

Edgar Filing: TROY GROUP INC - Form 10-Q

TROY GROUP INC
Form 10-Q
April 16, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 FEBRUARY 28, 2001.

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: 000-24413

TROY GROUP, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

33-0807798
(I.R.S. Employer Identification No.)

2331 SOUTH PULLMAN STREET
SANTA ANA, CALIFORNIA
(Address of principal executive offices)

92705
(Zip code)

(949) 250-3280
(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

As of March 30, 2001, there were 10,921,032 shares of our common stock
outstanding.

TROY GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q FOR THE
QUARTERLY PERIOD ENDED FEBRUARY 28, 2001

INDEX

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets
February 28, 2001 and November 30, 2000.....3

Consolidated Statements of Operations
for the Three Months ended February 28, 2001
and February 29, 2000.....4

Consolidated Statements of Cash Flows
for the Three Months ended February 28, 2001
and February 29, 2000.....5

Notes to Consolidated Financial Statements.....6-10

Item 2. Management's Discussion and Analysis of
Financial Condition and Results of Operations.....11

Item 3. Quantitative and Qualitative Disclosures About Market Risk.....15

PART II: OTHER INFORMATION

Item 1. Legal Proceedings.....16

Item 2. Changes in Securities and Use of Proceeds.....16

Item 3. Defaults Upon Senior Securities.....16

Item 4. Submission of Matters to a Vote of Security Holders.....16

Item 5. Other Information.....16

Item 6. Exhibits and Reports on Form 8-K.....16

PART I: FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

TROY GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

ASSETS		FEBRUARY 28, 2001 (Unaudited)

Current assets:		
Cash and cash equivalents.....	\$	--
Investment in available-for-sale securities.....		11,436
Accounts receivable, less allowance for doubtful accounts of \$604 and		

Edgar Filing: TROY GROUP INC - Form 10-Q

\$684, respectively.....	9,568
Income tax refund receivable.....	988
Inventories.....	8,106
Prepaid expenses and other.....	576
Deferred tax assets	1,313

Total current assets.....	31,987
Equipment and leasehold improvements, net.....	2,172
Other assets.....	9,152

Total assets.....	\$ 43,311
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Checks issued not yet presented for payment.....	\$ 267
Line of credit.....	246
Current portion of long-term debt.....	59
Accounts payable.....	4,205
Accrued expenses.....	2,356
Deferred service revenue.....	293

Total current liabilities.....	7,426

Long-term debt, net of current portion.....	255

Deferred tax liabilities.....	442

Stockholders' equity:	
Common stock, par value \$.01 per share; authorized 50,000,000 shares, issued 2001 10,921,032 shares; and 2000 10,880,764 shares.....	109
Preferred stock, no par value, authorized 5,000,000 shares, issued none....	--
Additional paid-in capital.....	20,964
Retained earnings.....	14,115

Total stockholders' equity.....	35,188

Total liabilities and stockholders' equity.....	\$ 43,311
	=====

See Notes to Consolidated Financial Statements.

3

TROY GROUP, INC.
CONSOLIDATED STATEMENTS
OF OPERATIONS
(UNAUDITED)

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

THREE MONTHS ENDED

FEBRUARY 28,	FEBRUARY 29,
2001	2000

Edgar Filing: TROY GROUP INC - Form 10-Q

Net sales.....	\$11,309	\$14,030
Cost of goods sold.....	6,856	7,334
Gross profit.....	4,453	6,696
Operating expenses:		
Selling, general and administrative	4,016	3,081
Research and development.....	1,298	987
Amortization of intangible assets.....	320	160
Operating income (loss).....	(1,181)	2,468
Interest income.....	210	192
Interest expense.....	(19)	(7)
Income (loss) before income taxes (credits)...	(990)	2,653
Provision for income taxes (credits).....	(405)	1,035
Net income (loss).....	\$ (585)	\$ 1,618
Net income (loss) per share:		
Basic	\$ (.05)	\$.15
Diluted.....	\$ (.05)	\$.14
Weighted-average shares outstanding:		
Basic	10,921	10,698
Diluted.....	10,921	11,498

See Notes to Consolidated Financial Statements.

