share, and bear interest at 1% per annum payable annually.

Analysis of Cash Flows

Operating activities used $513,300 in cash in the first half of fiscal 2000. This reflects a net loss of $44,600 less $110,800 in non-cash expenses, plus $579,500 in cash to fund changes in working capital items. The cash to fund changes in working capital items included an increase in accounts receivable of $603,600 in the six months ended November 30, 2000. This increase in accounts receivable occurred principally because billings totaled $1.72 million in the two months ended November 30, 2000 as compared to $1.52 million for the comparable period ended May 31, 2000, and because accounts receivable had been temporarily reduced at May 31, 2000 due to a large client receiving and paying for May shipments during the last month of fiscal 2000.

Investing activities used $8,100 in the first half of fiscal 2001. These activities consisted of acquired property, plant and equipment.

Financing activities used $78,000 in the first half of fiscal 2001. These activities consisted of net repayments of factoring advances and repayments of long-term debt.

Management believes that inflation has not had a material effect on the operations of the Company during the first half of fiscal 2001.

Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, operations of the Company may be exposed to fluctuations in currency values and interest rates. These fluctuations can vary the cost of financing, investing, and operating transactions. Because the Company has only fixed rate long-term convertible debentures and no foreign currency transactions, there is no material impact on earnings from fluctuations in interest and currency exchange rates.

PART II OTHER INFORMATION

Item 6 - Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K
None

SIGNATURES

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

GENERAL KINETICS INCORPORATED

Date: January 15, 2001	/s/ Larry M. Heimendinger
	Chairman of the Board (Principal Executive Officer)
Date: January 15, 2001	/s/ Sandy B. Sewitch
	Chief Financial Officer (Principal Accounting Officer and Principal Financial Officer)