KRONOS INC
Form 10-Q
February 09, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended December 30, 2000

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 0-20109

Kronos Incorporated

(Exact name of registrant as specified in its charter)

Massachusetts	04-2640942
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

297 Billerica Road, Chelmsford, MA	01824
(Address of principal executive offices)	(Zip Code)

(978) 250-9800

(Registrant's telephone number, including area code)

(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 ___

As of January 27, 2001, 12,504,613 shares of the registrant's Common Stock, $.01 par value, were outstanding.

KRONOS INCORPORATED

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share amounts)
UNAUDITED

	Three Months Ended	
	December 30, 2000	January 1, 2000
Net revenues:		
Product	$ 33,722	$ 36,152
Service	31,031	28,456
	64,753	64,608
Cost of sales:		
Product	7,797	8,291
Service	17,723	16,255

	25,520	24,546
Gross profit	39,233	40,062
Operating expenses and other income:		
Sales and marketing	22,302	21,931
Engineering, research and development	7,920	7,016
General and administrative	4,140	4,154
Amortization of intangible assets	1,734	1,551
Other income, net	(1,153)	(1,335)
	34,943	33,317
Income before income taxes	4,290	6,745
Provision for income taxes	1,501	2,496
Net income	$ 2,789	$ 4,249
Net income per common share:		
Basic	$ 0.23	$ 0.34
Diluted	$ 0.22	$ 0.32
Average common and common equivalent shares outstanding:		
Basic	12,368,715	12,462,471
Diluted	12,811,696	13,152,909

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
UNAUDITED

	December 30, 2000	Septem 200
ASSETS		
Current assets:		
Cash and equivalents	$ 21,197	$ 23
Marketable securities	21,833	10
Accounts receivable, less allowances of $7,033 at December 30, 2000 and $6,986 at September 30, 2000	64,512	71
Deferred income taxes	6,466	5
Other current assets	14,481	13
Total current assets	128,489	125
Property, plant and equipment, net	36,796	37
Marketable securities	16,400	17

Excess of cost over net assets of businesses acquired, net	31,526	29
Deferred software development costs, net	14,509	13
Other assets	14,133	16
Total assets	$ 241,853	$ 239
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,670	$ 8
Accrued compensation	18,940	19
Accrued expenses and other current liabilities	14,040	14
Deferred professional service revenues	23,586	23
Deferred maintenance revenues	51,021	48
Total current liabilities	114,257	114
Deferred maintenance revenues	14,202	15
Other liabilities	1,546	1
Shareholders' equity:		
Preferred Stock, par value $1.00 per share: authorized 1,000,000 shares, no shares issued and outstanding	--	
Common Stock, par value $.01 per share: authorized 20,000,000 shares, 12,634,728 shares issued at December 30, 2000 and September 30, 2000	126	
Additional paid-in capital	20,985	23
Retained earnings	100,633	97
Accumulated other comprehensive loss	(1,035)	(1
Cost of Treasury Stock (222,051 shares and 310,038 shares at December 30, 2000 and September 30, 2000, respectively)	(8,861)	(12
Total shareholders' equity	111,848	107
Total liabilities and shareholders' equity	$ 241,853	$ 239

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
UNAUDITED

	Three Months E	
	December 30, 2000	Ja
Operating activities:		
Net income	$ 2,789	$
Adjustments to reconcile net income to net cash and equivalents provided by operating activities:		
Depreciation	2,016	
Amortization of excess of cost over net assets of businesses acquired	1,735	
Amortization of deferred software development costs	1,919	
Provision for deferred income taxes	(264)	

Changes in certain operating assets and liabilities:	
Accounts receivable, net	6,710
Deferred maintenance revenue	(522)
Accounts payable, accrued compensation and other liabilities	(2,722)
Long term investment in leases	2,367
Other	(513)
Tax benefit from exercise of stock options	1,670
Net cash and equivalents provided by operating activities	15,185
Investing activities:	
Purchase of property, plant and equipment	(1,677)
Capitalization of software development costs	(2,813)
Increase in marketable securities	(9,993)
Acquisitions of businesses	(2,056)
Net cash and equivalents used in investing activities	(16,539)
Financing activities:	
Net proceeds from exercise of stock option and employee stock purchase plans	3,055
Purchase of treasury stock	(3,800)
Net cash and equivalents used in financing activities	(745)
Effect of exchange rate changes on cash and equivalents	95
Decrease in cash and equivalents	(2,004)
Cash and equivalents at the beginning of the period	23,201
Cash and equivalents at the end of the period	$ 21,197

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A - General

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals, that management considers necessary for a fair presentation of the Company's financial position and results of operations as of and for the interim periods presented pursuant to the rules and regulations of the Securities and Exchange Commission. Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures in these financial statements are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the fiscal year ended September 30, 2000. The results of operations for the three months ended December 30, 2000 are not necessarily indicative of the results for a full fiscal year. Certain reclassifications have been made in the accompanying consolidated financial statements in order to conform to the fiscal 2001 presentation.

