

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**  
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### FILER

#### **TSENG LABS INC**

CIK: **741742** | IRS No.: **232277100** | State of Incorp.: **UT** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **000-13502** | Film No.: **96663833**  
SIC: **3577** Computer peripheral equipment, nec

Mailing Address  
*6 TERRY DRIVE  
NEWTOWN PA 18940*

Business Address  
*6 TERRY DR  
NEWTOWN COMMONS  
NEWTOWN PA 18940  
2159680502*

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 September 30, 1996  
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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 0-13502  
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TSENG LABS, INC.  
-----

(Exact name of registrant as specified in its charter)

UTAH  
-----

87-0391229  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

6 Terry Drive, Newtown, PA  
-----

18940  
-----

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (215) 968-0502  
-----

(Former name, former address and former fiscal year,  
if changed since last report.)

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

Indicate the number of shares outstanding of each of the issuer's classes of  
common stock, as of the close of the period covered by this report (applicable  
only to corporate issuers).

Class - Common Stock, \$.005 Par Value  
-----

Outstanding at September 30, 1996 - 19,047,338 shares  
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This report includes a total of 10 pages.

PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

TSENG LABS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands)

<TABLE>  
<CAPTION>

ASSETS	September 30 1996	December 31, 1995
	(Unaudited)	
	<S>	<C>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 4,692	\$ 9,004
Short-term investments	17,011	30,210
Accounts receivable, net	8,744	5,924
Inventories	3,725	3,408
Prepaid expenses and other	3,428	1,771
	-----	-----
Total current assets	37,600	50,317
	-----	-----
PROPERTY AND EQUIPMENT, net of of accumulated depreciation of \$5,399 and \$4,326	9,138	7,696
	-----	-----
DEFERRED COSTS, net	5,119	3,817
	-----	-----
NOTES RECEIVABLE	6,499	803
	-----	-----
OTHER ASSETS	2,104	2,038
	-----	-----
	\$ 60,460	\$ 64,671
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
-----		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,012	\$ 2,834
Accrued expenses	895	1,131
	-----	-----
Total current liabilities	1,907	3,965
	-----	-----
DEFERRED INCOME TAXES	2,311	2,311
	-----	-----
SHAREHOLDERS' EQUITY:		
Common stock	98	97
Additional paid-in capital	11,073	10,316
Retained earnings	49,714	52,625
Treasury stock, at cost	(4,643)	(4,643)
	-----	-----
	56,242	58,395
	-----	-----
	\$ 60,460	\$ 64,671
	=====	=====

&lt;/TABLE&gt;

See accompanying notes to financial statements.

TSENG LABS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

<TABLE>  
<CAPTION>

	For the Three Months Ended September 30	
	1996	1995
	(Unaudited)	
<S>	<C>	<C>
NET SALES	\$ 12,360	\$ 8,880
COST OF SALES	9,694	6,973
Gross Profit	2,666	1,907
RESEARCH AND DEVELOPMENT	1,771	787
SELLING, GENERAL AND ADMINISTRATIVE	1,909	1,543
OPERATING INCOME (LOSS)	(1,014)	(423)
INTEREST INCOME	292	553
Income (loss) before income taxes	(722)	130
INCOME TAXES (BENEFIT)	(259)	30
NET INCOME (LOSS)	\$ (463)	\$ 100
NET INCOME (LOSS) PER SHARE	\$ (.02)	\$ .01
Weighted Average Common and Common Equivalent Shares Outstanding	19,047	19,028

</TABLE>

See accompanying notes to financial statements

TSENG LABS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

<TABLE>  
<CAPTION>

	For the Nine Months Ended September 30	
	1996	1995
	(Unaudited)	
<S>	<C>	<C>
NET SALES	\$ 23,211	\$ 29,860
COST OF SALES	19,039	22,318
Gross Profit	4,172	7,542
RESEARCH AND DEVELOPMENT	4,357	2,264
SELLING, GENERAL AND ADMINISTRATIVE	5,417	4,714
OPERATING INCOME (LOSS)	(5,602)	564
INTEREST INCOME	1,113	1,621
Income (loss) before income taxes	(4,489)	2,185
INCOME TAXES (BENEFIT)	(1,578)	725
NET INCOME (LOSS)	\$ (2,911)	\$ 1,460
NET INCOME (LOSS) PER SHARE	\$ (.15)	\$ .08
Weighted Average Common and Common Equivalent Shares Outstanding	19,001	18,994

