

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-17** | Period of Report: **1994-04-02**
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FILER

LOTUS DEVELOPMENT CORP

CIK: **711761** | IRS No.: **042757702** | State of Incorpor.: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-11626** | Film No.: **94529123**
SIC: **7372** Prepackaged software

Business Address
55 CAMBRIDGE PWY
CAMBRIDGE MA 02142
6175778500

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Quarterly Period Ended April 2, 1994 or

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Transition Period from _____ to _____

Commission File Number 0-11626

LOTUS DEVELOPMENT CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of
incorporation or organization)

04-2757702 (I.R.S. Employer Identification Number)

55 Cambridge Parkway, Cambridge, Massachusetts 02142
(Address of principal executive offices)
(Zip Code)

(617) 577-8500
(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 X NO

Indicate the number of shares outstanding of each of
the issuer's classes of common stock, as of the latest practicable date.

Class -----	Outstanding at April 30, 1994 -----
Common Stock, \$.01 par value	45,931,026 shares

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PART I. FINANCIAL INFORMATION
ITEM 1: FINANCIAL STATEMENTS
LOTUS DEVELOPMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended -----	
	April 2, 1994 -----	April 3, 1993 -----
Net sales	\$246,992	\$227,004
Cost of sales	46,408	50,379
	-----	-----
Gross margin	200,584	176,625
Expenses:		
Research and development	34,484	31,820
Sales and marketing	117,820	106,112
General and administrative	16,248	17,970
Other (income) / expense, net (Note D)	(1,314)	(68)
	-----	-----
Total expenses	167,238	155,834
Income before provision for income taxes	33,346	20,791
Provision for income taxes	12,005	8,524
	-----	-----
Net income	\$21,341	\$12,267
	=====	=====
Net income per share	\$0.45	\$0.29
	=====	=====
Weighted average common and common equivalent shares outstanding	47,707	42,598
	=====	=====

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

LOTUS DEVELOPMENT CORPORATION
 CONSOLIDATED BALANCE SHEETS
 (in thousands)

ASSETS

	April 2, 1994 (unaudited)	December 31, 1993
	-----	-----
Current assets:		
Cash and short-term investments (Note B)	\$476,889	\$416,693
Accounts receivable, net of allowances of \$28,014 and \$30,002	189,838	217,336
Inventory (Note C)	17,102	21,220
Other current assets	27,715	20,817
	-----	-----
Total current assets	711,544	676,066
	-----	-----
Property and equipment, net of accumulated depreciation and amortization of \$158,024 and \$153,768	124,298	127,437
Software and other intangibles, net of accumulated amortization of \$135,140 and \$123,016	84,538	88,625
Investments and other assets	13,541	13,217
	-----	-----
Total assets	\$933,921	\$905,345
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Notes payable to banks	\$ 1,526	\$ --
Current portion of long-term debt	28,480	28,480
Accounts payable and accrued expenses	183,965	199,926
Accrued and deferred income taxes	51,555	49,017
	-----	-----
Total current liabilities	265,526	277,423
	-----	-----
Deferred income taxes	49,524	49,531
Long-term debt	50,000	50,000
Stockholders' equity:		
Preferred stock, \$1.00 par value, 5,000 shares authorized, none issued	--	--
Common stock, \$.01 par value, 100,000 shares authorized; 62,152 shares issued;		

45,736 and 44,928 shares outstanding	622	622
Additional paid-in capital	258,228	251,414
Retained earnings	547,895	526,554
Treasury stock, 16,416 and 17,224 shares at an average cost of \$14.44 per share	(237,067)	(248,728)
Translation adjustment	(807)	(1,471)
	-----	-----
Total stockholders' equity	568,871	528,391
	-----	-----
Total liabilities and stockholders' equity	\$933,921	\$905,345
	=====	=====