NOTE B - Fiscal Quarters

The Company utilizes a system of fiscal quarters. Under this system, the first three quarters of each fiscal year end on a Saturday. However, the fourth quarter of each fiscal year will always end on September 30. Because of this, the number of days in the first quarter (91 days in fiscal 2001 and 93 days in fiscal 2000) and fourth quarter (92 days in fiscal 2001 and 91 days in fiscal 2000) of each fiscal year varies from year to year. The second and third quarters of each fiscal year will be exactly thirteen weeks long. This policy does not have a material effect on the comparability of results of operations between quarters.

NOTE C - Newly Issued Accounting Standards:

The Company adopted Financial Accounting Standards Board Statement ("FAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" on October 1, 2000." SFAS 133 requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings. The adoption of SFAS 133 by the Company as of October 1, 2000 had no material effect on Kronos' earnings or financial position.

At December 30, 2000 the Company holds foreign currency forward exchange contracts having original durations of less than 12 months. These forward contracts offset the impact of exchange-rate fluctuations on intercompany payables due from one of the Company's subsidiaries. At December 30, 2000 the forward contracts are accounted for as cash flow hedges and have an immaterial fair value.

NOTE D - Comprehensive Income

For the three months ended December 30, 2000 and January 1, 2000 comprehensive income consisted of the following (in thousands):

	Three Months Ended	
	December 30, 2000	January 1, 2000
Comprehensive income:		
Net income	$2,789	$4,249
Cumulative translation adjustment	125	--
Unrealized gains on .... available-for-sale securities	206	--
Total comprehensive income	$3,120	$4,249

NOTE E - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended	
	December 30, 2000	January 1, 2000
Net income (in thousands)	$ 2,789	$ 4,249
Weighted-average shares	12,368,715	12,462,471
Effect of dilutive securities:		
Employee stock options	442,981	690,438
Adjusted weighted-average shares and assumed conversions	12,811,696	13,152,909
Basic earnings per share	$ 0.23	$ 0.34
Diluted earnings per share	$ 0.22	$ 0.32

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

Forward Looking Statements

This discussion includes certain forward-looking statements about Kronos' business and its expectations. Any such statements are subject to risk that could cause the actual results to vary materially from expectations. For a further discussion of the various risks that may affect Kronos' business and expectations, see "Certain Factors That May Affect Future Operating Results" at the end of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

Revenues. Revenues for the first quarter of fiscal 2001 were $64.8 million as compared to $64.6 million for the first quarter of the prior year. Revenue growth was flat in the first quarter of fiscal 2001 and 22% in the first quarter of fiscal 2000. The revenue growth rate experienced in the first quarter of fiscal 2000 was favorably impacted in part due to demand for new products and product upgrades as well as related professional services and maintenance revenues resulting from customers' Year 2000 compliance efforts, and incremental revenues resulting from acquisitions of dealer territories during calendar 1999. Kronos has experienced lower growth rates over the past four quarters compared to historical growth rates. Management has attributed the lower growth rates to a combination of factors, including the transitory impact on demand for Kronos' products and services as a result of Year 2000 compliance efforts and the elongation of Kronos' sales cycle. Management believes that demand for Kronos' products and services continues to exist and anticipates that the revenue growth rates over the remainder of the fiscal year will exceed the growth rates experienced in fiscal 2000.

Product revenues for the quarter declined 7% to $33.7 million as compared to $36.2 million and product revenue growth of 9% in the first quarter of fiscal 2000. The decline in product revenues is principally attributable to lower than anticipated revenues from Kronos' independent dealer channel. Management believes that, given the increased sophistication of Kronos' products and the related heightened need for pre-sales technological support and other sales support, the dealer channel's sales cycle requires greater management and participation by Kronos. To address this trend, management anticipates expending greater resources to assist the dealer channel in the short term and increasing Kronos' emphasis on direct sales in the longer term.