</TABLE>

See accompanying notes to financial statements

TSENG LABS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

<TABLE>  
<CAPTION>

For the Nine Months Ended September 30	
1996	1995

<u>&lt;S&gt;</u>	<u>&lt;C&gt;</u>	(Unaudited)	<u>&lt;C&gt;</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$	(2,911)	\$ 1,460
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities -			
Depreciation and amortization		2,000	1,941
(Increase) decrease in -			
Accounts receivable		(2,820)	2,359
Inventories		(317)	(1,288)
Prepaid expenses and other		(1,657)	371
Other assets		(65)	(626)
Increase (decrease) in -			
Accounts payable		(1,822)	(1,598)
Accrued expenses		(236)	369
		-----	-----
Net cash (used in) provided by operating activities		(7,828)	2,988
		-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property and equipment		(2,515)	(1,598)
Increase in deferred costs		(2,229)	(1,584)
Decrease (increase) in short-term investments		13,199	(30,325)
Increase in notes receivable		(5,697)	--
		-----	-----
Net cash provided by (used in) investing activities		2,758	(33,507)
		-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from exercise of stock options		758	178
Purchase of Treasury stock		--	(371)
Dividends paid		--	(1,890)
		-----	-----
Net cash provided by (used in) financing activities		758	(2,083)
		-----	-----
Net decrease in cash and cash equivalents		(4,312)	(32,602)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		9,004	38,542
		-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$	4,692	\$ 5,940
		=====	=====
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Cash paid during the period for income taxes	\$	--	\$ 675
		=====	=====

</TABLE>

See accompanying notes to financial statements

1. SUMMARY FINANCIAL INFORMATION AND RESULTS OF OPERATIONS:

In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position as of September 30, 1996, the results of operations and the changes in financial position for the periods presented.

While the Company believes that the disclosures presented are adequate to make the information not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes included in the Company's latest annual report on Form 10-K. The results of operations for the interim periods presented are not necessarily indications of the results for the full year.

## 2. NET INCOME (LOSS) PER SHARE:

Net income (loss) per share was computed using the weighted average number of common shares and share equivalents outstanding during the periods.

## 3. INVENTORIES:

Inventories are stated at the lower of weighted average cost or market and consist of the following:

	September 30, 1996 -----	December 31, 1995 -----
	(In Thousands)	
Purchased parts	\$ 1,012	\$ 662
Finished goods	2,713	2,746
	-----	-----
	\$ 3,725	\$ 3,408
	=====	=====

## 4. SHORT-TERM INVESTMENTS

In connection with its purchase of short-term investments, in 1995 the Company adopted Statement of Financial Accounting Standards No. 115 "Accounting for Certain Investments in Debt and Equity Securities." Management determines the appropriate classification of debt and equity securities at the time of purchase and reevaluates such designation as of each balance sheet date. At September 30, 1996, all short-term investments have been classified as held-to-maturity. Held-to-maturity securities are carried at amortized cost, with coupon interest and dividends and discount and premium amortization included in income each period.

## 5. RECLASSIFICATIONS

Certain prior year balances have been reclassified to conform to the current year presentation.

## 6. NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 1996, the Company adopted Statement of Accounting Standards Nos. 121 and 123. The adoption of these standards did not have a material impact on the Company's financial position or results of operations.

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

### RESULTS OF OPERATIONS

Revenues for the three months ended September 30, 1996 were \$12,360,000, a 39% increase from the corresponding period in 1995. The revenue growth was due to a full quarter of shipments of the Company's ET6000 graphics chip, which offset anticipated lower demand for the Company's older second generation accelerator products. The Company began volume shipments of the ET6000 late in the second quarter of 1996. Higher shipments of the ET6000 during the September quarter contributed to an 83% increase in revenues from the immediately preceding 1996

quarter. While sales in the current quarter increased over both prior year and prior quarter levels, the ET6000-based solutions are high performance solutions competing in a mature and price competitive 2D graphics market. The Company anticipates that there will be continued pressure to further reduce prices for 2D graphics products and solutions. The Company has implemented a program to reduce the total cost of ET6000 based solutions but does not expect to realize the full benefit of this effort in the fourth quarter of 1996. Accordingly, it is likely that fourth quarter 1996 revenues and operating margins will be below third quarter 1996 levels. In addition, because of the competitive nature of the 2D graphics market, there can be no assurance that the Company will achieve the necessary long-term price reductions to maintain and/or increase unit shipments of the ET6000. It should be recognized that the Company has focused considerable resources on developing product for the emerging 3D graphics and multimedia markets.

Revenues for the nine months ended September 30, 1996 were \$23,211,000, a 22% reduction from the corresponding period in 1995. The decrease was due to a product transition during which sales of ET6000-based products were not sufficient to offset anticipated lower sales and selling prices for the Company's second generation accelerator products.