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

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LOTUS DEVELOPMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended	
	April 2, 1994	April 3, 1993
	-----	-----
Cash flows from operating activities:		
Net income	\$21,341	\$12,267
Depreciation and amortization	21,413	21,631
Decrease in accounts receivable	28,879	6,366
Decrease in inventory	4,459	4,552
Decrease in accounts payable and accrued expenses	(16,533)	(11,147)
Increase in accrued and deferred income taxes	2,472	4,867
Net change in other working capital items	(7,597)	(737)
	-----	-----
Net cash provided by operating activities	54,434	37,799
	-----	-----
Cash flows from investing activities:		
Purchases of property and equipment	(5,871)	(4,918)
Payments for software and other intangibles	(8,177)	(11,636)
Purchases of short-term investments, net	(8,168)	(6,483)
Other	(141)	1,797
	-----	-----
Net cash used for investing activities	(22,357)	(21,240)
	-----	-----
Cash flows from financing activities:		
Issuance of common stock	18,475	4,250
Increase (decrease) in short-term borrowings	1,476	(819)
	-----	-----

Net cash provided by financing activities	19,951	3,431
	-----	-----
Net increase in cash and cash equivalents	52,028	19,990
Cash and cash equivalents, beginning of year	164,849	121,133
	-----	-----
Cash and cash equivalents, end of first quarter	\$216,877	\$141,123
	=====	=====

Supplemental Cash Flow Information	Three Months Ended	
	April 2, 1994	April 3, 1993
	-----	-----
Interest received	\$3,238	\$946
Interest paid	\$887	\$1,224
Income taxes paid	\$9,474	\$3,959

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

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LOTUS DEVELOPMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)

A) Basis of Presentation

The accompanying unaudited consolidated balance sheets, statements of operations, and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair statement of the consolidated financial position at April 2, 1994, and of consolidated operations and cash flows for the interim periods ended April 2, 1994 and April 3, 1993.

The accompanying unaudited condensed financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and footnotes necessary for a complete presentation of operations, the financial position, and cash flows of the Company, in conformity with generally accepted accounting principles. The Company filed audited consolidated financial statements which included all information and footnotes necessary for such presentation for the years ended December 31, 1993 and December 31, 1992 in conjunction with its 1993 Annual Report on Form 10-K.

The results of operations for the interim period ended April 2, 1994 are not necessarily indicative of the results to be expected for the year.

B) Cash and Short-term Investments

Cash and short-term investments consist of the following:

	April 2, 1994	December 31, 1993
	-----	-----
Cash and cash equivalents	\$216,877	\$164,849
Short-term investments	260,012	251,844
	-----	-----
Cash and short-term investments	\$476,899	\$416,693
	=====	=====

The Company's investment portfolio is diversified and consists of cash equivalents and investments placed with high credit qualified institutions. The Company adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("FAS 115") at the beginning of 1994. The Company has the intent and ability to hold until maturity all securities that mature in less than one year. Accordingly, these "held-to-maturity" securities have been recorded at amortized cost. The Company has categorized all other securities as "available-for-sale", since the Company may liquidate these investments currently. FAS 115 requires that unrealized gains and losses on "available-for-sale" securities be excluded from earnings and reported in a separate component of stockholders' equity. In the first quarter of 1994, the unrealized loss was immaterial.

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LOTUS DEVELOPMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)

B) Cash and Short-term Investments (continued)

The amortized cost of securities, which approximates fair value, consists of the following at April 2, 1994:

<TABLE>

<CAPTION>

Type of security	Maturity Less than one year	Maturity One to five years	Total
-----	-----	-----	-----
<S>	<C>	<C>	<C>
Corporate bonds and Eurobonds	\$97,099	\$36,031	\$133,130
Commercial Paper	77,760	--	77,760
Collateralized Mortgage Obligations	25,643	8,295	33,938
	-----	-----	-----
	\$200,502	\$44,326	244,828
	=====	=====	
Cash and other cash equivalents			232,071

Total cash and short-term investments	\$476,899
---------------------------------------	-----------

</TABLE>

C) Inventory

Inventory consists of the following:

	April 2, 1994	December 31, 1993
Finished goods	\$11,066	\$13,962
Raw materials	6,036	7,258
	-----	-----
Total	\$17,102	\$21,220

D) Other (income) / expense , net

Other (income) / expense consists of the following:

	Three Months Ended	
	April 2, 1994	April 3, 1993
Interest income	(\$3,773)	(\$ 2,900)
Interest expense	1,762	2,831
Other, net	697	1
	-----	-----
Total	(\$1,314)	(\$ 68)