4

TROY GROUP, INC.
CONSOLIDATED STATEMENTS
OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	THREE MONTHS ENDED	
	FEBRUARY 28, 2001	FEBRUARY 29, 2000
Cash flows from operating activities:		
Net income (loss).....	\$ (585)	\$ 1,618
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		

Edgar Filing: TROY GROUP INC - Form 10-Q

Depreciation and amortization.....	510	344
Provision for doubtful accounts.....	--	30
Deferred taxes.....	(29)	--
Accretion of investment discounts, net.....	(140)	(73)
Changes in working capital components, net of effects from acquisition of companies (Increase) decrease in:		
Accounts receivable.....	912	4,852
Income tax refund receivable.....	(512)	--
Inventories.....	(1,864)	(814)
Prepaid expenses and other.....	(10)	30
Increase (decrease) in:		
Accounts payable.....	1,781	1,324
Accrued expenses.....	(303)	(553)
Income taxes payable.....	--	218
Deferred service revenue.....	73	409
	-----	-----
Net cash provided by (used in) operating activities.....	(167)	7,385
	-----	-----
Cash flows from investing activities:		
Acquisition of American Development, Inc.....	--	(1,233)
Purchase of equipment and leasehold improvements.....	(321)	(125)
Purchase of available-for-sale securities.....	(3,985)	(10,700)
Redemption of available-for-sale securities.....	2,642	6,662
Increase in other assets.....	(58)	(1,553)
	-----	-----
Net cash (used in) investing activities.....	(1,722)	(6,949)
	-----	-----
Cash flows from financing activities:		
Net borrowings on revolving line of credit.....	246	--
Payments on notes payable.....	(17)	(241)
Decrease in checks issued not presented for payment....	(588)	--
Proceeds from issuance of common stock.....	158	364
	-----	-----
Net cash provided by (used in) financing activities..	(201)	123
	-----	-----
Net increase (decrease) in cash and cash equivalents	(2,090)	559
Cash and cash equivalents, beginning of period.....	2,090	4,783
	-----	-----
Cash and cash equivalents, end of period.....	\$ --	\$ 5,342
	=====	=====

See Notes to Consolidated Financial Statements.

5

TROY GROUP, INC.
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
(unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes

Edgar Filing: TROY GROUP INC - Form 10-Q

required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended February 28, 2001 are not necessarily indicative of the results that may be expected for the year ended November 30, 2001. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for its fiscal year ended November 30, 2000 (File No. 000-24413).

Certain reclassifications have been made to the February 29, 2000 consolidated income statement to conform to the February 28, 2001 presentation with no effect on net income or stockholders' equity.

NOTE 2. INVENTORIES

Inventories consisted of the following as of February 28, 2001 and November 30, 2000 (amounts in thousands):

	FEBRUARY 28, 2001	NOVEMBER 30, 2000
	-----	-----
Raw materials.....	\$5,715	\$4,016
Work-in-process.....	135	150
Finished goods.....	2,256	2,076
	----	----
Total.....	\$8,106	\$6,242
	=====	=====

NOTE 3. INVESTMENT IN AVAILABLE-FOR-SALE SECURITIES

As of February 28, 2001, the Company had approximately \$11.4 million in corporate debt securities with contractual maturity dates of up to one year, which management has determined should be classified as available-for-sale. Market values approximated carrying values. Accordingly, no unrealized gains or losses were recorded at February 28, 2001. There were no gains or loss recognized for the three months ended February 28, 2001 or February 29, 2000.

