

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

AFFINITY TECHNOLOGY GROUP INC

CIK: **1007508** | IRS No.: **570991269** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-28152** | Film No.: **96665407**
SIC: **7373** Computer integrated systems design

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P O BOX 7907
COLUMBIA SC 29202

Business Address
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STE 101
COLUMBIA SC 29201
8032549006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended September 30, 1996

Commission file number: 0-28152

Affinity Technology Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

57-0991269

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

Affinity Technology Group, Inc.

1201 Main Street, 20th Floor
Columbia, SC 29201

(Address of principal executive offices)
(Zip code)

(803) 758-2511

(Registrant's telephone number, including area code)

1333 Main Street, Suite 101

Columbia, SC 29201-3201

(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 _____

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

27,859,408 shares of Common Stock, \$.0001 par value, as of November 10, 1996.

AFFINITY TECHNOLOGY GROUP, INC. AND SUBSIDIARIES

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Part I. Financial Information

Item 1. Financial Statements.

<TABLE>

AFFINITY TECHNOLOGY GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

<CAPTION>

| | September 30, 1996 ----- (Unaudited) | December 31, 1995 ----- (1) |
|---|---|--------------------------------------|
| | <C> | <C> |
| <S> | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents..... | \$39,045,374 | \$ 1,235,983 |
| Investments..... | 9,081,298 | - |
| Accounts receivable, net..... | 1,239,446 | 143,295 |
| Net investment in sales-type leases -- current..... | 1,296,001 | 297,576 |
| Inventories..... | 3,195,645 | 366,610 |
| Other current assets..... | 446,430 | 29,534 |
| | ----- | ----- |
| Total current assets..... | 54,304,194 | 2,072,998 |
| Net investment in sales-type leases -- non-current..... | 1,900,827 | 860,295 |
| Property and equipment, net..... | 4,037,557 | 1,446,675 |
| Software development costs | 298,772 | 203,048 |
| Other assets..... | 468,144 | 8,152 |
| | ----- | ----- |
| | \$61,009,494 | \$ 4,591,168 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of notes payable and capital lease obligations..... | \$ 96,595 | \$ 247,419 |
| Accounts payable and accrued expenses..... | 2,511,149 | 1,192,862 |
| Current portion of deferred revenue..... | 488,939 | 1,767,182 |
| | ----- | ----- |
| Total current liabilities..... | 3,096,683 | 3,207,463 |
| Notes payable and capital lease obligations, less current portion.... | 149,425 | 370,518 |
| Deferred revenue..... | 451,422 | 258,275 |
| Capital stock of subsidiary held by minority investor..... | 200,000 | 137,500 |
| Stockholders' equity: | | |
| Preferred stock, common stock and additional paid-in capital | 68,758,258 | 7,221,986 |
| Deferred compensation..... | (4,205,813) | (3,590,574) |
| Accumulated deficit..... | (7,440,481) | (3,014,000) |
| | ----- | ----- |
| Total stockholders' equity..... | 57,111,964 | 617,412 |
| | ----- | ----- |
| | \$61,009,494 | \$ 4,591,168 |
| | ===== | ===== |

<FN>

(1) The balance sheet at December 31, 1995 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See accompanying notes.

</FN>

</TABLE>

AFFINITY TECHNOLOGY GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

<TABLE>
<CAPTION>

| | Three Months | | Nine Months | |
|---|---------------------|--------------|---------------------|--------------|
| | Ended September 30, | | Ended September 30, | |
| | 1996 | 1995 | 1996 | 1995 |
| | ---- | ---- | ---- | ---- |
| <S> | <C> | <C> | <C> | <C> |
| Revenues: | | | | |
| Initial set-up, transactions and other..... | \$ 116,364 | \$ 7,686 | \$ 542,656 | \$ 16,722 |
| Sales and rental..... | 199,321 | 25,900 | 2,311,342 | 511,264 |
| License revenue..... | - | - | 1,800,000 | - |
| | ----- | ----- | ----- | ----- |
| Total revenues..... | 315,685 | 33,586 | 4,653,998 | 527,986 |
| Costs and expenses: | | | | |
| Cost of revenues..... | 212,620 | 16,500 | 2,725,427 | 209,662 |
| Research and development..... | 738,296 | 29,801 | 1,735,409 | 83,737 |
| Selling, general and administrative expenses. | 3,451,979 | 375,713 | 5,968,165 | 779,919 |
| | ----- | ----- | ----- | ----- |
| Total costs and expenses..... | 4,402,895 | 422,014 | 10,429,001 | 1,073,318 |
| Operating loss..... | (4,087,210) | (388,428) | (5,775,003) | (545,332) |
| Interest income (expense), net..... | 825,493 | (15,793) | 1,348,522 | (52,407) |
| | ----- | ----- | ----- | ----- |
| Net loss..... | \$ (3,261,717) | \$ (404,221) | \$ (4,426,481) | \$ (597,739) |
| | ===== | ===== | ===== | ===== |
| Net loss per share..... | \$ (0.12) | \$ (0.03) | \$ (0.19) | \$ (0.04) |
| | ===== | ===== | ===== | ===== |
| Weighted average shares outstanding..... | 27,786,723 | 15,430,971 | 22,908,466 | 14,968,500 |

