K TEL INTERNATIONAL INC
Form 10-Q
November 22, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2006

OR

o 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: 1-07115

K-TEL INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**41-0946588**
(State or other jurisdiction of incorporation or organization)	(I.RS. Employer Identification No.)
2491 Xenium Lane North, Plymouth, Minnesota	**55441**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(763) 559-5566**

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $0.01

(Title of class)

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 o No x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of November 13, 2006, the registrant had 13,653,738 shares of common stock outstanding.

K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

FORM 10-Q

FOR THE THREE AND NINE MONTH PERIODS

ENDED MARCH 31, 2006

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SAFE HARBOR STATEMENT UNDER THE
PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements of a non-historical nature under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may be identified by the use of terminology such as may, will, expect, anticipate, estimate, should, or continue or the negative thereof or other variations thereon or comparable terminology. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or from those results currently anticipated or projected. Such factors include, among other things, the following: changes in consumer purchasing; demand for and market acceptance of new and existing products; the impact from competition for recorded music; the outcome of legal proceedings; dependence on suppliers and distributors; success of marketing and promotion efforts; technological changes and difficulties; availability of financing; foreign currency variations; general economic, political and business conditions; and other matters. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements, except as required by law.

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K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

(in thousands except share data)

	March 31, 2006	June 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,374	$ 1,272
Accounts receivable, net of allowance for doubtful accounts of $4 at March 31 and June 30	1,172	2,045
Inventories	374	563
Royalty advances	6	6
Prepaid expenses and other	231	227
Total current assets	3,157	4,113
Property and equipment, net of accumulated depreciation and amortization of $1,156 at March 31 and $1,138 at June 30	61	84
Owned catalog masters, net of accumulated amortization of $3,237 at March 31 and $3,115 and June 30	376	498
	$ 3,594	$ 4,695
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current liabilities:		
Notes payable to affiliate and other	$ 11,618	$ 11,518
Accounts payable	1,103	1,727
Accrued royalties	1,898	1,760
Reserve for returns	254	221
Net liabilities of discontinued operations	30	30
Total current liabilities	14,903	15,256
Shareholders deficit:		
Common stock 50,000,000 shares authorized; par value $.01; 13,653,738 issued and outstanding at March 31 and June 30	136	136
Additional paid-in capital	21,292	21,292
Accumulated deficit	(32,628)	(31,923)
Accumulated other comprehensive loss	(109)	(66)
Total shareholders deficit	(11,309)	(10,561)
	$ 3,594	$ 4,695

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

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K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

(in thousands - except per share data)

	Three Months Ended March 31, 2006	2005	Nine Months Ended March 31, 2006	2005
Net sales	$ 1,144	$ 1,316	$ 3,642	$ 4,847
Costs and expenses:				
Cost of goods sold	432	405	1,517	2,098
Advertising	25	24	113	91
Selling, general and administrative	728	929	2,059	2,719
Total costs and expenses	1,185	1,358	3,689	4,908
Operating loss	(41)	(42)	(47)	(61)
Other income (expense)				
Interest expense	(232)	(162)	(631)	(464)
Other income (expense), net	5	(14)	(16)	133
Total other expense	(227)	(176)	(647)	(331)
Loss from continuing operations	(268)	(218)	(694)	(392)
Discontinued operations:				
Gain(loss) from discontinued operations, net of taxes	(8)	(22)	(11)	189
Net loss	$ (276)	$ (240)	$ (705)	$ (203)
Income (loss) per share basic and diluted:				
Continuing operations	$ (.02)	$ (.02)	$ (.05)	$ (.03)
Discontinued operations				.01
Net loss	$ (.02)	$ (.02)	$ (.05)	$ (.02)
Shares used in the calculation of loss per share - basic and diluted	13,654	13,654	13,654	13,654
Comprehensive loss:				
Net loss	$ (276)	$ (240)	$ (705)	$ (203)
Translation adjustment	13	(41)	(43)	69
Comprehensive loss	$ (263)	$ (281)	$ (748)	$ (134)

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

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K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

(in thousands)

	Nine Months Ended March 31, 2006	2005
Cash flows from operating activities:		
Net loss	$ (705)	$ (203)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	151	180
Loss on disposal of property and equipment		(11)
Discontinued operations		2
Changes in operating assets and liabilities:		
Accounts receivable, net	842	1,080
Inventories	180	(54)
Royalty advances	4	11
Prepaid expenses	(13)	16
Accounts payable	(604)	7
Accrued royalties	150	46
Reserve for returns	33	14
Cash provided by operating activities	38	1,088
Cash flows from investing activities:		
Purchases of property and equipment	(8)	(55)
Other		(12)
Cash used in investing activities	(8)	(67)
Cash flows from financing activities:		
Borrowings on notes payable	2,831	3,460
Payments on notes payable	(2,731)	(3,331)
Cash provided by financing activities	100	129
Effect of exchange rates on cash	(28)	32
Net increase in cash and equivalents	102	1,182
Cash and equivalents at beginning of period	1,272	147
Cash and equivalents at end of period	$ 1,374	$ 1,329

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

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K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BUSINESS AND LIQUIDITY

K-tel International, Inc. (the Company , K-tel or the registrant) was incorporated in 1968 and currently has its corporate offices located in Plymouth, Minnesota. Through its operating subsidiaries, K-tel licenses its music catalog internationally and markets entertainment products mainly derived from its catalog through retail and direct response marketing channels in the United States and Europe. The Company has a focused method of distribution that targets the strengths of selected individual retailers and supplies products suited to each retailer s needs. These products are derived mainly from the Company s master recordings music catalog with the objective of realizing more competitive profit margins. K-tel seeks to license its trademarks to other companies in businesses unrelated to K-tel s current operations. Licenses are granted for a royalty or fee, with no cost to the Company.

On October 10, 2005, K-tel, through a wholly owned subsidiary, entered into a trademark license agreement with BCI Eclipse Company, LLC (BCI) and, effective October 16, 2005, entered into a phonograph record license agreement with BCI.

Discontinued Operations

The Company s consumer products business, which was concentrated in Europe, consisted primarily of housewares, consumer convenience items and exercise equipment. The Company discontinued its consumer products operations in Germany, the United Kingdom and the United States in June 2000, November 2000 and January 2001, respectively. Accordingly, these activities have been presented in the accompanying financial statements as discontinued operations. The accompanying condensed consolidated financial statements have been prepared to reflect the consumer products division as a discontinued operation. The net liabilities of discontinued operations at March 31, 2006 and June 30, 2005, and losses from discontinued operations for the three and nine months ended March 31, 2006 and 2005, relate primarily to legal matters and completion of statutory reporting requirements for the former operations in Germany.

Liquidity

During the nine months ended March 31, 2006 and 2005, the Company incurred net losses from continuing operations of $694,000 and $392,000, respectively. Operating activities provided $38,000 and $1,088,000 of cash during the nine months ended March 31, 2006 and 2005, respectively. Additionally, the Company had a working capital deficit of $11,746,000 at March 31, 2006.

The Company s ability to continue its present operations and implement future expansion plans successfully is contingent mainly upon its ability to maintain its line of credit arrangements with K-5 Leisure Products, Inc. (See Note 3), increase its revenues and profit margins, and ultimately attain and sustain profitable operations. Without increased revenues and sustained profitability, the Company s current operations will likely not generate cash sufficient to fund operations and service its indebtedness on an ongoing basis. Management is focusing its efforts on music licensing, music downloads and limited music distribution. However, there can be no assurance that the Company will achieve profitable operations through these efforts. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES