SONICS & MATERIALS INC
Form 10QSB
February 08, 2002

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

FORM 10-QSB

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2001

OR

[_] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

COMMISSION FILE NUMBER: 0-20753

SONICS & MATERIALS, INC.
(Exact name of small business issuer as specified in its charter)

DELAWARE	06-0854713
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

53 CHURCH HILL ROAD
NEWTOWN, CONNECTICUT 06470
(Address of principal executive offices)

TELEPHONE NUMBER (203) 270-4600
(Issuer's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes [X] No [_]

As of February 8, 2002, there were 3,520,100 shares of the Registrant's Common Stock outstanding.

Transitional Small Business Disclosure Format (Check one):

Yes [_] No [X]

* The Balance Sheet at June 30, 2001 has been taken from the audited financial statements at that date. All other financial statements are unaudited.

Sonics & Materials, Inc.
CONSOLIDATED CONDENSED BALANCE SHEETS

	As of December 31, 2001 (Unaudited)	June 30, 2001 *
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,179,488	$ 820,835
Accounts receivable, net of allowance for doubtful accounts of $35,793 at December 31, 2001 and $53,470 at June 30, 2001	1,377,764	1,335,861
Inventories	3,649,357	3,961,383
Other current assets	61,844	65,788
Total current assets	6,268,453	6,183,867
PROPERTY PLANT & EQUIPMENT - NET	488,934	3,754,724
OTHER ASSETS	235,193	618,925
Total Assets	$ 6,992,580	$ 10,557,516

LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Note payable - bank	$490,000	$1,190,000
Current maturities of long-term debt	110,035	186,781
Accounts payable	494,884	347,580
Customer advances	33,267	147,535
Commissions payable	96,455	76,903
Accrued expenses	333,201	452,734
Total current liabilities	1,557,842	2,401,533
LONG-TERM DEBT	97,855	3,381,460
DEFERRED GAIN ON SALE OF REAL ESTATE	319,898	-
Total liabilities	1,975,595	5,782,993
STOCKHOLDERS' EQUITY		
Common stock - par value $.03 per share; authorized, 10,000,000 shares; issued and outstanding, 3,520,100 shares at December 31, 2001 and June 30, 2001	105,603	105,603
Additional paid in capital	6,575,010	6,575,010
Retained earnings (accumulated deficit)	(1,663,628)	(1,906,090)
Total stockholders' equity	5,016,985	4,774,523
Total liabilities and stockholders' equity	$ 6,992,580	$ 10,557,516

* Taken from the audited financial statements at June 30, 2001.

The accompanying notes are an integral part of these statements.

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Sonics & Materials, Inc.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(unaudited)

	For the Three Months Ended December 31,		For the Six Decem
	2001	2000	2001
Net sales	$ 2,596,860	$ 2,926,626	$ 4,725,194
Cost of sales	1,584,167	1,903,870	2,895,060
Gross profit	1,012,693	1,022,756	1,830,134
Operating expenses			
Selling expense	463,235	758,448	851,378
General and administrative	211,976	332,379	438,450
Research and development	104,062	89,430	199,659
Total operating expenses	779,273	1,180,257	1,489,487
Operating income (loss)	233,420	(157,501)	340,647

Other income (expense)			
Gain on sale of real estate	8,419	-	16,837
Interest expense	(10,349)	(103,612)	(97,757)
Other income (expense)	(3,463)	5,929	11,668
	(5,393)	(97,683)	(69,252)
Income (loss) before provision for income taxes	228,027	(255,184)	271,395
Provision for income taxes	28,933	-	28,933
Net income (loss)	$ 199,094	($ 255,184)	$ 242,462
BASIC AND DILUTED INCOME (LOSS) PER SHARE			
Net income (loss) per share	$0.06	($0.07)	$0.07
Weighted average number of shares outstanding	3,520,100	3,520,100	3,520,100

The accompanying notes are an integral part of these statements.

