FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**
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FILER

EXECUTONE INFORMATION SYSTEMS INC

CIK:**725282**| IRS No.: **860449210** | State of Incorp.:**VA** | Fiscal Year End: **1231**
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SIC: **7385** Telephone interconnect systems

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2036556500

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 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 No. 0-11551

EXECUTONE Information Systems, Inc.
(Exact name of registrant as specified in its charter)

Virginia	86-0449210
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6 Thorndal Circle, Darien, Connecticut	06820
(Address of principal executive offices)	(Zip Code)

(203) 655-6500
(Registrant's telephone number, including area code)

N/A
(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 X No

The number of shares outstanding of registrant's Common Stock, $.01 par value per share, as of April 29, 1994 was 43,958,846.

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EXECUTONE Information Systems, Inc.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

EXECUTONE INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except for share amounts)

	March 31, 1994 (Unaudited)	December 31, 1993 (Restated)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,522	$ 7,406
Accounts receivable, net of allowance of $882 and $1,017	36,636	37,567
Inventories	29,404	29,092
Prepaid expenses and other current assets	6,877	5,789
Net assets of discontinued operation	9,667	8,538
Total Current Assets	90,106	88,392
PROPERTY AND EQUIPMENT, net	15,028	14,727
INTANGIBLE ASSETS, net	43,627	44,215
DEFERRED TAXES	24,738	25,200
OTHER ASSETS	5,588	2,623
NET ASSETS OF DISCONTINUED OPERATION	---	397
	$ 179,087	$ 175,554
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 2,854	$ 2,989
Accounts payable	27,732	29,295
Accrued payroll and related costs	8,412	7,750
Accrued liabilities	7,085	7,057
Accrued restructuring costs	1,259	1,381

Deferred revenue and customer deposits	18,548	17,713
Total Current Liabilities	65,890	66,185
LONG-TERM DEBT	33,601	32,279
LONG-TERM DEFERRED REVENUE	1,513	1,345
TOTAL LIABILITIES	101,004	99,809
STOCKHOLDERS' EQUITY:		
Common stock: $.01 par value; 60,000,000 shares authorized; 43,876,915 and 41,205,498 issued and outstanding	439	412
Additional paid-in capital	69,745	68,275
Retained earnings	7,899	7,058
Total Stockholders' Equity	78,083	75,745
	$ 179,087	$ 175,554

The accompanying notes are an integral part of these consolidated balance sheets.

EXECUTONE INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except for per share amounts)

	3 Months Ended March 31, 1994	1993 (Restated)
REVENUES:		
Product	$ 29,086	$ 30,593
Base	36,221	32,471
	65,307	63,064
COST OF REVENUES	39,386	37,966
Gross Profit	25,921	25,098
OPERATING EXPENSES:		
Research, development & engineering	2,162	1,809
Selling, general & administrative	22,452	20,371
	24,614	22,180
OPERATING INCOME	1,307	2,918
INTEREST, AMORTIZATION AND OTHER EXPENSES, NET:		
Cash	422	794
Noncash	742	715
	1,164	1,509
INCOME BEFORE INCOME TAXES FROM CONTINUING OPERATIONS	143	1,409

PROVISION FOR INCOME TAXES:		
Cash	100	83
Noncash (utilization of pre-acquisition tax benefits - refer to Note E)	(43)	480
TOTAL PROVISION FOR INCOME TAXES	57	563
INCOME FROM CONTINUING OPERATIONS	86	846
INCOME (LOSS) FROM DISCONTINUED OPERATIONS [NET OF INCOME TAXES OF $102 AND $(82)]	153	(123)
GAIN ON DISPOSAL OF DISCONTINUED OPERATIONS (NET OF INCOME TAXES OF $403)	604	---
NET INCOME	$ 843	$ 723
EARNINGS PER SHARE:		
INCOME FROM CONTINUING OPERATIONS	$ ---	$ 0.02
INCOME FROM DISCONTINUED OPERATIONS	0.02	---
NET INCOME	$ 0.02	$ 0.02
WEIGHTED AVG. COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	47,898	47,713

The accompanying notes are an integral part of these consolidated statements.