6

NOTE 4. STOCK OPTION AND STOCK WARRANT PLANS

During the three months ended February 28, 2001, the Company did not grant any options to acquire shares of common stock. The following is a summary of total outstanding options and stock warrants at February 28, 2001:

OPTIONS AND WARRANTS OUTSTANDING				OPTIONS AND WARR
RANGE OF EXERCISE PRICES	NUMBER OF OPTIONS	WEIGHTED-AVERAGE EXERCISE PRICE	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	NUMBER OF OPTION
\$3.50	106,666	\$3.50	4.3 years	106,666
\$6.31 - 8.00	1,546,000	\$7.09	8.5 years	552,750
\$13.16 - 14.25	25,000	\$13.38	8.8 years	--

Edgar Filing: TROY GROUP INC - Form 10-Q

1,677,666

659,416

At February 28, 2001, there were 1,145,000 shares remaining available for grant under the Company's option plans.

NOTE 5. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share:

	THREE MONTHS ENDED	

	(amounts in thousands, except per share data)	
	FEBRUARY 28, 2001	FEBRUARY 29, 2000
	-----	-----
NUMERATOR FOR BASIC AND DILUTED NET INCOME PER SHARE:		
Net income (loss).....	\$ (585)	\$1,618
	=====	=====
DENOMINATOR:		
Denominator for basic net income (loss) per share -- weighted-average shares outstanding.....	10,921	10,698
Effect of employee stock options and warrants....	--	800
	-----	-----
Denominator for diluted net income (loss) per share.....	10,921	11,498
	=====	=====
NET INCOME (LOSS) PER SHARE:		
Basic.....	(\$.05)	\$0.15
	=====	=====
Diluted.....	(\$.05)	\$0.14
	=====	=====

If the Company would have generated net income for the quarter ending February 28, 2001, then the denominator for diluted net income per share would have been 10,972,000 after adjusting the basic weighted-average shares outstanding by 51,000 shares for the effect of stock options and warrants.

NOTE 6. BUSINESS COMBINATIONS

AMERICAN DEVELOPMENT, INC.

On February 18, 2000, the Company acquired certain assets and assumed certain liabilities of American Development, Inc., a software development company, in exchange for 42,654 shares of \$0.01 par value common stock, \$1,179,000 in cash and \$54,000 in direct expenses. The total acquisition cost was \$2,652,000, including \$330,000 recorded in connection with warrants issued to a consultant,

Edgar Filing: TROY GROUP INC - Form 10-Q

and was allocated as follows:

Current assets	
Equipment and leasehold improvements	
Other assets	
Intangible assets, including customer list, assembled workforce, core technology and goodwill	
Current liabilities assumed	

The acquisition has been accounted for as a purchase and results of operations of American Development, Inc. since the date of acquisition are included in the Company's consolidated financial statements.

CABLENET TECHNOLOGIES

On May 9, 2000, the Company acquired North Carolina-based CableNet Technologies, which specializes in printer enhancement and connectivity technology, in exchange for 54,386 shares of \$0.01 par value common stock, \$1,945,000 in cash, \$62,000 in direct expenses and \$306,000 recorded in connection with warrants issued to a consultant. The total acquisition cost was \$3,088,000 and was allocated as follows:

Current assets	\$ 301,000
Equipment and leasehold improvements	17,000
Intangible assets, including customer list, assembled workforce, core technology and goodwill.....	2,817,000
Current liabilities assumed.....	(47,000)

	\$3,088,000
	=====

The acquisition has been accounted for as a purchase and results of operations of CableNet Technologies since the date of acquisition are included in the Company's consolidated financial statements.

NOTE 6. BUSINESS COMBINATIONS, CONTINUED

Pro Forma consolidated results of operations for the three months ended February 28, 2000 as though American Development, Inc. and CableNet Technologies had been acquired as of December 1, 1999 are as follows (amounts in thousands, except per share data):

Sales.....	\$ 14,530
	=====
Net income.....	\$ 1,584

Net income per share:	

Edgar Filing: TROY GROUP INC - Form 10-Q

Basic.....	\$0.15
	=====
Diluted.....	\$0.14
	=====

The above amounts reflect pro forma adjustments for amortization of intangibles and number of shares outstanding. This pro forma financial information does not purport to be indicative of the results of operations had the American Development, Inc. and CableNet Technologies acquisition actually taken place at the earlier date.

