

Edgar Filing: LOTUS PACIFIC INC - Form 10-Q

LOTUS PACIFIC INC
Form 10-Q
May 18, 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 March 31, 2001

() 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 March 31, 2001:

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

LOTUS PACIFIC, INC.

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LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	ASSETS	March 31, 2001 (Unaudited)	June 30, 2000 (Audited)
Current assets:			
Cash		\$ 25,794,802	\$ 27,942,258
Accounts receivable		38,581,121	19,534,974
Accounts receivable from related parties		10,855,844	5,653,533
Inventory		28,469,339	13,185,391
Prepaid expenses		985,646	1,533,045
Other		---	89,633
Income tax receivable		2,060,349	---
Deferred tax asset		1,313,000	---
		-----	-----
Total current assets		108,060,101	67,938,834
Property and equipment:			
Furniture and office equipment		4,741,331	2,717,683
Equipment		1,337,946	1,175,859
Leasehold improvements		497,287	234,086
		-----	-----
		6,576,564	4,127,628
Less: accumulated depreciation		2,183,835	1,317,636
		-----	-----

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	4,392,729	2,809,992
	-----	-----
Other assets:		
Restricted cash	---	300,000
Notes receivable	4,734,189	11,860,000
Goodwill, net of accumulated amortization of \$16,981,203 at March 31, 2001 and \$11,091,760 at June 30, 2000	65,545,067	64,576,749
Investment in unconsolidated subsidiary	3,103,803	4,329,925
Other	117,339	745,003
	-----	-----
	73,500,398	81,811,677
	-----	-----
	\$185,953,228	\$152,560,503
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Line of credit	\$ 3,000,000	\$ 1,278,000
Accounts payable and accrued expenses	28,558,583	19,233,547
Accounts payable to related parties	25,002,251	15,261,506
Notes payable	762,612	1,500,000
Deposits	31,684	---
Income taxes payable	---	2,434,150
Stock purchase payable	3,100,000	---
	-----	-----
Total current liabilities	60,455,130	39,707,203
	-----	-----
Minority interest in subsidiaries	17,043,393	6,425,633
	-----	-----
Commitments		
Stockholders' equity:		
Common stock	64,133	64,133
Deferred stock compensation	(12,568,827)	(16,643,967)
Preferred stock, Series A	4	4
Additional paid-in capital	200,779,951	191,037,695
Treasury stock	(7,057,102)	(7,057,102)
Accumulated deficit	(72,763,454)	(60,973,096)
	-----	-----
	108,454,705	106,427,667
	-----	-----
	\$185,953,228	\$152,560,503
	=====	=====

See notes to consolidated financial statements.

LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2001 AND 2000
(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2001	2000	2001	2000
	-----	-----	-----	-----
Sales	\$49,356,450	\$25,013,831	\$254,907,299	\$55,679,192

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Cost of sales	46,499,665	20,622,930	221,691,003	44,488,265
	-----	-----	-----	-----
Gross profit	2,856,785	4,390,901	33,216,296	11,190,927
Operating expenses:				
Selling, general, and administrative expenses	10,962,387	14,267,227	28,316,115	28,586,297
Research and development	4,226,458	2,574,706	16,507,293	4,474,662
	-----	-----	-----	-----
	15,188,845	16,841,933	44,823,408	33,060,959
	-----	-----	-----	-----
Operating income (loss)	(12,332,060)	(12,451,032)	(11,607,112)	(21,870,032)
	-----	-----	-----	-----
Other income (expense):				
Interest income	221,821	153,913	1,076,606	290,722
Interest expense	(3,500)	---	(4,786)	---
Other income	26,495	109,457	30,249	148,241
Gain on sale of sub- sidiaries' stock	---	42,317,838	---	42,317,838
Minority interest in (income) loss of con- solidated subsidiaries	1,289,047	(3,987)	735,393	31,302
Foreign exchange gain	(4,549)	---	123,444	---
Equity in earnings (loss) of unconsolidated subsidiaries	(146,929)	321,307	(1,226,122)	976,594
	-----	-----	-----	-----
	1,382,385	42,898,528	734,784	43,764,697
	-----	-----	-----	-----
Net income (loss) before income taxes	(10,949,675)	30,447,496	(10,872,328)	21,894,665
Income tax expense (benefit)	(6,604,477)	14,700,000	918,030	14,700,000
Net income (loss)	\$ (4,345,198)	\$15,747,496	\$ (11,790,358)	\$ 7,194,665
	=====	=====	=====	=====
Loss per share				
Basic and diluted	\$ (0.07)	\$ 0.25	\$ (0.18)	\$ 0.11
	=====	=====	=====	=====
Weighted average shares	64,133,795	63,579,406	64,133,795	63,503,568
	=====	=====	=====	=====

See notes to consolidated financial statements.