EXECUTONE INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Three Months Ended March 31, 1994	1993 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Income from continuing operations	$ 86	$ 846
Adjustments to reconcile net income to net cash provided by continuing operations:		
Depreciation and amortization	1,938	2,035
Noncash expenses, including noncash interest expense, provision for income taxes not currently payable and provision for losses on accounts receivable	383	658
	2,407	3,539

Net change in working capital items	(1,154)	845
NET CASH PROVIDED BY CONTINUING OPERATIONS	1,253	4,384
Cash Flows from Discontinued Operations	(551)	(958)
NET CASH PROVIDED BY OPERATING ACTIVITIES	702	3,426
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(850)	(509)
Other	(1,719)	(28)
NET CASH USED BY INVESTING ACTIVITIES	(2,569)	(537)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restructuring cost payments	(122)	(73)
Borrowings (repayments) under revolving credit facility	2,587	(2,364)
Repayment of term note under credit facility	(312)	(312)
Repayments of other long-term debt	(417)	(378)
Repurchase of stock	(750)	---
Proceeds from issuances of stock	997	268
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	1,983	(2,859)
INCREASE IN CASH AND CASH EQUIVALENTS	116	30
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	7,406	7,404
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 7,522	$ 7,434

The accompanying notes are an integral part of these consolidated statements.

EXECUTONE INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE A - NATURE OF THE BUSINESS

EXECUTONE Information Systems, Inc. (the "Company") designs, manufactures, markets, installs, supports and services voice processing systems and provides cost-effective long-distance telephone service. The Company is also a leading supplier of specialized hospital communications equipment. Products are sold under the EXECUTONE, INFOSTAR, IDS, LIFESAVER and INFOSTAR/ILS brand names through a worldwide network of direct sales and service offices and independent distributors.

NOTE B - BASIS OF PRESENTATION

The accompanying unaudited consolidated 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 Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments, which include normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented have been included.

As of July 1, 1988, an accumulated deficit of approximately $49.7 million was eliminated.

NOTE C - SALE OF VODAVI COMMUNICATIONS SYSTEMS DIVISION

As of March 31, 1994 the Company sold its Vodavi Communications Systems Division (VCS), which sold telephone equipment to supply houses and dealers under the brand names STARPLUS and INFINITE, for approximately $10.9 million. Proceeds of the sale consisted of approximately $9.7 million in cash and a $1.2 million note, fully secured by a letter of credit and payable in September 1995. The proceeds were received on April 11, 1994 and were used to reduce borrowings under the Company's credit facility. As of March 31, 1994, the cash portion of the proceeds is reflected in the Consolidated Balance Sheet as Net assets of Discontinued Operation and the note portion of the receivable is included in other assets. The application of these proceeds as of March 31, 1994 would have reduced long-term debt to $23.8 million.

The sale resulted in an after-tax gain of $604,000 (net of income tax provision of $403,000). The results of VCS have been reported separately as a discontinued operation in the Consolidated Statement of Operations. Prior year consolidated financial statements have been restated to present VCS as a discontinued operation. Net revenues of the discontinued operation for the three-month periods ended March 31, 1994 and 1993 were $8.6 million and $7.3 million, respectively.

NOTE D - INCOME TAXES

The Company accounts for income taxes in accordance with FAS 109, Accounting for Income Taxes. The deferred tax asset represents the benefits that are more likely than not to be realized from the utilization of pre and post-acquisition tax benefit carryforwards, which include net operating losses, tax credits and the excess of tax bases over the fair value of the net assets at acquisition.

For the three-month periods ended March 31, 1994 and 1993, the Company made cash payments for income taxes of approximately $50,000 and $6,000, respectively.

NOTE E - EARNINGS PER SHARE

Earnings per share is based on the weighted average number of shares of common stock, convertible preferred stock (which was entirely converted in 1993) and dilutive common stock equivalents (which include stock options and warrants) outstanding during the periods. Common stock equivalents and the convertible debentures which are antidilutive have been excluded from the computations.

NOTE F - INVENTORIES

Inventories are stated at lower of first-in, first-out ("FIFO") cost or market and consist of the following at March 31, 1994 and December 31, 1993 (amounts in thousands):

	3/31/94	12/31/93
Raw Materials	$ 3,120	$ 3,363
Finished Goods	26,284	25,729
	$29,404	$29,092

NOTE G - OTHER MATTERS

For the three-month periods ended March 31, 1994 and 1993, the Company made cash payments of approximately $1.1 million and $1.6 million, respectively, for interest expense on indebtedness.

