LOTUS PACIFIC INC
Form 10-Q
February 15, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2000

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

Commission File Number: 000-24999

LOTUS PACIFIC, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State of Organization)

52-1947160
(I.R.S. Employer Identification Number)

200 Centennial Avenue, Suite 201, Piscataway, New Jersey 08854
(Address of Principal Executive Offices)

(732) 885-0100
(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 proceeding 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.

(1) Yes X No ____ (2) Yes X No ____

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of December 31, 2000:

Class	Number of Shares
Common Stock Par Value $.001 Per Share	64,133,795

LOTUS PACIFIC, INC.

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LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 2000 (Unaudited)	June 30, 2000 (Audited)
Current Assets:		
Cash..............................	$ 16,959,509	$ 27,942,258
Accounts receivable...............	55,477,961	19,534,974

Accounts receivable from related parties	21,869,996	5,653,533
Inventory........................	20,144,385	13,185,391
Prepaid expenses.................	1,526,545	1,533,045
Other............................	---	89,633
Deferred tax asset...............	1,313,000	---
Total current assets..........	117,291,396	67,938,834
Property and equipment:		
Furniture and office equipment....	3,267,968	2,717,683
Equipment........................	1,854,612	1,175,859
Leasehold improvements...........	446,989	234,086
	5,569,569	4,127,628
Less: accumulated depreciation....	1,833,632	1,317,636
	3,735,937	2,809,992
Other assets:		
Restricted cash..................	---	300,000
Notes receivable.................	8,300,000	11,860,000
Goodwill, net of accumulated amortization of $14,875,186 at December 31, 2000 and $11,091,760 at June 30, 2000....	60,793,323	64,576,749
Investment in unconsolidated subsidiary	3,250,732	4,329,925
Other............................	173,044	745,003
	72,517,099	81,811,677
	$193,544,432	$152,560,503
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit....................	$ 3,000,000	$ 1,278,000
Accounts payable and accrued expenses	27,899,398	19,233,547
Accounts payable to related parties	30,151,704	15,261,506
Notes payable.....................	622,372	1,500,000
Deposits..........................	32,047	---
Income taxes payable..............	3,188,463	2,434,150
Total current liabilities......	64,893,984	39,707,203
Minority interest in subsidiaries....	18,332,440	6,425,633
Commitments		
Stockholders' equity:		
Common stock......................	64,133	64,133
Deferred stock compensation........	(15,291,461)	(16,643,967)
Preferred stock, Series A..........	4	4
Additional paid-in capital.........	201,020,689	191,037,695
Treasury stock....................	(7,057,102)	(7,057,102)
Accumulated deficit...............	(68,418,255)	(60,973,096)
	110,318,008	106,427,667
	$193,544,432	$152,560,503

See Notes to Interim Consolidated Financial Statements

LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2000	1999	2000	1999
Sales	$105,643,919	$19,609,595	$205,550,849	$30,847,338
Cost of sales	93,857,107	14,821,931	175,191,338	23,974,463
Gross profit	11,786,812	4,787,664	30,359,511	6,872,875
Operating expenses:				
Selling, general, and administrative expenses	8,934,780	8,582,549	17,353,728	14,786,874
Research and development	3,935,870	959,010	12,280,835	2,049,610
	12,870,650	9,541,559	29,634,563	16,836,484
Operating income (loss)	(1,083,838)	(4,753,895)	724,948	(9,963,609)
Other income (expense):				
Interest income	425,382	62,138	854,785	128,443
Interest expense	82,819	---	(1,286)	---
Other income	(7,286)	---	3,754	23,680
Minority interest in (income) loss of consolidated subsidiaries	408,015	(172,909)	(553,654)	465,257
Foreign exchange gain	107,782	---	127,993	---
Equity in earnings (loss) of unconsolidated subsidiaries	(1,020,854)	63,130	(1,079,193)	326,048
	(4,142)	(47,641)	(647,601)	943,428
Net income (loss) before income taxes	(1,087,980)	(4,801,536)	77,347	(9,020,181)
Income tax expense	2,879,578	---	7,522,507	---
Net loss	$ (3,967,558)	$(4,801,536)	$ (7,445,160)	$(9,020,181)
Loss per share Basic and diluted	$(0.06)	$(0.07)	$(0.12)	$(0.14)
Weighted average shares	64,133,795	64,544,474	64,133,795	64,544,474