<FN>

See accompanying notes.

</FN>
</TABLE>

<TABLE>

AFFINITY TECHNOLOGY GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Nine Months | |
|---|---------------------|--------------|
| | Ended September 30, | |
| | 1996 | 1995 |
| | ---- | ---- |
| <S> | <C> | <C> |
| Operating activities | | |
| Operating activities | | |
| Net loss..... | \$ (4,426,481) | \$ (597,739) |
| Adjustments to reconcile net loss to net cash used in operating | | |

| | | |
|--|--------------|-------------|
| activities: | | |
| Depreciation and amortization..... | 442,046 | 110,866 |
| Amortization of deferred compensation..... | 761,720 | - |
| Deferred revenue..... | (1,085,096) | 1,513,032 |
| Changes in assets and liabilities: | | |
| Accounts receivable..... | (1,003,082) | (158,602) |
| Net investment in sales-type leases..... | (2,038,956) | (504,000) |
| Inventories..... | (2,829,035) | (466,025) |
| Other assets..... | (569,927) | (35,735) |
| Accounts payable and accrued expenses..... | 1,264,730 | 606,486 |
| | ----- | ----- |
| Net cash (used in) provided by operating activities..... | (9,484,081) | 468,283 |
| Investing activities | | |
| Purchases of property and equipment..... | (2,972,149) | (876,555) |
| Software development costs..... | (143,316) | (172,618) |
| Purchases of investments, net..... | (9,081,298) | - |
| Purchase of other assets..... | (349,618) | - |
| | ----- | ----- |
| Net cash used in investing activities..... | (12,546,381) | (1,049,173) |
| Financing activities | | |
| Proceeds from notes payable..... | 1,450,000 | 1,019,416 |
| Payments on notes payable and capital leases..... | (1,831,958) | (143,299) |
| Proceeds from IPO, net..... | 60,091,805 | - |
| Exercise of stock warrants..... | 45,417 | - |
| Exercise of stock options..... | 22,090 | - |
| Increase in minority interest..... | 62,500 | 75,000 |
| | ----- | ----- |
| Net cash provided by financing activities..... | 59,839,854 | 951,117 |
| | ----- | ----- |
| Net increase in cash..... | 37,809,392 | 370,227 |
| Cash and cash equivalents at beginning of period..... | 1,235,983 | 29,985 |
| | ----- | ----- |
| Cash and cash equivalents at end of period..... | \$39,045,375 | \$ 400,212 |
| | ===== | ===== |

<FN>

See accompanying notes.

</FN>

</TABLE>

AFFINITY TECHNOLOGY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 1996

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) which, in the opinion of management, are necessary for a fair presentation of the results for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of Affinity Technology Group, Inc. for the year ended December 31, 1995.

2. Inventories

Inventories consist of the following:

| | September 30, 1996 | December 31, 1995 |
|--|-----------------------|----------------------|
| Electronic parts and other components..... | \$1,809,063 | \$ 182,680 |
| Work in progress..... | 742,767 | 229,930 |
| Finished goods..... | 643,815 | - |
| | ----- | ----- |
| | 3,195,645 | 412,610 |
| Inventory valuation reserve..... | - | (46,000) |
| | ----- | ----- |

\$3,195,645
=====

\$ 366,610
=====

Inventories in the amount of \$46,000, for which a reserve was recorded as of December 31, 1995, were charged against the reserve during the quarter ended June 30, 1996.