ITEM 2:
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Results of Operations

Revenue for the first quarter of 1994 increased 9% over the comparable period in 1993. The Company's revenues are derived primarily from desktop applications and communications products and services. Lotus' desktop applications include spreadsheets, word processing, graphics, end-user database and personal information management software products. Lotus' communications products and services include Notes, cc:Mail and consulting services. Worldwide revenue from desktop applications was essentially unchanged in the first quarter of 1994 compared to the prior year period. Revenue from the Company's Windows desktop applications grew significantly compared to the prior

year period, while revenue from DOS desktop applications continued to decline, but at a rate slower than that experienced in the prior year. Sales of SmartSuite, the Company's comprehensive suite of Windows desktop applications, more than quadrupled from the prior year period and represented 44% of total Windows desktop applications revenue in the first quarter of 1994, compared to 13% in the first quarter of 1993. This substantial increase reflects the market shift from standalone desktop applications to integrated suites. Prices for Windows desktop applications decreased compared to the same quarter in the prior year as competition for Windows desktop applications intensified. The Company anticipates that downward pressure on pricing for Windows desktop applications will continue in 1994. Revenue from communications products and services more than doubled compared with the first quarter of 1993 and represented 29% of total revenue in the first quarter of 1994 compared to 14% in the first quarter of 1993. Increased sales of communications products and services reflect the growing momentum behind workgroup and networked computing. Revenue outside the U.S. accounted for 55% of worldwide revenue and compared with 51% for the same period in 1993. The impact of foreign currency fluctuations on international revenues was insignificant.

The gross margin percentage of 81% for the first quarter of 1994 compares with 78% for the same period in 1993. The rate was favorably affected by the achievement of manufacturing efficiencies resulting from higher production volumes, the closing of the Puerto Rican manufacturing plant in mid-1993, and material cost reductions. The margin improvement was also attributable to a greater proportion of higher margin communication products in the sales mix and to reduced manufacturing and delivery costs resulting from an increase in license sales.

The 8% increase in research and development reflects a constant level of desktop development spending quarter over quarter and significantly higher spending associated with the development and enhancement of the Company's communications products and Working Together technology. To a lesser degree, higher spending was driven by development efforts to translate and localize products for international markets. Capitalized software costs for the first quarter of 1994 were \$7.0 million compared with \$6.0 million for the same period in 1993.

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ITEM 2:

Management's Discussion and Analysis of
Financial Condition and Results of Operations

Results of Operations (continued)

Sales and marketing expenses grew 11% in the first quarter of 1994 compared with the same 1993 period. The growth was driven by the Company's investment in its communications business and in SmartSuite. Increased spending on advertising and marketing programs for SmartSuite reflects the market shift from standalone applications to integrated suites. In addition, the Company has continued its efforts to attract users transitioning from DOS to Windows, to expand the worldwide support organization, and to grow the consulting services business.

Other income and expense consists primarily of interest income and interest expense. Despite declining interest rates, interest income was higher in the first quarter of 1994 compared with the first quarter of 1993 because of higher average cash and short-term investment balances. Interest expense declined primarily due to scheduled repayments of long-term debt obligations.

The estimated tax rate for 1994 of 36% compares with 41% for the first quarter of 1993. The decrease in the rate reflects the benefit from the reinstatement of the research and development credit in the second half of 1993 and benefits derived from the Company's manufacturing operations in Dublin, Ireland.

Financial Condition

Cash and short-term investments increased \$60 million to \$477 million at April 2, 1994. The two primary sources of cash flow in the first quarter of 1994 were \$54 million of cash generated by operations and \$18 million in proceeds from the issuance of common stock under the Company's employee stock plans. The Company used a portion of the cash for investing activities, including \$6 million for the purchase of property and equipment and \$8 million for payments for software and other intangibles.

A substantial portion of the Company's cash and short-term investments are either deposited in financial institutions located in Puerto Rico or held by subsidiaries outside the United States. These investments can be readily transferred to the United States as required, subject to income and/or withholding taxes upon repatriation. Taxes have already been provided for the tax liability which would result.