During the three-month periods ended March 31, 1994 and 1993, noncash financing activities other than those related to the sale of VCS (See Note C) included capital lease obligations incurred in connection with equipment acquisitions of $256,000 and $99,000, respectively, noncash proceeds for issuances of stock from application of credits under an option credit plan of $155,000 and $170,000, respectively, and Common Stock Purchase Warrants exercised thru bond conversion of $1.0 million and $104,000, respectively.

In December 1993, there was a fire at the Company's main subcontractor's production facility in China. As a result, additional costs were incurred to manufacture product at Company facilities and alternative manufacturing subcontractors. The Company believes it will be reimbursed by its insurance carrier for these costs and, accordingly, has established a receivable of $1.8 million for amounts incurred through March 31, 1994.

Refer to the consolidated statements of cash flows for information on all cash-related operating, investing and financing activities.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The Company's revenues are primarily derived from sales of its products and services through a worldwide network of Company-owned direct sales and service offices and independent distributors. The Company's end-user revenues are derived from two primary sources: (1) sales of systems to new customers, which include sales of application-specific software options ("product revenues"), and (2) servicing the end-user base through the upgrade, expansion, enhancement (which includes sales of application-specific software options) and maintenance of previously installed systems, as well as revenues from the INFOSTAR/LD+ program (commonly referred to as "base revenues"). Base revenues usually generate higher operating income margin than initial sales of systems, since the Company's selling expenses for base revenues are lower than those for initial system sales. Sales of the Company's application-specific software options and related services generally produce higher operating income margin than both system sales and base revenues due to the added performance value and relatively low production costs of such proprietary software and services.

Results of Operations

Total revenues for the three-month period ended March 31, 1994 were 4% higher than the comparable 1993 period. Product revenues for the three-month period ended March 31, 1994 decreased slightly from the corresponding 1993 period due, primarily, to inventory shortages caused by a fire which occurred at the Company's main subcontractor's production facility in China in December 1993 (see page 10). Base revenues for the three-month period ended March 31, 1994 were 12% higher than the comparable 1993 period. The increase in base revenues was primarily attributable to continuing growth in sales to the Company's existing customer base, including increased sales of systems upgrades, expansions and maintenance as well as volume increases generated by the LD+ program.

For the three-month period ended March 31, 1994, gross profit as a percentage of total revenues was 39.7% a minimal change from 39.8% for the comparable 1993 period. While bookings of newer, higher margin products continue to grow, they have not yet significantly increased gross margin due to the costs of entering new markets, the minimal relative revenue generated by these new products and increased backlog resulting from inventory shortages.

Operating income as a percentage of total revenues for the three-month period ended March 31, 1994 was 2.0% as compared to 4.6% for the corresponding 1993 period due to higher operating expenses. Research, development and engineering expenses continue to reflect increased investments in engineering for the development of new higher margin products. SG&A expenditures increased primarily due to the investment of resources necessary to service the Company's expanding customer base and new product lines and higher sales volume.

Interest, amortization and other expenses, net for the three-month period ended March 31, 1994 was lower than the corresponding 1993 period due, primarily, to lower interest expense for the Company's credit facility resulting from lower borrowing levels and an interest rate reduction on the Company's bank borrowings.

For the three-month period ended March 31, 1994 the Company recorded a provision for income taxes of $57,000 for continuing operations, $102,000 for discontinued operations and $403,000 for the gain on the sale of its VCS division. Of the total provision, $462,000 was recorded as a reduction of the deferred tax asset to reflect the utilization of pre-acquisition tax benefits. As a result of the utilization of these benefits, the Company does not have a significant tax liability for the period. The Company has substantial tax benefit carryforwards which means that minimal taxes will be paid in the near future.

In December 1993, a fire occurred at the Company's main subcontractor's production facility in Shinzen, China, causing inventory shortages. The Company attempted to alleviate production restrictions and product shortages caused by the fire through existing inventory, equivalent equipment substitution, purchases from other subcontractors and/or production at the Company's own facilities, but was unable to ship approximately $3 million of orders during the quarter. A new facility has since been built and is expected to reach full capacity by June 30, 1994. The Company estimates that by June 30, 1994, it will have incurred approximately $3 million in additional direct costs related to the emergency production, of which $1.8 million has been incurred as of March 31, 1994. The Company believes these additional costs will be recovered from insurance and, accordingly, has established a receivable for amounts incurred through March 31, 1994.

If all of the product that was ordered had been available for shipment, the Company estimates that its revenues would have been $68.3 million and that net income would have increased by approximately $900,000 to $1.7 million or $0.04 per share.

