STORAGE COMPUTER CORP
Form 10-Q
May 17, 2004
Table of Contents

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, 2004

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 1-13616

STORAGE COMPUTER CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	02-0450593
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

11 RIVERSIDE DRIVE, NASHUA, NH 03062

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE)

(603) 880-3005

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 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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of shares outstanding of the registrant s class of common stock, as of the latest practicable date.

CLASS	OUTSTANDING AT April 28, 2004
Common Stock $ .001 par value per share	38,901,125

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements.

Storage Computer Corporation

Consolidated Balance Sheets

	March 31, 2004 (Unaudited)	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,595	$ 72,581
Accounts receivable, net	55,178	135,730
Inventories	1,245,777	1,390,291
Other current assets	156,592	187,247
Total current assets	1,478,142	1,785,849
Property and equipment, net	308,470	345,709
Goodwill	2,692,611	2,692,611
Other intangibles, net	805,057	949,057
Total assets	$ 5,284,280	$ 5,773,226
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 555,918	$ 565,182
Accrued expenses	1,968,433	1,808,044
Deferred revenue	141,038	133,538
Notes payable	965,379	846,184
Total current liabilities	3,630,768	3,352,948
Commitments and contingencies		
Stockholders equity:		
Common stock	38,837	38,650
Additional paid-in capital	85,800,788	85,612,531
Accumulated deficit	(84,186,113)	(83,230,903)
Total stockholders equity	1,653,512	2,420,278
Total liabilities and stockholders equity	$ 5,284,280	$ 5,773,226

See Notes to Consolidated Financial Statements.

3

Table of Contents

Storage Computer Corporation

Consolidated Statements of Operations (Unaudited)

	March 31, 2004	March 31, 2003
Revenues:		
Products and services	$ 91,018	$ 277,984
License fees		
Total revenues	91,018	277,984
Costs and expenses:		
Cost of products and services	209,938	247,061
Cost of license fees, primarily legal fees		259,715
Research and development	213,328	285,909
Sales and marketing	130,943	162,191
General and administrative	303,801	377,137
Amortization of intangibles	144,000	144,000
Total costs and expenses	1,002,010	1,476,013
Operating loss	(910,992)	(1,198,029)
Other income (expense), net:		
Interest expense, net	(41,646)	(4,480)
Other income (expense)	(2,572)	425
Total other income (expense), net	(44,218)	(4,055)
Net loss	(955,210)	(1,202,084)
Dividends on preferred stock including amortization of the beneficial conversion features		(17,595)
Net loss applicable to common stockholders	$ (955,210)	$ (1,219,679)
Loss applicable to common stockholders per basic and dilutive share	$ (0.03)	$ (0.04)
Basic and dilutive shares outstanding	38,700,082	34,421,825

See Notes to Consolidated Financial Statements.

Table of Contents

Storage Computer Corporation

Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended	
	March 31, 2004	March 31, 2003
Cash flows from operating activities:		
Net loss	$ (955,210)	$ (1,202,084)
Reconciliation to operating cash flows:		
Depreciation and amortization of property and equipment	37,239	60,419
Amortization of other intangibles	144,000	144,000
Provision for obsolete inventory	66,243	(25,000)
Stock issued to 401(k) plan	2,516	4,244
Non-cash compensation for services	185,748	
Changes in current operating assets and liabilities:		
Accounts receivable	80,552	77,195
Inventories	78,271	61,909
Due from officers and directors		(1,581)
Other current assets	30,655	(44,377)
Accounts payable, accrued expenses and deferred revenue	158,625	(233,052)
Net cash used in operations	(171,361)	(1,158,327)
Cash flows from investing activities:		
Capital expenditures		
Net cash (used in) provided by investing activities		
Cash flows from financing activities:		
Reduction of Notes payable	(805)	
Proceeds from Notes payable	120,000	
Net proceeds from issuance of common stock for stock options	180	4,957
Net cash provided by financing activities	119,375	4,957
Effect of exchange rate changes on cash		
Net decrease in cash and cash equivalents	(51,986)	(1,153,370)
Cash and cash equivalents-beginning of period	72,581	2,680,599
Cash and cash equivalents-end of period	$ 20,595	$ 1,527,229
Supplemental cash flow information:		
Cash payments of interest	$	$ 4,367
Preferred stock dividends paid in common stock	$	$ 44,917

See Notes to Consolidated Financial Statements.