See Notes to Interim Consolidated Financial Statements

LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(Unaudited)

	2000	1999
Cash flows from operating activities:		
Net loss................................	$ (7,445,160)	$ (9,020,181)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in earnings of unconsolidated subsidiaries	1,079,193	(326,048)
Depreciation and amortization...........	4,392,867	5,658,072
Amortization of deferred stock compensation	10,393,017	---
Minority interest in subsidiary.........	(553,654)	(872,923)
Changes in assets and liabilities:		
Increase in accounts receivable.........	(35,942,987)	1,683,219
Increase in accounts receivable from related parties.................	(16,164,463)	---
Increase in inventory..................	(6,958,994)	(328,792)
Decrease in prepaid expenses...........	6,500	---
Decrease (increase) in other current assets	89,633	(1,236,338)
Decrease in restricted cash............	300,000	----
Increase in deposits...................	---	(3,935,931)
Decrease in other assets...............	571,959	120,835
Increase in deferred tax asset..........	(1,313,000)	---
Increase in accounts payable and accrued expenses	8,665,851	3,561,011
Increase in accounts payable to related parties	14,890,198	---
Increase in income taxes payable........	754,313	---
Net cash used in operating activities......	(27,234,727)	4,697,076)
Cash flows from investing activities:		
Purchase of property and equipment.......	(1,441,941)	(459,906)
Purchase of investments	---	(3,466,800)
Proceeds from sale of subsidiary preferred stock	13,257,500	---
Net cash provided by (used in) investing activities	11,815,559	(3,926,706)
Cash flows from financing activities:		
Increase in investment deposits	32,047	---
Decrease in loans receivable............	3,560,000	---
Proceeds from line of credit............	1,722,000	---
Repayments of notes payable.............	(877,628)	---

Net cash provided by financing activities..	4,436,419	---
Net decrease in cash......................	(10,982,749)	(8,623,782)
Cash, beginning of year...................	27,942,258	30,779,486
Cash, end of year.........................	$16,959,509	$22,155,704
Supplemental disclosure of cash flow information:		
Cash paid for interest..................	$ 84,105	$ ---
Cash paid for taxes.....................	$ 9,050,000	$ ---

See Notes to Interim Consolidated Financial Statements

LOTUS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2000
(Unaudited)

NOTE 1 GENERAL

Lotus Pacific, Inc. creates, manages, and operates communications and network technology companies. LPFC and its subsidiaries (the "Company") provide solutions for the communications and network technology markets. The Company is primarily engaged in the development, manufacture, and distribution of products used for broadband Internet access, including "DOCSIS certified" data-over-cable equipment, digital subscriber line ("DSL") access and networking devices.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X relating to interim financial statements. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K of Lotus Pacific, Inc. for the year ended June 30, 2000 ("fiscal 2000").

In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary to present fairly the information set forth in the accompanying condensed consolidated financial statements have been included. The results reported in these condensed consolidated financial statements for the six-month period ended December 31, 2000, should not be regarded as necessarily indicative of results that may be expected for the year ended June 30, 2001 ("fiscal 2001").

The accompanying unaudited condensed consolidated financial statements include the accounts of LPFC and its four majority-owned subsidiaries: Arescom, Inc. (81%), Correlant Communications, Inc. (64.7%), and Lotus World, Inc. (90.5%), and Regent Electronics Corp. (92.3% owned). The minority interests in the subsidiaries are reflected as such on the balance sheet in accordance with generally accepted accounting principles. All intercompany transactions have been eliminated in consolidation.