As of March 31, 1994 the Company sold its Vodavi Communications Systems Division (VCS), which sold telephone equipment to supply houses and dealers under the brand names STARPLUS and INFINITE, for approximately $10.9 million. Proceeds of the sale consisted of approximately $9.7 million in cash and a $1.2 million note, fully secured by a letter of credit and payable in September 1995. The proceeds were received on April 11, 1994 and were used to reduce borrowings under the Company's credit facility. As of March 31, 1994, the cash portion of the proceeds is reflected in the Consolidated Balance Sheet as Net assets of Discontinued Operation and the note portion of the receivable is included in other assets. The application of these proceeds as of March 31, 1994 would have reduced long-term debt to $23.8 million.

The sale of VCS resulted in an after-tax gain of $604,000 (net of income tax provision of $403,000). The results of VCS have been reported separately as a discontinued operation in the Consolidated Statement of Operations. Prior year consolidated financial statements have been restated to present VCS as a discontinued operation. Net revenues of the discontinued operation for the three-month periods ended March 31, 1994 and 1993 were $8.6 million and $7.3 million, respectively.

Liquidity and Capital Resources

The Company's liquidity is represented by cash, cash equivalents and cash availability under its existing credit facilities. The Company's liquidity was approximately $26 million and $29 million as of March 31, 1994 and December 31, 1993, respectively.

At March 31, 1994 and December 31, 1993, cash and cash equivalents amounted to $7.5 million and $7.4 million, respectively, which represented 8% of current assets. The Company generated $1.3 million in cash from continuing operations, after funding approximately $3.0 million in costs relating to the emergency production requirements, during the three-month period ended March 31, 1994 as compared to $4.4 million in cash from continuing operations for the corresponding 1993 period. In addition to funding the emergency production costs, the Company also repurchased stock of $0.8 million and purchased equipment of $0.9 million.

Total debt at March 31, 1994 was $36.5 million, an increase of $1.2 million from $35.3 million at December 31, 1993. The increase in debt is primarily due to increased borrowing levels under the revolving credit facility of $2.6 million and capital lease agreements for equipment purchases of $0.3 million. This was partially offset by common stock purchase warrants exercised through bond conversions of $1.0 million and repayments of other long-term debt of $0.7 million.

On April 11, 1994, the Company received the cash proceeds from the sale of the VCS division of $9.7 million, of which $2.2 million was used to reduce the Company's term loan and $7.5 million was used to reduce the Company's revolving credit facility.

As of April 29, 1994, approximately $16.4 million of direct borrowings was available under the Company's credit facility. The Company believes that borrowings available under the credit facility and cash flow from operations will be sufficient to meet working capital and other requirements for the next twelve months.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Not applicable.

Item 2. CHANGES IN SECURITIES

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

Not applicable.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits

11 - Statement Regarding Computation of Per Share Earnings

b) Reports on Form 8-K

Not applicable.

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.

EXECUTONE Information Systems, Inc.

Dated: May 12, 1994

/s/ Alan Kessman
Alan Kessman
Chairman, President and
Chief Executive Officer

Dated: May 12, 1994

/s/ Anthony R. Guarascio
Anthony R. Guarascio
Vice President Finance and
Chief Financial Officer

EXHIBIT 11

EXECUTONE INFORMATION SYSTEMS, INC. AND SUBSIDIARIES
STATEMENT REGARDING COMPUTATION OF PER SHARE EARNINGS

	3 Months Ended March 31, 1994	1993 (Restated)
INCOME FROM CONTINUING OPERATIONS	$ 86,000	$ 845,000
DISCONTINUED OPERATIONS:		
INCOME (LOSS) FROM OPERATIONS, NET OF INCOME TAXES	153,000	(122,000)
GAIN ON DISPOSAL, NET OF INCOME TAXES	604,000	---
NET INCOME	$ 843,000	$ 723,000
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	42,724,000	31,323,000
COMMON STOCK EQUIVALENTS:		
Add - Net shares assumed to be issued for dilutive stock options and warrants	3,638,000	4,114,000
Add - Shares assumed to be issued on conversion of preferred stock (converted entirely in 1993) and exercise of related warrants	1,536,000	12,276,000
TOTAL WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	47,898,000	47,713,000
EARNINGS PER COMMON SHARE:		
Income From Continuing Operations	$ ---	$ 0.02
Income From Discontinued Operations	0.02	---

Net Income	$ 0.02	$ 0.02