5

Table of Contents

Storage Computer Corporation

Notes to Consolidated Financial Statements

March 31, 2004

Note A The Company

Storage Computer Corporation (the Company SCC or we), a pioneer in RAID (Redundant Array of Independent Disks) technology is a provider of high performance storage software solutions focused on developing advanced storage architectures to address the emerging needs of high-bandwidth and other performance-impaired applications. Storage Computer s technology supports a variety of applications including advanced database activities, wide area network storage and sophisticated business continuity topologies including:

Networked Attached Storage

Storage Area Networks

Direct Attached Storage

Storage Wide Area Networking

Note B Basis of Presentation

The condensed consolidated financial statements include the accounts of Storage Computer Corporation and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all 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 related notes included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, containing our Consolidated financial statements for the fiscal year ended December 31, 2003. In management s opinion, the accompanying consolidated financial statements reflect all adjustments, all of which are of a normal, recurring nature, to fairly present our consolidated financial position, consolidated results of operations and consolidated cash flows. The consolidated results of operations for the three months ended March 31, 2004 are not necessarily indicative of the results to be expected for the full year.

Certain 2003 amounts have been reclassified to conform to the current period presentation. These reclassifications did not change previously reported total assets, liabilities, and stockholders equity or net loss.

Note C Liquidity Matters

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has suffered recurring losses from operations and negative cash flows that raise substantial doubt about its ability to continue as a going concern.

Management recognizes that the Company s continuation as a going concern is dependent upon its ability to generate sufficient cash flow to allow the Company to satisfy its obligations on a timely basis. The generation of sufficient cash flow is dependent on the successful expansion of the Company s share of the market for its software, controlling costs and securing new financing. Management s efforts in regard to these matters are described below. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Table of Contents

Our future success depends on maintaining adequate liquidity and working capital to meet our operational requirement; Revenues from products and services have fallen dramatically and continued to fall in the first quarter of 2004. We did not receive any revenue from license fees in 2003 or in the first quarter of 2004. and there can be no assurances that we will be able to secure license fees at all during the coming twelve months. Furthermore, given the continued volatility of the global securities markets and, in particular, the market for the securities of technology companies, as well as the recent results of our pending legal actions concerning enforcement of our intellectual property rights, we cannot assure you that we will be able to secure additional debt or equity financing. Our failure to maintain adequate liquidity and working capital would have a material adverse effect on the Company, our financial condition and results of operations.

We incurred operating losses through 2003 and we continue to incur operating losses at this time. While the development and introduction of our new products continues, our actual sales revenue has declined significantly over the last year and continues to be at a low level. In response, we have reduced our activity level in marketing, sales and administration and implemented cost reduction programs primarily in employee headcount, the use of independent software subcontractors and the level of expenses for development, travel and administration.

Our operating plan and related cash flow projections for 2003 were estimated by management anticipating only a base level of revenue from sales of our new products to new and existing customers and product upgrades, replacements parts and maintenance services from our existing customer base. We did not include any potential revenues from license fee activities. We initially projected our costs and expenses using our then current level of operating expenses for our core business activity and only the minimum requirements for the defense of our intellectual property.