Sonics & Materials, Inc.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(unaudited)
For the Six Months Ended December 31,

	2001	2000
Net cash provided by operations	$ 426,374	$ 33,404
Net cash provided by (used in) investing activities	3,992,629	(49,319)
Net cash used in financing activities	(4,060,350)	(173,425)
Net increase (decrease) in cash for the period	358,653	(189,340)
Cash and cash equivalents - at beginning of period	820,835	719,183
Cash and cash equivalents - at end of period	$ 1,179,488	$ 529,843
Cash paid during period for:		
Interest	$ 13,219	$ 217,658
Income taxes	-	-

Sonics & Materials, Inc.
Notes to Consolidated Condensed Financial Statements
December 31, 2001
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

The accompanying financial statements for the interim periods are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. These financial statements should be read in conjunction with the financial statements and notes thereto, together with the management's discussion and analysis, contained on Form 10-KSB for the year ended June 30, 2001. The results of operations for the three and six months ended December 31, 2001 are not necessarily indicative of the results for the entire fiscal year ending June 30, 2002.

The accompanying financial statements reflect the consolidated operations of Sonics & Materials, Inc. and its wholly-owned subsidiary, Tooltex, Inc. through the date of the sale of 90% of the common stock of Tooltex, Inc. on August 21, 2001. All significant intercompany accounts and transactions have been eliminated in consolidation.

NOTE 2: SALE OF TOOLTEX, INC. STOCK

On August 21, 2001, the Company sold a 90% interest in the stock of Tooltex to PK Spur Co. (PK), an Ohio corporation owned by the president of Tooltex, and his wife. In consideration, PK issued a $125,000 promissory note, payable in 23 installments of $2,000 including interest at 7% per annum commencing in October 2001, with a final balloon payment of outstanding principal and accrued interest. The note is guaranteed by the president of Tooltex, and is secured by a security interest in certain Tooltex assets. In conjunction with the sale, the Company and Tooltex entered into a representation and distribution agreement pursuant to which Tooltex will sell and distribute the Company's products.

The Company changed the accounting for its investment in Tooltex from the consolidation to the cost method, effective on the date of sale. Tooltex reported sales of approximately $90,000 and a net loss of approximately $25,000 in the quarter ended September 30, 2001.

NOTE 3: SALE OF COMPANY FACILITY

On August 31, 2001, the Company sold to Acme Realty (Acme), a New York general partnership, its manufacturing facility located in Newtown, Connecticut for $4,000,000 in cash, less expenses of $244,000. The Company used the proceeds to pay outstanding Industrial Revenue Bond principal and accrued interest totaling $3,289,000, and to increase working capital. In conjunction with the sale, the Company entered into a triple net lease with Acme for an initial term of ten years plus two five-year renewal options. The Company recorded a deferred gain on the sale of $337,000, which will be amortized over the lease term.

Following is a schedule of minimum lease payments due under the operating lease for the property:

Years ending June 30,	
2002	$ 328,292
2003	323,185
2004	316,813
2005	326,522
2006	336,304
Thereafter	1,903,843
	$3,534,959

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NOTE 4: NET INCOME PER SHARE

Net income per share is based on the weighted average number of common and common equivalent shares outstanding during the period, calculated using the treasury stock method. Stock options of which approximately 346,000 are currently outstanding, are antidilutive for all periods and accordingly, are not included in the per share computations.

NOTE 5: INCOME TAXES

The effective tax rate for the six months ended December 31, 2001 was 10.7% due to the utilization of regular net operating loss carryovers of $168,000 and federal tax credits of $6,000. These tax benefits had previously been subject to deferred tax valuation allowances. The Company also has available capital loss carryovers to offset the entire capital gain income recognized on the sale of real estate in the first quarter of 2001. The gain is being amortized for financial reporting purposes over the term of the related lease, but will be recognized in full as of the transaction date for income tax purposes.

Future taxable income in fiscal 2002 will be subject to an effective tax rate in the range of 40%-45%.