NOTE 7. SEGMENT INFORMATION

The following tables summarize revenues and net income (loss) by operating segment and unallocated corporate for the three months ended February 28, 2001 and February 29, 2000:

	THREE MONTHS ENDED	

	(amounts in thousands)	
	FEBRUARY 28, 2001	FEBRUARY 29, 2000
	-----	-----
Revenues:		
Financial Payment Solutions.....	\$ 9,136	\$ 9,716
Connectivity.....	2,173	4,314
	-----	-----
	\$ 11,309	\$ 14,030
	=====	=====
Net income (loss):		
Financial Payment Solutions.....	\$ 604	\$ 1,019
Connectivity.....	(513)	1,199
Unallocated Corporate.....	(676)	(600)
	-----	-----
	\$ (585)	\$ 1,618
	=====	=====

NOTE 8. CASH FLOW INFORMATION

Supplemental disclosure of cash flow information

THREE MO

(amounts i
FEBRUARY 28, 2001

Edgar Filing: TROY GROUP INC - Form 10-Q

Cash paid during the period for:	
Interest.....	\$ 18
	=====
Income taxes.....	\$ 35
	=====
Supplemental schedule of noncash investing and financing activities	
Purchase of American Development, Inc. in 2000:	
Total purchase price.....	\$ --
Less fair value of common stock and stock warrants issued in connection with the acquisition.....	--

Cash purchase price.....	\$ --
	=====

10

ITEM 2

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

The following discussion and analysis should be read in conjunction with our Consolidated Financial Statements and related Notes included in this report. This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform act of 1995. The statements contained in this report that are not historical in nature, particularly those that utilize terminology such as "may," "will," "should," "expects," "anticipates," "estimates," "believes" or "plans," or comparable terminology, are forward-looking statements based on current expectations and assumptions.

Various risks and uncertainties could cause actual results to differ materially from those expressed in forward-looking statements. These risks and uncertainties include the growth in acceptance of TROY's electronic payment solutions by online brokerage firms, e-merchants and other bill payment applications; the timely and successful development and integration of the Bluetooth and other wireless standards; the market acceptance of products incorporating wireless printing technologies; the ability to continue to develop and market other e-commerce payment, networked payment and wireless and other connectivity technologies; TROY's ability to refocus its management and resources on these emerging technologies; the ability to hire and retain qualified management, technology and other personnel; the impact of competition from existing and new technologies and companies; the ability to identify and assimilate acquired companies and technologies; the continued demand for printed financial documents; and other factors .

We own or have rights to trademarks that we use in connection with the sale of our products. Troy(R), eCheck Secure(TM), PrintraNet(TM), TROYmark(TM) and StarACH(TM) are among the trademarks that we own.

BACKGROUND

We are a leading worldwide provider of financial payment solutions. Our software, firmware and hardware solutions enable businesses to electronically transmit and output financial payment information across computer networks and the Internet.

Our products consist of financial payment solutions and connectivity products that serve a wide variety of industries including e-commerce retailers, online brokerages, telecommunications, financial services, insurance, computer

Edgar Filing: TROY GROUP INC - Form 10-Q

hardware, automotive, personnel and others.

Our financial payment solutions consist of e-commerce payment solutions and networked computer payment solutions. Our e-commerce payment solutions enable Internet merchants to accept payments from their customers' checking accounts as an alternative to credit cards. Our networked computer payment solutions include software, firmware, hardware and imaging supplies that enable standard laser printers to print MICR lines, graphics, barcodes and forms and to perform additional functions such as auditing, status checking and security.

Our connectivity products enhance the connectivity of devices that transmit information over computer networks and the Internet.