NOTE 3 INVENTORIES

As of December 31, 2000, inventories consist of the following:

Raw materials	---
Work-in-process	---
Finished goods	$20,144,385

	$20,144,385

The above inventory balances as of December 31, 2000 are net of reserves for potential excess quantities and obsolescence of approximately $3,192,503.

NOTE 4 STOCK BASED COMPENSATION

The Company's subsidiary, Arescom, Inc. (Arescom), granted 550,000 Incentive Stock Options (ISOS) to employees during the six months ended December 31, 2000. Arescom recorded deferred compensation of $1,100,000 and amortized deferred compensation of $99,304. The amortization of deferred compensation for ISOS granted in the prior year is $3,661,686.

The Company's subsidiary, Correlant Communications, Inc. (Correlant), also has an Incentive Stock Option Plan and it has elected to follow APB Opinion 25 "Accounting of Stock Issued to Employees" in accounting for its employee stock options. When calculating the deferred compensation, the options had to be split between Lotus shares and Correlant shares because the Lotus shares granted include a contingent component associated with the grant. The contingent component was that the shares of Lotus stock could be sold when certain financial goals were met. Lotus lifted the restriction during the six months and, accordingly, Correlant amortized all of the deferred compensation from the original grant date. The total amortization amounted to $6.7 million. The amortization expense was charged to research and development, $4.8 million and to general and administrative expense, $1.3 million.

NOTE 5 INCOME TAXES

The Company's December 31, 2000 provision for income taxes differed from the amount computed by applying the statutory U.S. Federal income tax rate to income before income taxes and minority interest as follows:

U.S. Federal income tax provision at Federal statutory rate	$ 30,000
Amortization of goodwill.............	1,325,000
Deferred compensation amortization....	3,661,500
Minority Interest in subsidiaries.....	195,000
Equity in loss of unconsolidated subsidiaries	400,000
State income taxes net of federal income tax effect	1,650,000
Other.................................	261,007

$7,522,507
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NOTE 6 PREFERRED STOCK

During the six months ended December 31, 2000, Arescom sold preferred stock to third parties for net proceeds of $13,257,500.

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

Lotus Pacific, Inc. ("LPFC") creates, manages, and operates communications and network technology companies. LPFC and its subsidiaries (the "Company") provide solutions for the communications and network technology markets. The Company is primarily engaged in the development, manufacture, and distribution of products used for broadband Internet access, including "DOCSIS certified" data-over-cable equipment, digital subscriber line ("DSL") access and networking devices.

RESULTS OF OPERATIONS

REVENUES

For the quarter ended December 31, 2000, the Company's revenue was $105.6 million, compared with $19.6 million for the same period of the previous year. Revenue in the first half of fiscal 2000 was $205.6 million, an increase of 566% over the first two quarters of fiscal 1999. The revenue growth in the three- and six-month periods was primarily due to increases in sales by Correlant Communications, Inc. ("Correlant") and Arescom, Inc. ("Arescom"), which were acquired by LPFC in March 1999. For the three-month period ended December 31, 2000, Regent Electronics Corp. ("Regent") and Lotus World, Inc. ("Lotus World"), two subsidiaries of the Company, had insignificant operating revenues.

COST OF SALES

Cost of sales consisted principally of the cost of components, contracted manufacturing charges, other materials, in certain case labor related to testing and warranty expenses. The company outsourced substantially all of its manufacturing operation, and had no manufacturing plant. Cost of sales increased from $14.8 million during the three-month period ended December 31, 1999 to $93.9 million in the corresponding period ended December 31, 2000. Cost of sales increased from $24.0 million during the six-month period ended December 31, 1999 to $175.2 million in the corresponding period ended December 31, 2000. This increase in cost of sales reflected the increase level of sales. The gross margin were 11.2% and 14.8% for the three-month period and six-month period ended December 31, 2000, respectively. The Company expects that gross margin will fluctuate due to changing product mix, different sales prices, and product quantities shipped to various customers.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were $8.9 million in the second quarter of fiscal 2000 compared to $8.6 in the corresponding quarter of the prior year, a 4% increase. For the first two quarters of fiscal 2000, selling, general and administrative expenses were $17.4 million, compared to $14.8 million in the first two quarter of fiscal 1999, a 17.4% of increase. The increase was primarily the result of increased staffing and growth in recruiting and facility related expenses.