The Company did not provide for the tax benefit of net operating losses incurred during the comparable 2000 period due to uncertainty as to their realization.

Any statements in this filing that are not statements of historical fact are forward-looking statements that are subject to a number of important risks and uncertainties that could cause actual results to differ materially. Specifically, any forward looking statements in this filing related to the Company's objective for future growth, profitability and financial returns are subject to a number of risks and uncertainties, including, but not limited to, risks related to a growing market demand for Sonics' existing and new products, continued growth in sales and market share of Sonics and its USS products, pricing, market acceptance of existing and new products, a fluctuation in the sales product mix, general economic conditions, competitive products, and product technology development. There can be no assurance that such objectives will be achieved.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following information should be read in conjunction with the unaudited financial statements included herein, see Item 1, and the financial information contained in the Company's latest annual report on Form 10-KSB for the year ended June 30, 2001.

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2000.

NET SALES. Net sales for the quarter ended December 31, 2001 decreased $330,000 or 11.3% compared with the same quarter in fiscal year 2001. This decrease resulted from the elimination of Tooltex, Inc. revenues, which was sold in August 2001. The decrease in revenues was partially offset by the increase in plastics assembly product sales.

COST OF SALES AND GROSS PROFITS. Cost of sales decreased from 65.1% in the three months ended December 31, 2000 to 61.0% for the three months ended December 31, 2001. In spite of the decline in sales, the improvement in cost of sales enabled gross profits to remain essentially the same, amounting to $1,013,000 in the current quarter and $1,023,000 in the comparable quarter of the prior fiscal year. The improvement in gross profit margins resulted from a combination of a more favorable product mix and the full realization of savings made as a result of cost cutting measures taken in the second and third quarters of fiscal year 2001.

SELLING EXPENSES. Selling expenses for the second quarter of fiscal 2002 decreased $295,000 or 38.9% compared with the same quarter in fiscal 2001. As a percentage of net sales, selling expense decreased from 25.9% to 17.8% over the same period. The improvement in the level of selling expenses was achieved both on an absolute basis and as a percentage of sales. The principal areas of selling expense reduction were in payroll, advertising and promotional costs. In addition, selling expenses decreased as a result of the sale of Tooltex, Inc.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the second quarter of fiscal 2002 decreased $120,000 compared with the second quarter of the prior fiscal year. The principal reason for the decrease in these expenses is due to the sale of Tooltex, Inc.

INTEREST EXPENSE. Interest expense decreased by $93,000 compared with the same period in fiscal year 2001. The savings in interest resulted from the elimination of Industrial Revenue Bond indebtedness relating to the sale of real estate in August 2001, as well as a significant decline in interest rates.

INCOME TAXES. The effective tax rate for the three months ended December 31, 2001 was 12.7% due to the utilization of regular net operating loss carryovers of $120,000 and federal tax credits of $6,000. These tax benefits had previously been subject to deferred tax valuation allowances. The Company also has available capital loss carryovers to offset the entire capital gain income recognized on the sale of real estate in the

first quarter of 2001. The gain is being amortized for financial reporting purposes over the term of the related lease, but will be recognized in full as of the transaction date for income tax purposes.

Future taxable income in fiscal 2002 will be subject to an effective tax rate in the range of 40%-45%.

The Company did not provide for the tax benefit of net operating losses incurred during the comparable 2000 period due to uncertainty as to their realization.

SIX MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THE SIX MONTHS ENDED DECEMBER 31, 2000.

NET SALES. Net sales for six months ended December 31, 2001 decreased $1,005,000 compared to the prior comparable period. The majority of the decline resulted from the elimination of Tooltex, Inc. revenues as a result of the sale of that subsidiary in August 2001.

COST OF SALES AND GROSS PROFITS. Cost of sales decreased from 63.3% for the six months ended December 31, 2000 to 61.3% for the six months ended December 31, 2001. Accordingly, gross margins improved from 36.7% to 38.7%. A decline in the plastics product line gross margin caused by less favorable product mix was more than offset by the elimination of the lower-margin Tooltex product line as well as savings from the full realization of cost cutting measures begun in the second quarter of fiscal year 2001.