Since our projected levels of revenues from products and services have not been achieved and additional financing has not been completed, management implemented further reductions in operating expense cash flow requirements to allow the Company to continue in business. On August 1, 2003, we implemented a salary reduction plan, adjusted fringe benefit packages, and reduced headcount to further reduce costs. In January 2004, salaries were reduced further in response to the need to preserve cash flow. Reductions in 2004 salaries are compensated for through a stock based compensation plan (requires no cash expenditure). In August 2003 our Chief Executive Officer and principal stockholder, through an affiliate of the Company controlled by him, began advancing funds to supplement the Company s cash flow for operating expenses and occupancy costs until operating cash flows improve and permanent additional financing can be arranged. Originally such advances were unsecured, due upon demand and accrued interest at the affiliate s cost of funds. Subsequently, the Board of Directors, with the Chief Executive Officer abstaining, approved the Company formalizing the agreement with the affiliate in the form of a $500,000 line of credit secured by all the assets of the Company with interest at the affiliate s cost of funds which is currently 26% and a one year term renewal by mutual agreement of the parties. The amount outstanding under the line of credit was $477,480 and $358,285 at March 31, 2004 and December 31, 2003 respectively.

While the dilutive effect might be significant, the Company continues to receive inquires from interested investors to provide equity financing using a variety of alternatives and the Company is pursuing these alternatives. Although there can be no assurances that we will obtain additional capital, management is committed to achieving or exceeding its operating plan for 2004 and intends to implement those additional cost reductions and improvements in cash flow necessary to achieve this success.

In July 2003, we engaged iCapital Finance, Inc. of Irvine, California as the Company s investment banking firm to assist us in structuring financing, providing access to capital resources, identifying candidates for marketing and distribution alliances, and to advise the Company on other strategic decisions. In September 2003, we established a sales representation relationship with Latin American Sales Solutions Consultants for our product offerings into the Latin American market. In April 2004, we signed a strategic alliance partnership agreement with MTC Direct (Micro Technology Concepts, Inc.). MTC Direct will carry Storage Computer s CyberNAS software product offering in their portfolio for distribution and private labeling worldwide. We continue to explore and negotiate strategic alliance relationships to market our new products and who would also provide the Company financial support.

The Company received notification from the American Stock Exchange (AMEX) on April 29, 2003 that the Company was not in compliance with certain listing standards relating to stockholders equity and net losses. In June 2003, the Company submitted a plan to AMEX setting forth a plan for compliance with the AMEX continuing listing standards. On July 28, 2003, AMEX notified the Company that it had accepted the proposed plan and granted an extension until October 31, 2004 to regain compliance. During such period, the Company s common stock will continue to trade on AMEX and the Company will be subject to periodic review of its progress consistent with its plan.

A delisting of our common stock from AMEX would materially reduce the liquidity of our common stock and result in a corresponding material reduction in the price of our common stock. In addition, any such delisting would materially adversely affect our access to the capital markets and the limited liquidity and reduced price of our common stock would materially adversely affect our ability to raise capital through alternative financing sources on terms acceptable to us or at all.

Table of Contents

There can be no assurances that our marketing efforts will be successful or that we will obtain additional capital or continue to receive funds from the affiliate of the Company as described above. If we are not successful in obtaining financing or other capital, the ability of the Company to continue operations at this level will be seriously impaired.

In addition, reference should be made to Liquidity and Capital Resources in Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations below.

Note D Stockholders Equity

A summary of changes in stockholders equity for the three months ended March 31, 2004 follows:

	Common Stock				
	Shares	Par Value	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders Equity
Balance December 31, 2003	38,650,060	$ 38,650	$ 85,612,531	$ (83,230,903)	$ 2,420,278
Stock issued to 401(k) plan	6,989	7	2,509		2,516
Stock issued and compensatory stock options granted for investment banking and consulting services, respectively	180,000	180	185,748		185,928
Net loss				(955,210)	(955,210)
Balance March 31, 2004	38,837,049	$ 38,837	$ 85,800,788	$ (84,186,113)	$ 1,653,512

Note E Related Party Transactions

In August 2001, the Company s Board of Directors approved the issuance of advances secured by demand notes receivable with interest at prime plus 1% to executive officers and directors of the Company in the aggregate amount of $500,000 for the purpose of purchasing the common stock of the Company in the public market. Demand notes receivable and accrued interest totaling $133,247 were outstanding at December 31, 2002. In May of 2003, $130,150 of demand notes receivable from three directors were forgiven and charged to other income (expense) in recognition of