11

OVERVIEW

Net sales are generated from the sale of our connectivity and financial payment solutions and services. We recognize revenue from the sale of our products when the goods are shipped to the customer and we recognize service revenue over the period of the contract on a straight-line basis. In the three months ended February 28, 2001 and the fiscal year ended November 30, 2000, a reseller of our imaging supplies, Cannon IV Inc., accounted for 6.4% and 9.2%, respectively, of our net sales, of which we believe a significant portion was sold to a single customer. In addition, a reseller of our laser printers and connectivity products, Comark, Inc. also sold products to this same customer which accounted for 0.2% and 0.6%, respectively, of our net sales for the three months ended February 28, 2001 and the fiscal year ended November 30, 2000. We also sell our products directly to the significant customer of Cannon IV and Comark. Direct sales to these resellers' significant customer were 0.0% and 0.3% of our net sales for the three months ended February 28, 2001 and the fiscal year ended November 30, 2000, respectively. We do not have a written or oral contract with Cannon IV, Comark or their significant customer. All sales are made through purchase orders.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain information derived from our consolidated statements of operations expressed as a percentage of net sales:

	Three Months Ended	
	February 28, 2001	February 29 2000
Net sales.....	100.0%	100.0%
Cost of goods sold.....	60.6	52.3
Gross Profit.....	39.4	47.7
Selling, general and administrative expenses.....	35.5	22.0
Research and development expenses.....	11.5	7.0
Amortization of intangible assets.....	2.8	1.1
Operating income (loss).....	(10.4)	17.6
Interest income.....	1.8	1.4
Interest expense.....	(0.2)	(0.1)

Edgar Filing: TROY GROUP INC - Form 10-Q

Income (loss) before income taxes (credits)	(8.8)	18.9
Provision for income taxes (credits).....	(3.6)	7.4
Net income (loss).....	(5.2)%	11.5 %

THREE MONTHS ENDED FEBRUARY 28, 2001 COMPARED TO THREE MONTHS ENDED FEBRUARY 29, 2000

NET SALES. Our net sales were \$11.3 million for the three months ended February 28, 2001, with \$9.1 million attributable to financial payment solutions and \$2.2 million attributable to connectivity products and software. Net sales in the three months ended February 28, 2001 decreased by \$2.7 million, or 19.4%, from \$14.0 million in the three months ended February 29, 2000. This decrease in net sales represents a \$1.1 million decrease in sales of our laser printers, impact printers, proprietary imaging supplies and services, a decrease of \$2.0 million in sales of our connectivity products and software. These decreases were partially offset by an increase of \$0.4 million in sales of our electronic payment solutions. Net sales were not significantly affected by price changes. The decrease in our net sales for the three months ended February 28, 2001, as compared to net sales for the three months ended February 29, 2000, can be attributed to a \$1.9 million non-recurring software licensing sale in the first quarter of

2000 as well as the implementation of our strategy to shift our focus away from our established financial payment solutions and toward our electronic payment solutions and wireless printing opportunities. In connection with our shift in focus, we may continue to license our software technology to third parties as we consider appropriate. To the extent that our mix of revenue sources continues to shift toward sales of connectivity products and technology licensing, our net sales could vary from historical patterns.

COST OF GOODS SOLD. Cost of goods sold decreased by \$478,000 or 6.5% to \$6.9 million in the three months ended February 28, 2001 from \$7.3 million in the three months ended February 29, 2000. This decrease was primarily due to decreased net sales. Cost of goods sold as a percentage of net sales increased to 60.6% in the three months ended February 28, 2001 from 52.3% in the three months ended February 29, 2000. In connection with our shift in focus, we may enter into agreements to license technology from other companies. As a result of these agreements, cost of goods sold could vary from historical patterns.