Service revenues for the first quarter of fiscal 2001 increased 9% to $31.0 million as compared to $28.5 million and service revenue growth of 43% in the first quarter of fiscal 2000. The growth in service revenues in the first quarter of fiscal 2001 principally reflects an increase in maintenance revenue from expansion of the installed base and, to a lesser extent, incremental maintenance revenues resulting from Kronos' acquisitions of various dealer territories over the past four quarters. The growth in service revenues in the first quarter of fiscal 2000 principally reflects an increase in maintenance revenue from expansion of the installed base and the level of services sold to the installed base, as well as an increase in the level of maintenance contracts and professional services accompanying new and upgrade sales. Also contributing to the growth in the first quarter of fiscal 2000 were maintenance and professional service revenues resulting from Kronos' acquisition of its largest dealer territory in June 1999.

Gross Profit. Gross profit as a percentage of revenues was 61% in the first quarter of fiscal 2001, decreasing from 62% in the comparable period of the prior year. The decrease in margin was directly attributable to lower product revenues. Service revenue, which generates lower gross margin, has grown faster than product revenue and represents a greater proportion of total revenue in the first quarter than in the comparable period of the prior year. Product gross profit as a percentage of product revenues was 77% in the first quarter of fiscal 2001 and 2000. Software, which typically generates higher gross profit, was a greater proportion of product revenues in the first quarter as compared to the prior year. However, higher software development amortization and production costs due to lower sales volume offset the effect of this favorable mix. Service gross profit as a percentage of service revenues was 43% in the first quarter of 2001 and 2000. Management anticipates that product and service gross margin for the remainder of the fiscal year will be comparable to that experienced in the first quarter.

Net Operating Expenses. Net operating expenses as a percentage of revenues were 54% and 52% in the first quarter of fiscal 2001 and 2000. The increase in operating expenses in the first quarter as compared to the prior year was attributable to increases in program and infrastructure costs incurred to support anticipated increases in business volume, product development efforts and amortization of intangible assets related to acquisitions. Sales and marketing expenses as a percentage of revenues were 34% in the first quarter of fiscal 2001 and 2000. Management anticipates sales and marketing expenses as a percentage of revenues to increase in the second quarter of fiscal 2001, but at a lower rate than the comparable period of the prior year. Engineering, research and development expenses as a percentage of revenues were 12% in the first quarter of fiscal 2001 as compared to 11% in the first quarter in the prior year. Engineering expenses of $7.9 million and $7.0 million in the first quarter of fiscal 2001 and 2000, respectively, are net of capitalized software development costs of $2.8 million and $2.3 million, respectively. The growth in engineering, research and development expenses this year resulted principally from the continuing research, design and development of software and hardware technology. General and administrative expenses as a percentage of revenues were 6% in the first quarter of fiscal 2001 and 2000. Amortization of intangible assets as a percentage of revenues was 3% and 2% in the first quarter of fiscal 2001 and 2000, respectively. The increase in amortization expense is principally related to various dealer territory acquisitions completed in the past four quarters. Kronos amortizes these costs over the assets estimated remaining economic lives. Other income, net is principally attributable to interest income earned from Kronos' cash as well as investments in its marketable securities and lease portfolio.

Income Taxes. The provision for income taxes as a percentage of pretax income was 35% and 37% in the first quarter of fiscal 2001 and 2000, respectively. The lower effective income tax rate experienced in fiscal 2001 was principally attributable to tax benefits resulting from Kronos' investment tax credits. Management anticipates the effective income tax rate for the remainder of the fiscal year will be comparable to the rate experienced in the first quarter.

Liquidity and Capital Resources

Working capital as of December 30, 2000, amounted to $14.2 million as compared to $10.7 million at September 30, 2000. During fiscal 2000 Kronos' working capital was reduced as Kronos' funded its investment in its corporate headquarters facility and other property, plant and equipment, as well as the repurchase of common shares under Kronos' stock repurchase program and, to a lesser extent, payments related to acquisitions of dealer territories. Cash and equivalents and marketable securities amounted to $59.4 million as of December 30, 2000 and $51.4 million as of September 30, 2000.

Cash generated from operations amounted to $15.2 million in the first quarter of fiscal 2001 as compared to $12.2 million in the first quarter of fiscal 2000. The increase is principally attributable to a smaller decline in accrued compensation and deferred professional services in the Q1 of fiscal 2001 as compared Q1 of fiscal 2000. Cash used for property, plant and equipment decreased to $1.7 million in the first quarter of fiscal 2001 from $7.0 million in the first quarter of fiscal 2000. Fiscal 2000 investments in property, plant and equipment included approximately $5.0 million related to the construction of Kronos' corporate headquarters campus. Kronos' use of cash for acquisition of businesses in Q1 of fiscal 2001 was principally related to the acquisition of a dealer territory in November 2000.