3. License Revenue

Deferred license revenue at December 31, 1995 related to a non-exclusive, perpetual, royalty-free license, granted to a financial institution, to use one of the Company's software products, Assets3. At December 31, 1995, the financial institution had paid the Company \$1,237,500 as a license fee for use of an initial version of Assets3 in the United States, which fee was deferred at December 31, 1995 pending delivery of the product. The Company delivered the product to the financial institution in the quarter ended March 31, 1996, and accordingly recognized the deferred revenue during such quarter. In addition, such financial institution has exercised its option to purchase for \$562,500 a perpetual, royalty-free license to use Assets3 in North America, which option became exercisable upon the Company's enhancement of such system. The Company delivered such enhancement during the quarter ended June 30, 1996 and recorded such additional license fee as revenue during such quarter.

4. Net Loss Per Share of Common Stock

Net loss per share of Common Stock amounts presented on the face of the condensed consolidated statements of operations have been computed based on the weighted average number of shares of Common Stock outstanding in accordance with Accounting Principles Board No. 15 ("APB No. 15"). Under this guidance, options, warrants, convertible preferred stock and other potentially dilutive securities are considered as outstanding only if their effect is dilutive (i.e. increasing the net loss per share).

For periods presented prior to the Company's initial public offering on May 1, 1996 and which were presented in the Company's Registration Statement on Form S-1 filed in connection with the Company's initial public offering of Common Stock and the Company's Form 10-Q for the quarter ended March 31, 1996, net income (loss) per share amounts were presented in accordance with APB No. 15 as modified by Staff Accounting Bulletin No. 83 ("SAB 83") of the Securities and Exchange Commission. Under SAB 83, all issuances of the Company's Common Stock options, warrants, convertible preferred stock and other potentially dilutive securities, at prices below the initial public offering price during the twelve month period preceding the offering, were included as Common Stock equivalents as if they had been issued at the Company's inception, regardless of whether the effect was dilutive or anti-dilutive. SAB 83 applies to all periods presented prior to the Company's initial public offering. The net loss per share of Common Stock for the three and nine month periods ended September 30, 1996 and 1995 presented in accordance with APB 15 as modified by SAB 83 is presented supplementary below:

<TABLE>
<CAPTION>

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 1996 | 1995 | 1996 | 1995 |
| | ---- | ---- | ---- | ---- |
| <S> | <C> | <C> | <C> | <C> |
| Net loss per share under APB No. 15 as modified by SAB 83..... | \$ (0.09) | \$ (0.01) | \$ (0.13) | \$ (0.02) |
| Shares used in computing net loss per share under APB No. 15 as modified by SAB 83..... | 35,482,971 | 29,953,618 | 33,258,795 | 29,491,147 |

</TABLE>

5. Purchase of Assets

On May 1, 1996, the Company purchased for \$450,000 certain furniture, fixtures, equipment and computer hardware of Association Membership Services, Inc. d/b/a Electronic Merchant Services ("EMS"), a private company principally engaged in the business of developing and marketing software designed to process credit cards and other transactions. On September 26, 1996, the Company purchased substantially all of the remaining net assets of EMS, consisting primarily of software and certain intellectual property and contract rights, for a purchase price to be calculated based on the revenues generated by such assets during the three year period following the transaction. Under the terms of the agreement governing such transaction, the Company paid to EMS the sum of \$375,000 which amount is refundable to the Company in certain instances. Due to the current financial condition of EMS, the Company does not anticipate that EMS will be able to refund any portion of the \$375,000 that subsequently may become payable by EMS to the Company under the terms of the agreement.

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

Overview

The Company was formed in January 1994 to develop and market technologies that enable financial institutions and other businesses to provide consumer financial services electronically with reduced or no human intervention.

To date, the Company has generated minimal operating revenues, has incurred significant losses and has experienced substantial negative cash flow from operations. The Company had an accumulated deficit as of September 30, 1996 of \$7,440,481 with operating losses of \$3,261,717 and \$4,426,481 for the three and nine months ended September 30, 1996, respectively.

Results of Operations

Revenues

The Company's revenues for the three and nine months ended September 30, 1996 were \$315,685 and \$4,653,998, respectively, compared to \$33,586 and \$527,986, respectively, for the corresponding periods of 1995. To date, the Company's revenues have been tied primarily to the installation of ALMs under new contracts. Revenues for the three month period ended September 30, 1996 decreased significantly as compared to the first two quarters of 1996 due to the lower number of ALM installations during such quarter.