Sales to two customers represented approximately 46% and 43% of the Company's revenues in the three-and nine-month periods ended September 30, 1996. Sales to two customers represented approximately 53% and 30% of the Company's revenues in the corresponding periods in 1995.

Cost of sales as a percentage of revenues was 78% and 79% in the three-month periods ended September 30, 1996 and 1995, and 82% and 75% in the nine-month periods ended September 30, 1996 and 1995, respectively. While margins in the three-month periods ended September 30, 1996 and 1995 remained relatively constant, the product mix changed substantially, with margins on ET6000 products in the 1996 quarter replacing margins generated by the Company's second generation accelerator products during the corresponding period in 1995. The increase in costs as a percentage of revenue in the nine-month period ended September 30, 1996, when compared to the corresponding period in 1995, is due to lower margins on older products which represented a significant percentage of total sales in the first half of 1996 and a \$600,000 write-down on older technology based inventory recorded in the first quarter of 1996. As discussed above, the Company expects pricing pressures to intensify in the 2D graphics market.

Research and development expense increased by 125% and 92% in both the three-and nine-month periods ended September 30, 1996 when compared to the corresponding periods in 1995. This increase is due primarily to increased personnel to support the development of the ET6000 family of 2D and 3D graphics accelerators, the cost of licensing certain technologies included in the Company's products, and the pursuit of new opportunities to expand the Company's line of products addressing multimedia and communications applications. The Company currently expects that its research and development expenditures will continue to increase as the Company continues to attempt to respond to both shorter life cycles in the graphics and PC market as a whole and develop new technologies to address multimedia and communications applications.

Operating expenses decreased to 15% of revenues in the three-month period ended September 30, 1996 from 17% in the corresponding prior year period. The decrease is due to the higher revenue levels between periods and the fixed nature of certain of the Company's operating expenses. Operating expenses increased to 23% of revenues in the nine-month period ended September 30, 1996 from 16% in the

corresponding period in 1995. The increase is due to lower revenue levels between periods, increased investments in personnel to enhance the Company's operations, marketing and sales efforts, and the fixed nature of certain of the Company's operating expenses.



The Company's effective income tax rate was a benefit of 36% and 35% in the three- and nine-month periods ended September 30, 1996 compared to an expense of 23% and 33% in the corresponding periods of 1996. The primary reason for the change is the difference in pretax income levels between periods.

Inflation is not expected to have a significant adverse impact on the Company's operations.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company's ability to generate cash adequate to meet its requirements results primarily from operating cash flow and the availability of bank borrowing. The Company believes that these sources are sufficient to fund the Company's short-term working capital requirements. Total working capital was \$35,693,000 and \$46,352,000 at September 30, 1996 and December 31, 1995, respectively. The decrease in working capital was caused primarily by the Company's investment in facilities, equipment and tools to enhance its advanced research and product development facilities, systems and functions and its secured advance to the entity that designs, manufactures and markets specialty graphics memory. The Company also has a bank line of credit providing total availability of \$2,500,000. There were no borrowings under this line during the three months ended September 30, 1996.

#### PART II. OTHER INFORMATION

##### Item 6. Exhibits and Reports on Report 8-K

(a) The following is a list of exhibits filed as part of the Form 10-Q:

None

(b) Reports on Form 8-K

There were no reports on Form 8-K filed for the three months ended September 30, 1996.

#### 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.

TSENG LABS, INC.

Dated: November 14, 1996

By: /s/JACK TSENG

-----  
Jack H-N Tseng  
Chairman, President and CEO

Dated: November 14, 1996

By: /s/JOHN A. VIGNA

-----

John A. Vigna  
Executive Vice President  
Chief Operating Officer

Dated: November 14, 1996

By: /s/MARK H. KARSCH

-----  
Mark H. Karsch  
Senior Vice President  
Chief Financial Officer

Dated: November 14, 1996

By: /s/BARBARA J. HAWKINS

-----  
Barbara J. Hawkins  
Vice President  
Chief Administrative Officer

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.

TSENG LABS, INC.

Dated: November 14, 1996

By:

-----  
Jack H-N Tseng  
Chairman, President and CEO

Dated: November 14, 1996

By:

-----  
John A. Vigna  
Executive Vice President  
Chief Operating Officer

Dated: November 14, 1996

By:

-----  
Mark H. Karsch  
Senior Vice President  
Chief Financial Officer

Dated: November 14, 1996

By:

-----  
Barbara J. Hawkins  
Vice President  
Chief Administrative Officer

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<FISCAL-YEAR-END>	DEC-31-1996
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