SELLING EXPENSES. Selling expenses decreased $592,000 compared with the same period of the prior year. This decrease took place in the areas of payroll, commissions, advertising and promotional costs. In addition, selling expenses decreased as a result of the sale of Tooltex, Inc.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for the six months ended December 31, 2001 decreased $176,000 compared with the comparable period of the prior fiscal year. The principal reason for this decline was the elimination of these costs caused by the sale of Tooltex, Inc.

INTEREST EXPENSE. Interest expense decreased $120,000 in the six months ended December 31, 2001. The savings in interest resulted from the elimination of Industrial Revenue Bond indebtedness relating to the sale of real estate in August 2001 and a significant decline in interest rates.

INCOME TAXES. The effective tax rate for the six months ended December 31, 2001 was 10.7% due to the utilization of regular net operating loss carryovers of $168,000 and federal tax credits of $6,000. These tax benefits had previously been subject to deferred tax valuation allowances. The Company also has available capital loss carryovers to offset the entire capital gain income recognized on the sale of real estate in the first quarter of 2001. The gain is being amortized for financial reporting purposes over the term of the related lease, but will be recognized in full as of the transaction date for income tax purposes.

Future taxable income in fiscal 2002 will be subject to an effective tax rate in the range of 40%-45%.

The Company did not provide for the tax benefit of net operating losses incurred during the comparable 2000 period due to uncertainty as to their realization.

LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet strengthened steadily in the last two quarters. Contributing to the improved balance sheet is the Company's return to profitability, in part, due to the cost cutting measures taken beginning in the second quarter of fiscal year 2001, the sale of the Company's manufacturing facility in Newtown, CT, and the sale of Tooltex, Inc.

Working capital increased by $928,000 June 30, 2001 and December 31, 2001. Cash amounted to $1,179,000 at December 31, 2001, an increase of $359,000 over the fiscal year end close. The note payable to the Company's bank was reduced by $700,000 during this same period of time.

The Company's debt/equity ratio, during the six months ended December 31, 2001 also improved, declining from 1.2 times to 0.4 times.

The Company's principal outside source of working capital is a $1,500,000 bank credit facility (the "Line of Credit"). The Line of Credit bears interest at the bank's base lending rate (4.75% at December 31, 2001). Advances under the Line of Credit are at the bank's sole discretion. The entire principal balance of the Line of Credit, which at December 31, 2001 was $490,000, is due and payable upon the demand of the bank. The borrowings under the Line of Credit may be prepaid in whole or in part, without premium or penalty, at any time. Indebtedness under the Company's Line of Credit and the term loan are secured by substantially all of the assets of the Company. The credit agreement also subjects the Company to various covenants, including restrictions on future borrowings and encumbrances, and the maintenance of minimum tangible net worth, leverage and fixed charge coverage ratios, as defined. The Company met its covenants as of December 31, 2001.

IMPACT OF INFLATION

The Company does not believe that inflation significantly affected its results of operations for the current fiscal quarter.

MARKET RISK

The Company does not hold or trade derivative instruments. Financial instruments subject to changes in interest rates consist primarily of floating rate debt. Due to the repayment in August 2001 of its Industrial Development Bonds, the Company's exposure to interest rate fluctuations is not material. The Company's transactions are generally conducted and its accounts are denominated in U.S. dollars. Consequently, exposure to foreign risk is not significant.