Initial Set-up, Transactions, and Other. Revenues from initial set-up, transactions and other amounted to \$116,364 and \$542,656 for the three and nine months ended September 30, 1996, respectively, compared to \$7,686 and \$16,722 for the corresponding periods in 1995. The increases during 1996 reflect volume increases as significantly more ALMs were installed during the first nine months of 1996 compared to the corresponding period in 1995.

Sales and Rental. Sales and rental revenues were \$199,321 and \$2,311,342 for the three and nine months ended September 30, 1996, respectively, compared to \$25,900 and \$511,264 for the corresponding periods in 1995. The increases are due to an increase in the number of ALMs installed during 1996 as compared to 1995.

License Revenue. License revenue amounted to \$1,800,000 during the nine months ended September 30, 1996. This item related to a non-exclusive, perpetual, royalty-free license granted to a financial institution to use Assets3. The financial institution paid the Company \$1,237,500 in 1995 as a license fee for use of an initial version of Assets3 in the United States, which fee was deferred at December 31, 1995 and recognized as revenue in the quarter ended March 31, 1996 upon delivery of the product. In addition, such financial institution has exercised its option to purchase for \$562,500 a perpetual, royalty-free license to use Assets3 in North America upon the Company's enhancement of such system. The Company delivered such enhancement during the quarter ended June 30, 1996 and recorded such additional license fee as revenue during such quarter.

Costs and Expenses

Cost of Revenues. Cost of revenues for the three and nine months ended September 30, 1996 totaled \$212,620 and \$2,725,427, respectively, compared to \$16,500 and \$209,662 for the corresponding periods in 1995. The increase is primarily due to an increase in the number of ALMs installed during 1996 and costs associated with system enhancements provided to existing customers.

Research and Development. Research and development costs totaled \$738,296 and \$1,735,409 for the three and nine months ended September 30, 1996, respectively, compared to \$29,801 and \$83,737 for the corresponding periods in 1995. Cost increases in this area are primarily attributable to increased staffing deployed in the development of new products. The Company's major research and development activities during the three and nine month periods ended September 30, 1996 are related to the development of the Company's "Second Look" program, auto loan and mortgage loan products and credit card and deposit account services. The Company anticipates that it will continue to commit substantial resources to research and development activities for the foreseeable future.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses totaled \$3,451,979 and \$5,968,165 for the three and nine months ended September 30, 1996, respectively, compared to \$375,713 and \$779,919 for the corresponding periods in 1995. These increases are primarily due to additional salaries and wages expense resulting from increased levels of staffing to prepare for volume increases as well as the amortization of deferred compensation expense resulting from stock options granted in 1995 and 1996.

Interest Income/Expense. Interest income was \$836,413 and \$1,404,991 for the three and nine months ended September 30, 1996, respectively. No interest income was reported in the corresponding period in 1995. In 1996, the majority of interest income was attributable to interest earned from the investment of the proceeds of the Company's initial public offering as well as interest income relating to ALMs under capital leases.

Interest expense for the three and nine months ended September 30, 1996 was \$10,920 and \$56,469, respectively.

Liquidity and Capital Resources

The Company has generated operating losses of \$7,440,781 since its inception and has financed its operations primarily through the sale of debt and equity securities, capital lease obligations, bank financing and loans from affiliates. The Company has on two occasions financed, and may from time to time in the future finance, its operations through the sale of ALM rental contracts to a commercial factor.

On May 1, 1996, the Company successfully completed its initial public offering of 5,060,000 shares of its Common Stock. The offering yielded net proceeds to the Company of approximately \$60.1 million. The Company used a portion of the proceeds of this offering to repay outstanding bank debt, and expects to use the remaining balance to implement an extensive marketing plan, to fund research and development and capital expenditures and for general corporate purposes, which may include the acquisition of services, products, technologies or companies that complement or otherwise enhance the Company's existing business.

On May 1, 1996, the Company purchased for \$450,000 certain furniture, fixtures, equipment and computer hardware of EMS, a private company principally engaged in the business of developing and marketing software designed to process credit cards and other transactions. On September 26, 1996, the Company purchased substantially all of the remaining net assets of EMS, consisting primarily of software and certain intellectual property and contract rights, for a purchase price to be calculated based on the revenues generated by such assets during the three year period following the transaction. Under the terms of the agreement governing such transaction, the Company paid to EMS the sum of \$375,000 which amount is refundable to the Company in certain instances. Due to the current financial condition of EMS, the Company does not anticipate that EMS will be able to refund any portion of the \$375,000 that subsequently may become payable by EMS to the Company under the terms of the agreement.