The Company's financial reserves are represented by cash, short-term investments and unused portions of credit facilities. The Company believes its financial reserves and funds provided by ongoing operations are adequate to meet future liquidity requirements.

PART II. OTHER INFORMATION

ITEM 1:

LEGAL PROCEEDINGS

The Company commenced an action on July 2, 1990 in the U.S. District Court in Boston against Borland International, Inc. ("Borland") (Civ. Action No. 90-11662-K), alleging infringement of its copyrights in the Lotus 1-2-3 software program by Borland's "Quattro" and "Quattro Pro" software products. The action against Borland alleges that the "1-2-3 compatible modes" of Quattro and Quattro Pro identically recreate substantial and significant elements of 1-2-3's user interface, including its menu structure and command choices. The action sought an injunction preventing further sale of the infringing products and seeks an award of damages, attorney's fees and costs. On July 31, 1992, the Court found that Borland has infringed the Company's copyrights by copying the menu commands, menu command structure, macro language and keystroke sequences of Lotus 1-2-3.

On June 30, 1993, the Court ruled in the Company's favor on all of the remaining copyright issues in the case except the Company's claim that the macro key reader for Quattro Pro for DOS and Quattro Pro for Windows infringes the Company's copyrights in 1-2-3. On August 19, 1993, the Court found that the macro key reader for the Quattro Pro products has infringed the Company's copyrights. On August 19, 1993, the Court enjoined permanently Borland from developing, manufacturing or selling versions of Quattro Pro, Quattro Pro SE and Quattro Pro for Windows that include Borland's "1-2-3 emulation" interface and/or its "Key Reader" facility and set a date in October of 1994 for a trial by jury to determine the amount of damages Borland owes the Company because of its infringements. On September 10, 1993, Borland appealed the Court's decisions that it has infringed the Company's copyrights and the permanent injunction pertaining to such products to the United States Court of Appeals for the First Circuit. This appeal was argued before the Court of Appeals on April 6, 1994.

A suit was filed against the Company on July 27, 1989, in the U.S. District Court in New York City by REFAC International, Ltd. ("REFAC"). The suit alleges that the Company has committed patent infringement with respect to a U.S. patent issued in 1983 entitled "A Process and Apparatus for Converting A Source Program Into An Object Program". The Court has determined to resolve issues concerning validity of the patent before addressing the alleged infringement. In July 1993, a trial was held on one of those issues, the Company's claim that the patent is unenforceable by reason of inequitable conduct in front of the Patent Office. That issue is pending the judge's decision. If

the Company prevails on this issue, judgment will be entered on its behalf. If it does not prevail, the Company intends to file one or more motions for summary judgment on other grounds claiming that the subject patent is invalid or unenforceable. The Company believes that the claim of infringement is without merit.

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ITEM 6:
Exhibits and Reports on Form 8-K

(a) Exhibits
Part I:

Exhibit 11* - Computation of Primary and Fully Diluted Earnings per Share - page 10

Part II:

None.

(b) Reports on Form 8-K

None.

*filed herewith

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.

LOTUS DEVELOPMENT CORPORATION

(Registrant)

By /s/ Edwin J. Gillis
Edwin J. Gillis, Senior Vice

President of Finance and Operations
(Chief Financial Officer)

By /s/ Lyn L. Benton
Lyn L. Benton, Vice President
of Finance and Corporate Services
and Corporate Controller
(Principal Accounting Officer)

Date: May 16, 1994

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EXHIBIT 11

LOTUS DEVELOPMENT CORPORATION
COMPUTATION OF PRIMARY AND FULLY DILUTED
EARNINGS PER SHARE
(in thousands, except per share data)

	Three Months Ended	
	April 2, 1994	April 3, 1993
Net income	\$21,341	\$12,267
Weighted average shares outstanding during the period	45,290	41,963
Common stock equivalent shares	2,417	635
Common and common stock equivalent shares outstanding for purpose of calculating primary net income per share	47,707	42,598
Incremental shares to reflect full dilution	156	--
Total shares for purpose of calculating fully diluted net income per share	47,863	42,598
Primary net income per share	\$0.45	\$0.29
Fully diluted net income per share	\$0.45	\$0.29