GROSS PROFIT. As a result of the above factors, gross profit decreased by \$2.2 million to \$4.5 million in the three months ended February 28, 2001 from \$6.7 million in the three months ended February 29, 2000. Gross profit as a percentage of net sales decreased to 39.4% in the three months ended February 28, 2001 from 47.7% in the three months ended February 29, 2000. This decrease was also primarily due to a software licensing sale in the three months ended February 29, 2000.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased by \$935,000 or 30.3% to \$4.0 million in the three months ended February 28, 2001 from \$3.1 million in the three months ended February 29, 2000. This increase was due primarily to additional operating expenses of \$270,000 as a result of our acquisitions, an increase of \$665,000 due to increases in personnel, promotions and other expenses. Selling, general

Edgar Filing: TROY GROUP INC - Form 10-Q

and administrative expenses as a percentage of net sales increased to 35.5% in the three months ended February 28, 2001 from 22.0% in the three months ended February 29, 2000, due to our acquisition strategy and our associated growth requirements. In connection with our shift in focus, we intend to continue to invest in marketing expenditures, substantially increase the size of the sales force, and add technical resources as required. As a result of these expenditures and hiring initiatives, we expect selling, general and administrative expenses to continue to exceed historical levels. This forward-looking statement will be impacted by the timing and amount of these expenditures, our ability to attract and retain sales and marketing personnel and the associated costs of such personnel, and the success of our marketing efforts.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses increased by \$311,000 or 31.5% to \$1.3 million in the three months ended February 28, 2001 from \$1.0 million in the three months ended February 29, 2000. Of this increase, \$171,000 was due to additional research and development expenses as a result of our acquisitions. Research and development expenses as a percentage of net sales was 11.5% in the three months ended February 28, 2001 and 7.0% in the three months ended February 29, 2000. In connection with our growth initiatives and efforts to develop new wireless printing technologies, we expect research and development expenses to continue to exceed historical levels as we add additional personnel and incur additional related costs. This forward-looking statement will be impacted by the timing and amount of additional research and development expenditures and our ability to attract and retain research and development personnel and the associated costs of such personnel.

AMORTIZATION OF INTANGIBLE ASSETS. Amortization of intangible assets increased by \$160,000 or 100.0% to \$320,000 in the three months

13

ended February 28, 2001 from \$160,000 in the three months ended February 29, 2000. This increase was the result of increases in the intangible assets associated with our acquisitions.

OPERATING INCOME (LOSS). As a result of the above factors, operating income decreased by \$3.6 million or 147.9% to \$1.2 million loss in the three months ended February 28, 2001 from \$2.5 million in the three months ended February 29, 2000. Operating income as a percentage of net sales decreased to (10.4)% in the three months ended February 28, 2001 from 17.6% in the three months ended February 29, 2000.

INTEREST INCOME. Interest income increased by \$18,000 to \$210,000 in the three months ended February 28, 2001 from \$192,000 in the three months ended February 29, 2000. This income was due to our investment of proceeds from our initial public offering.

INTEREST EXPENSE. Interest expense increased by \$12,000 to \$19,000 in the three months ended February 28, 2001 from \$7,000 in the three months ended February 29, 2000. This increase was due to increased borrowings under our line of credit.

INCOME TAXES. Income taxes decreased to a \$405,000 tax credit in the three months ended February 28, 2001 from a \$1.0 million expense in the three months ended February 29, 2000. This decrease is a result of decreased income before income taxes. Income taxes (credits) as a percentage of pretax income (loss) increased to 41% in the three months ended February 28, 2001 from 39% in the three months ended February 29, 2000.

Edgar Filing: TROY GROUP INC - Form 10-Q

LIQUIDITY AND CAPITAL RESOURCES

Prior to our initial public offering in July, 1999, our primary source of liquidity was through cash generated from operations and borrowings under our revolving credit facility and term loans.

Cash flows used by operating activities were \$167,000 in the three months ended February 28, 2001 compared to \$7.4 million provided by operating activities in the three months ended February 29, 2000. This decrease was due primarily to an increase in inventories and the income tax receivable and a decrease in accrued expenses, partially offset by a decrease in accounts receivable and an increase in accounts payable. The accounts receivable decrease resulted primarily from collections. The increase in inventories resulted primarily from purchases of printers in anticipation of model changes and anticipated sales of connectivity and wireless products.