RECENTLY ISSUED PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 141, Business Combinations, which addressed the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No. 141 requires the purchase method of accounting to be used for business combinations initiated after June 30, 2001 and eliminates the pooling of interest method. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets, which addressed the recognition and measurement of goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 also addressed the initial recognition and measurement of intangible assets acquired outside of a business combination whether acquired individually or with a group of other assets. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that intangible assets with indefinite lives and goodwill will not be amortized, but will rather be tested at least annually for impairment. Although SFAS No. 142 is not required to be adopted by the Company until fiscal 2003, its provisions must be applied to goodwill and other intangible assets acquired after June 30, 2001. As of December 31, 2001, the Company does not have any goodwill or other intangible assets relating to business combinations that were accounted for under APB Opinion No. 16. Accordingly, the adoption of SFAS No. 142 is not expected to have a material impact on the Company's financial position or results of operations.

Item 6. Exhibits and Reports on Form 8K.

(a) Exhibits.

3(i)	Certificate of Incorporation of the Registrant, as amended (incorporated by reference from Exhibit 3.1 of Amendment No. 3 to Registration Statement No. 33-96414).
3(ii)	Amended By-laws of the Registrant (incorporated by reference from Exhibit 3.2 of Registration Statement No. 33-96414).
10(i)	Form of Employment Agreement between the Registrant and Robert S. Soloff (incorporated by reference from Exhibit 10.1 of Registration Statement No. 33-96414).
10(ii)	1995 Incentive Stock Option Plan and form of Stock Option Agreement (incorporated by reference from Exhibit 10.3 of Registration Statement No. 33-96414).
10(iii)	Lease between Registrant and Aston Investment Associates (Aston, PA) (incorporated by reference from Exhibit 10.5 of Registration Statement No. 33-96414).

10(iv)	Lease between Registrant and Janine Berger (Gland, Switzerland) (incorporated by reference from Exhibit 10.7 of Registration Statement No. 33-96414).
10(v)	Form of Sales Representation Agreement (incorporated by reference from Exhibit 10.8 of Registration Statement No. 33-96414).
10(vi)	Form of Sales Distribution Agreement (incorporated by reference from Exhibit 10.9 of Registration Statement No. 33-96414).
10(vii)	Credit Agreement, dated September 19, 1997, between Brown Brothers Harriman & Co. and Registrant (incorporated by reference from Exhibit 10(xii) of the Registrant's Form 10KSB for the year ended June 30, 1997).
10(viii)	Term Loan Note of Registrant, dated September 19, 1997; payable to the order of Brown Brothers Harriman & Co. in the original principal amount of $427,000 (incorporated by reference from Exhibit 10(xiii) of the Registrants Form 10KSB for the year ended June 30, 1997).
10(ix)	Line of Credit Note of Registrant, dated September 19, 1997, payable to the order of Brown Brothers Harriman & Co. in the original principal amount of $1,500,000 (incorporated by reference from Exhibit 10(xiv) of the Registrants Form 10KSB for the year ended June 30, 1997).
10(x)	General Security Agreement from Registrant to Brown Brothers Harriman & Co. dated September 19, 1997 (incorporated by reference from Exhibit 10(xvii) of the Registrants Form 10KSB for the year ended June 30, 1997).
10(xi)	Lease between Registrant and Acme Realty, dated August 30, 2001(incorporated by reference from Registrant's Form 10-KSB for the year ended June 30, 2001).
10(xii)	Stock Purchase Agreement by and between PK Spur Co., and Sonics & Materials, Inc., with Respect to 90% of the Issued and Outstanding Shares of Common Stock of Tooltex, Inc., dated August 21, 2001(incorporated by reference from Registrant's Form 10KSB for the year ended June 30, 2001).

(b)

On August 27, 2001, the Company filed a Current Report on Form 8-K announcing the sale of 90% of the Common Stock of Tooltex to PK Spur, Co.

On August 31, 2001, the Company filed a Current Report on Form 8-K announcing the Sale-Leaseback of the Company's Newtown, Connecticut Manufacturing Facility.

On September 14, 2001, the Company filed a Current Report on Form 8-K disclosing the disposition of its facility in Newtown, Connecticut.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SONICS & MATERIALS, INC.

Date: February 8, 2002

By /s/ Robert S. Soloff

Robert S. Soloff,
President