LOTUS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, 2001 AND 2000
(Unaudited)

	2001	2000
	-----	-----
Cash flows from operating activities:		
Net loss	\$ (11,790,358)	\$ 7,194,665
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in earnings of unconsolidated		

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subsidiaries	1,226,122	(976,594)
Depreciation and amortization	6,995,010	10,813,168
Amortization of deferred stock compensation	11,928,588	---
Gain on sale of subsidiaries' stock	---	(42,317,838)
Minority interest in subsidiary	(735,393)	895,419
Changes in assets and liabilities:		
Increase in accounts receivable	(19,046,147)	(11,611,215)
Increase in accounts receivable from related parties	(5,202,311)	---
Increase in inventory	(15,283,948)	(2,956,299)
Decrease in prepaid expenses	547,399	---
Decrease (increase) in other current assets	89,633	(1,475,232)
Increase in income tax benefit	(2,060,349)	---
Decrease in restricted cash	300,000	---
Increase (decrease) in deposits	31,684	(263,575)
(Increase) decrease in other assets	627,664	(599,687)
Increase in deferred tax asset	(1,313,000)	---
Increase in accounts payable and accrued expenses	9,325,036	26,765,130
Increase in accounts payable to related parties	9,740,745	---
Increase (decrease) in income taxes payable	(2,434,150)	14,700,000
	-----	-----
Net cash provided by (used in) operating activities	(17,053,775)	167,942
	-----	-----
Cash flows from investing activities:		
Purchase of property and equipment	(2,461,604)	(950,417)
Purchase of investments	(4,000,000)	(6,316,987)
Proceeds from sale of subsidiary stock	13,257,500	63,864,750
Notes receivable	---	(1,311,748)
	-----	-----
Net cash provided by investing activities	6,795,896	55,285,598
	-----	-----
Cash flows from financing activities:		
Decrease in investment deposits	---	(44,172,070)
Payments of notes receivable	7,125,811	---
Proceeds from line of credit	1,722,000	---
Repayments of notes payable	(737,388)	(195,565)
	-----	-----
Net cash provided by (used in) financing activities	8,110,423	(44,367,565)
	-----	-----
Net (decrease) increase in cash	(2,147,456)	11,085,905
Cash, beginning of year	27,942,258	30,779,486
	-----	-----
Cash, end of year	\$25,794,802	\$41,865,391
	=====	=====
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 84,105	\$ ---
	=====	=====
Cash paid for taxes	\$ 9,050,000	\$ ---
	=====	=====

See notes to consolidated financial statements.

LOTUS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2001

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(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 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, and Internet set-top boxes. The Company also provides private label online auction services in foreign markets.

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 nine-month period ended March 31, 2001 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: Regent Electronics Corp. (92.3% owned), Correlant Communications, Inc. (66.5%), Arescom, Inc. (81%) and Lotus World, Inc. (90.5%) 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 March 31, 2001, inventories consist of the following:

Raw materials	---
Work-in-process	---
Finished goods	\$28,469,339

	\$28,469,339
	=====

The above inventory balances as of March 31, 2001 are net of reserves for potential excess quantities and obsolescence of approximately \$2,452,709.

LOTUS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(CONTINUED)
MARCH 31, 2001
(Unaudited)

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NOTE 4 STOCK BASED COMPENSATION

The Company's subsidiary, Arescom, Inc. (Arescom), granted 550,000 Incentive Stock Options (ISO) to employees during the nine months ended March 31, 2001. Arescom recorded deferred compensation of \$1,100,000 and amortized deferred compensation of \$148,956. The amortization of deferred compensation for ISO granted in the prior year is \$5,388,802.

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 as follows:

	For the Nine Months Ended March 31, 2001	For the Nine Months Ended March 31, 2000	For the Six Months Ended December 31, 2000	For the Three Months Ended September 30, 2000
	-----	-----	-----	-----
U.S. Federal income tax provision at Federal statutory rate	\$(3,805,000)	\$7,665,000	\$ 30,000	\$ 407,800
Amortization of goodwill	2,010,000	2,060,000	1,325,000	630,000
Deferred compensation amortization	4,175,000	---	3,661,500	2,996,700
Tax basis on sale of subsidiary stock	---	5,325,000	---	---
Minority interest in subsidiaries	260,000	---	195,000	---
Equity in (income) loss of unconsolidated subsidiaries	430,000	(350,000)	400,000	---
Benefit of subsidiary pre-consolidation losses	(1,250,000)	---	---	---
State income taxes net of federal income tax effect	(950,000)	---	1,650,000	---
Other	48,030	---	261,007	608,429
	-----	-----	-----	-----
	\$ 918,030	\$14,700,000	\$ 7,500,507	\$4,642,929
	=====	=====	=====	=====

NOTE 6 PREFERRED STOCK

During the nine months ended March 31, 2001, Arescom, Inc. sold preferred stock to third parties for net proceeds of \$13,257,500.