Cash flows used in investing activities were \$1.7 million in the three months ended February 28, 2001 compared to \$6.9 million used in the three months ended February 29, 2000. Included in cash flows used in investing activities in the three months ended February 28, 2001 was \$1.3 million in net purchases of available-for-sale securities. In connection with split-dollar life insurance arrangements with our majority shareholders, we have agreed to pay the underlying life insurance premiums as a condition of continued employment. Annual premiums on these policies are approximately \$428,000 per year.

Cash flows used by financing activities were \$201,000 in the three months ended February 28, 2001 compared to cash flows provided by financing activities of \$123,000 in the three months ended February 29, 2000.

We currently have a \$5.0 million general line of credit and a \$10.0 million acquisition line of credit with Comerica Bank - California. Both lines of credit are secured by substantially all of our assets

14

and are subject to certain financial covenants. In connection with the general line of credit agreement, we have a \$650,000 standby letter of credit sublimit agreement of which \$80,000 was outstanding at February 28, 2001. \$246,000 was outstanding against the general line of credit on February 28, 2001 and no borrowings were outstanding against the acquisition line of credit. As of February 28, 2001 \$4,674,000 was available under the general line of credit and all \$10.0 million was available under the acquisition line of credit. The acquisition line of credit expires on October 1, 2001. The general line of credit has no expiration date.

We believe that cash generated by operating activities, the net proceeds from our initial public offering and funds available under our credit facility will be sufficient to finance our operating activities for at least the next 12 months. To the extent that the funds generated from these sources are insufficient to finance our operating activities, we would need to raise additional funds through public or private financing. We cannot assure you that additional financing will be available on terms favorable to us, or at all.

In March 2001, Troy established a stock repurchase program under which Troy's common stock, with an aggregate market value up to \$4.0 million, may be acquired in the open market. As of April 11, 2001, Troy has purchased approximately 45,000 shares of common stock in the open market, at an average price of \$3.27 per share, under the stock repurchase program. Approximately \$3.8 million remains available for future common stock repurchases.

Edgar Filing: TROY GROUP INC - Form 10-Q

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss to future earnings, to fair values or to future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, exchange rates, commodity prices, equity prices and other market changes. Market risk is attributed to all market sensitive financial instruments, including long term debt.

We do not utilize derivative financial instruments. Accordingly, our exposure to market risk is through our investments in available-for-sale securities and our bank debt which bears interest at variable rates. Available-for-sale securities consist of corporate debt securities. Approximately all of these securities have contractual maturity dates of up to one year. At February 28, 2001, market values approximated carrying values. Due to the short-term maturities of these securities, management believes that there is no significant market risk. At February 28, 2001, we had approximately \$11.4 million in cash, cash equivalents and investments in available-for-sale securities, and, accordingly, a sustained decrease in the rate of interest earned of 1% would cause a decrease in the amount of interest earned of \$114,000. The bank debt is a revolving line of credit. All borrowings bear interest based upon the reference rate per annum as announced by the bank (8.5% at February 28, 2001) less .25%. At February 28, 2001, there was \$246,000 outstanding under the line of credit agreement and, accordingly, a sustained increase in the reference rate of 1% would cause an increase in the amount of interest expense of \$2,000.

15

PART II: OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

Not applicable.

ITEM 2 - CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5 - OTHER INFORMATION

None.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

Exhibit
Number

DESCRIPTION

Edgar Filing: TROY GROUP INC - Form 10-Q

None.

(b) Reports On Form 8-K

None.

16

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.

TROY GROUP, INC.

April 16, 2001

/s/ Patrick J. Dirk

Patrick J. Dirk
Chairman, President and Chief Executive Officer

/s/ Del L. Conrad

Del L. Conrad
Chief Financial Officer

17