RESEARCH AND DEVELOPMENT

In the second quarter of fiscal 2000, research and development expenses increased $3.0 million to $3.9 million, or 310%, from $1.0 million in the same quarter of fiscal 1999. For the six-month period ended December 31, 2000, the Company's research and development expenses increased approximately 500% compared to the same period of the last year. The increase was primarily due to the growth of our research and development staff and consultants to support the commercial development of current and future products and nonrecurring engineering charges.

DEPRECIATION & GOODWILL AMORTIZATION

The Company has accumulated approximately $75.7 million of goodwill from acquisitions of businesses since September 1997. For the six-month period ended December 31, 2000, the Company's depreciation and goodwill amortization expenses were approximately $4.4 million, compared to $5.7 million for the same period of the prior year.

NET LOSS AND LOSS PER SHARE

For the second quarter of fiscal 2001, the Company had a net loss of $4.0 million, or $0.06 per share, compared to $4.8 million or $0.07 per share of net loss for the same period of the prior year. The decrease in net loss was mainly due to the increase in sales revenue accompanied by relatively less increase in operating expenses. Excluding $2.1 million of depreciation and goodwill amortization expenses, the net loss would be $1.9 million, or $0.03 per share.

For the six-month period ended December 31, 2000, the Company had a net loss of $7.4 million, or $0.12 per share, compared to $9.0 million, or $0.14 per share, of net loss for the same period of the prior year. Excluding $4.4 million of depreciation and goodwill amortization expenses, the net loss would be $3.0 million, or $0.05 per share.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2000, the Company's liquid assets, consisting of cash and cash equivalents, totaled $17.0 million, compared with $27.9 million as of June 30, 2000.

For the six-month period ended December 31, 2000, net cash used by operating activities was $27.2 million, compared with $4.7 million used at the same period of the previous year. The increase in net cash used by operating activities was primarily due to the combination of substantial increase in accounts receivables, offset partially by the increase of accounts payable.

For the six-month period ended December 31, 2000, net cash provided by investing activities were $11.8 million. The Company purchased $1.4 million of equipment. Arescom, one of the Company's subsidiaries, sold preferred stock to third parties for net proceeds of $13.3 million.

For the six-month period ended December 31, 2000, net cash provided by financial activities were $4.4 million, primarily from decrease in loan receivable and proceeds from line of credit.

The Company has no material long-term debt.

The Company believes that existing cash and cash equivalents together with funds generated from operations will be sufficient to meet its operating and investment requirements for the next 12 months. The Company's continuing operating and investing activities may nevertheless make it necessary or desirable that LPFC obtain additional financing, through loans or public or private offerings of its securities or securities of its subsidiaries. There can be no assurance that any additional financing will be available to the Company on commercially reasonable terms, if at all.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

The Company has not entered into any transactions using derivative financial instruments or derivative commodity instruments and believes that its exposure to market risk associated with other financial instruments is not material.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults by the Registrant on its Senior Securities

None

Item 4. Submission of Matters to A Vote of Security Holders

None

Item 5. Other Information

a) On January 5, 2001, the Board of Directors of the Company appointed William G. Hu as Chief Executive Officer of the Company to succeed the late president, Jeremy Wang, and as Chairman of the Board of Directors of Acumen Technology, Inc. ("Acumen"), a wholly-owned subsidiary of the Company. Jeremy Wang, the late President of the Company, passed away in an accident in late December 2000.

b) Due to scheduling conflicts, Mr. Kuan C. Tsai resigned as director of the Company in January 2001.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LOTUS PACIFIC, INC.

Date: February 15, 2001

By: /s/ William G. Hu

William G. Hu, Chief Executive Officer

By: /S/ David Li

David Li, Chief Financial Officer