Under Kronos' stock repurchase program, Kronos repurchased 61,000 common shares in the first quarter of fiscal 2001 at a cost of $2.3 million. The common shares repurchased under the program are used for Kronos' employee stock option plans and employee stock purchase plan. Cash provided by operations was more than sufficient to fund investments in capitalized software development costs, property, plant and equipment and stock repurchases. Kronos believes it has available adequate cash and investments and operating cash flow to fund its investments in property, plant and equipment, software development costs, cash payments related to acquisitions and any additional stock repurchases for the foreseeable future.

Certain Factors That May Affect Future Operating Results

Except for historical matters, the matters discussed in this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). Kronos desires to take advantage of the safe harbor provisions of the Act and is including this statement for the express purpose of availing itself of the protection of the safe harbor with respect to all forward looking statements that involve risks and uncertainties.

Kronos' actual operating results may differ from those indicated by forward looking statements made in this Quarterly Report on Form 10-Q and presented elsewhere by management from time to time because of a number of factors including the potential fluctuations in quarterly results, timing and acceptance of new product introductions by Kronos and its competitors, the ability to attract and retain sufficient technical personnel, competitive pricing pressure, the dependence on Kronos' time and attendance product line, and the dependence on alternate distribution channels and on key vendors, as further described below and in Kronos' Annual Report on Form 10-K for the fiscal year ended September 30, 2000, which are specifically incorporated by reference herein.

Potential Fluctuations in Quarterly Results. Kronos' quarterly operating results may fluctuate as a result of a variety of factors, including the purchasing patterns of its customers, mix of products and services sold, the timing of the introduction of new products and product enhancements by Kronos and its competitors, market acceptance of new products, competitive pricing pressure and general economic conditions. Kronos historically has realized a relatively larger percentage of its annual revenues and profits in the fourth quarter and a relatively smaller percentage in the first quarter of each fiscal year, although there can be no assurance that this pattern will continue. In addition, while Kronos has contracts to supply systems to certain customers over an extended period of time, substantially all of Kronos' product revenue and profits in each quarter result from orders received in that quarter. If near-term demand for Kronos' products weakens or if significant anticipated sales in any quarter do not close when expected, Kronos' revenues for that quarter will be adversely affected. Kronos believes that its operating results for any one period are not necessarily indicative of results for any future period.

Product Development and Technological Change. Continual change and improvement in computer software and hardware technology characterize the markets for frontline labor management systems. Kronos' future success will depend largely on its ability to enhance the capabilities and increase the performance of its existing products and to develop new products and interfaces to third party products on a timely basis to meet the increasingly sophisticated needs of its customers. Although Kronos is continually seeking to further enhance its product offerings and to develop new products and interfaces, there can be no assurance that these efforts will succeed, or that, if successful, such product enhancements or new products will achieve widespread market acceptance, or that Kronos' competitors will not develop and market products which are superior to Kronos' products or achieve greater market acceptance.

Dependence on Alternate Distribution Channels. Kronos markets and sells its products through its direct sales organization, independent dealers and OEMs. In Q1 of fiscal 2001, approximately 14% of Kronos' revenue was generated through sales to dealers and OEMs. A reduction in the sales efforts of Kronos' major dealers and/or OEMs, the termination or changes in their relationships with Kronos, or the failure of Kronos to monitor and incent its independent dealers and OEMs, could have a material adverse affect on the results of Kronos' operations.

Attracting and Retaining Sufficient Technical Personnel for Product Development, Support and Sales. Kronos has encountered intense competition for experienced technical personnel for product development, technical support and sales and expects such competition to continue in the future. Any inability to attract and retain a sufficient number of qualified technical personnel could adversely affect Kronos' ability to produce, support and sell products in a timely manner.

Competition. The frontline labor management industry is highly competitive. Technological changes such as those allowing for increased use of the Internet may also create the potential for new entrants. Although Kronos believes it has core competencies that are not easily obtainable by competitors, maintaining Kronos' technological and other advantages over competitors will require continued investment by Kronos in research and development and marketing and sales programs. There can be no assurance that Kronos will have sufficient resources to make such investments or be able to achieve the technological advances necessary to maintain its competitive advantages. Increased competition could adversely affect Kronos' operating results through price reductions and/or loss of market share.

PART II. OTHER INFORMATION

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the fiscal quarter ended December 30, 2000.

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.

KRONOS INCORPORATED

By /s/ Paul A. Lacy
Paul A. Lacy
Vice President of Finance
and Administration

(Duly Authorized Officer and
Principal Financial Officer)

February 9, 2001