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NOTE 7 INVESTMENT IN SUBSIDIARY

In January the Company agreed to refund \$7,100,000 to an investor that purchased 355,000 shares of Correlant Communications Inc.'s common stock from the Company during the fiscal year ended June 30, 2000. The refund increased the Company's ownership of Correlant from 64.7% to 66.5%. As of March 31, 2001, the Company has paid \$4,000,000 and owes \$3,100,000. The Company has recorded goodwill associated with the refund of \$6,857,761.

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 March 31, 2001, the Company's revenue was \$ 49.4 million, compared to \$ 25.0 million for the same period of the previous year. On a year to date basis, revenue in the first nine months of fiscal 2001 was \$ 254.9 million, an increase of 358% over the first nine months of fiscal 2000. The revenue growth in the three- and nine-month periods was primarily due to the expanded operations of Correlant Communications ("Correlant") and Arescom, Inc. ("Arescom"), both of which were acquired by LPFC in March 1999.

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 \$20.6 million during the three-month period ended March 31, 2000 to \$46.5 million in the corresponding period ended March 31, 2001. Cost of sales increased from \$44.5 million during the nine-month period ended March 31, 2000 to \$221.7 million in the corresponding period ended March 31, 2001. This increase in cost of sales reflected the increased level of sales. The gross margins were approximately 6% and 13% for the three-month period and nine-month period ended March 31, 2001, 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 \$11.0 million in the March quarter fiscal 2001 compared to \$14.3 million in the March quarter of the prior year, a 23% decrease. For the first three quarters of fiscal 2001, selling, general and administrative expenses were \$28.3 million, compared to \$28.6 million in the first three quarters of fiscal 2000. The decrease in the third quarter and the moderate increase in the first three quarters reflected more streamlined operation by LPFC and its subsidiaries.

RESEARCH AND DEVELOPMENT

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In the third quarter of fiscal 2001, research and development expenses increased \$1.7 million to \$4.2 million, or 64%, from \$2.6 million in the same quarter of fiscal 2000. For the nine-month period ended March 31, 2001, the Company's research and development expense increased nearly 4 times compared to the same period of the prior year. The increase was attributable to the expanded operations by the Company's subsidiaries acquired or established during the second half of fiscal 1999.

DEPRECIATION & GOODWILL AMORTIZATION

The Company has accumulated approximately \$82.5 million of goodwill from acquisitions of businesses since September 1997. The goodwill is amortized on the straight-line basis over 10 years. For the three-month period ended March 31, 2001, the depreciation and amortization decreased approximately 29% to \$2.5 million compared to the same period of the prior year. For the nine-month period ended March 31, 2001, the Company's depreciation and goodwill amortization expenses were approximately \$7.0 million, compared to \$10.8 million for the same period of the prior year. The decrease was attributable to the write-off of certain businesses related to some of the Company's subsidiaries.

NET INCOME (LOSS) AND EARNING PER SHARE

For the third quarter of fiscal 2001, the Company had net loss of \$4.3 million, or \$0.07 per share, compared to a net income of \$15.7 million for the same period of the prior year. Excluding \$2.5 million of depreciation and goodwill amortization expenses, the net loss would be \$1.8 million, or \$0.03 per share. The Company's loss during the current period reflected deteriorating macro-economic environment in telecommunication industry. Specifically, the contracting gross margin reflected increasing competitions in our industry. Excluding the gains from the sale of Correlant stock in the corresponding prior period, the loss was comparable to that of the same period last year.

For the nine months ended March 31, 2001, the Company had net loss of \$11.8 million, or \$0.18 per share, compared to the gain of \$7.2 million for the same period of the prior year. Excluding \$7.0 million of depreciation and goodwill amortization expenses, the net loss would be \$4.8 million, or \$0.05 per share.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2001, the Company's liquid assets, consisting of cash and cash equivalents, totaled \$25.8 million, compared with \$27.9 million as of June 30, 2000.

For the nine-month period ended March 31, 2001, net cash used by operating activities was \$14.0 million compared to \$0.2 million net cash provided by operations from the same period of the previous year.

For the nine-month period ended March 31, 2001, net cash provided by investing activities was \$3.7 million, attributable primarily to the private placement of certain Arescom preferred stock.

For the nine-month period ended March 31, 2001, the Company had net cash inflow of \$8.1 million from financing activities attributable to the decrease of certain loan receivable. For the same period of 2000, LPFC had a cash outflow of \$44.4 million that was attributable to the repayment of deposits received in fiscal 1999 for a proposed purchase of securities which was subsequently cancelled.

The Company has no material long-term debt.

The Company believes that the existing cash and cash equivalents together with

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funds generated from operations will be sufficient to meet its operating requirements for the next 12 months. The Company's continuing operating and investing activities may nevertheless make it necessary or desirable that the Company obtains additional financing through loans or additional public or private offerings of its securities. 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

None.

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 PACIFIC, INC.

Date: May 18, 2001

By: /S/ William G. Hu

William G. Hu, Chief Executive Officer

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By: /S/ David Li

David Li, Chief Financial Officer