Cash used in investing activities of approximately \$12,546,000 during the nine months ended September 30, 1996 related primarily to capital expenditures and the purchase of high grade investment securities. Cash flows from financing activities of approximately \$59,840,000 were primarily attributable to proceeds received from the Company's initial public offering.

The Company believes that the proceeds from the sale of the Common Stock and

available borrowings will be sufficient to meet the Company's anticipated operating and capital expenditure requirements for the foreseeable future, including planned expenditures for the enhancement of the Affinity ALM, the development of Assets3 and general research and development.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

Statements in this report that are not descriptions of historical facts may be forward-looking statements that are subject to risks and uncertainties, including economic, competitive and technological factors affecting the Company's operations, markets, products, services and prices, as well as other specific factors discussed in the Company's filings with the Securities and Exchange Commission, including the factors set forth under the caption "Risk Factors" in the Company's Registration Statement on Form S-1 (File No. 333-1170). These and other factors may cause actual results to differ materially from those anticipated.

Part II. Other Information

Item 1, 2, 3, 4 and 5 are not applicable.

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

(a) Exhibits

Exhibit 27 - Financial Data Schedule

(b) Reports on Form 8-K

No reports on Form 8-K were filed by the Company during the quarter ended September 30, 1996.

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.

Affinity Technology Group, Inc.

By: /s/ Joseph A. Boyle
Joseph A. Boyle
Senior Vice President and Chief Financial Officer

Date: November 14, 1996

EXHIBIT INDEX

| Exhibit Number | Description |
|-------------------|-------------------------|
| 27 | Financial Data Schedule |

<TABLE> <S> <C>

<ARTICLE> 5

| <S> | <C> | <C> |
|------------------------------|-------------|-------------|
| <PERIOD-TYPE> | 3-MOS | 9-MOS |
| <FISCAL-YEAR-END> | DEC-31-1996 | DEC-31-1996 |
| <PERIOD-END> | SEP-30-1996 | SEP-30-1996 |
| <CASH> | 39,045,374 | 39,045,374 |
| <SECURITIES> | 9,081,298 | 9,081,298 |
| <RECEIVABLES> | 4,436,274 | 4,436,274 |
| <ALLOWANCES> | 0 | 0 |
| <INVENTORY> | 3,195,645 | 3,195,645 |
| <CURRENT-ASSETS> | 54,304,194 | 54,304,194 |
| <PP&E> | 4,544,537 | 4,544,537 |
| <DEPRECIATION> | 506,980 | 506,980 |
| <TOTAL-ASSETS> | 61,009,494 | 61,009,494 |
| <CURRENT-LIABILITIES> | 3,096,683 | 3,096,683 |
| <BONDS> | 0 | 0 |
| <PREFERRED-MANDATORY> | 0 | 0 |
| <PREFERRED> | 0 | 0 |
| <COMMON> | 0 | 0 |
| <OTHER-SE> | 57,111,964 | 57,111,964 |
| <TOTAL-LIABILITY-AND-EQUITY> | 61,009,494 | 61,009,494 |
| <SALES> | 0 | 0 |
| <TOTAL-REVENUES> | 315,685 | 4,653,998 |
| <CGS> | 0 | 0 |
| <TOTAL-COSTS> | 4,402,895 | 10,429,001 |
| <OTHER-EXPENSES> | 0 | 0 |
| <LOSS-PROVISION> | 0 | 0 |
| <INTEREST-EXPENSE> | (825,493) | (1,348,522) |
| <INCOME-PRETAX> | (3,261,717) | (4,426,481) |
| <INCOME-TAX> | 0 | 0 |
| <INCOME-CONTINUING> | (3,261,717) | (4,426,481) |
| <DISCONTINUED> | 0 | 0 |
| <EXTRAORDINARY> | 0 | 0 |
| <CHANGES> | 0 | 0 |
| <NET-INCOME> | (3,261,717) | (4,426,481) |
| <EPS-PRIMARY> | (0.12) | (0.19) |
| <EPS-DILUTED> | (0.12) | (0.19) |

</TABLE>