SOUTHWALL TECHNOLOGIES INC /DE/
Form 10-Q
August 09, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the quarterly period ended July 1, 2001

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the transition period from ______ to ______

Commission File Number: 0-15930

SOUTHWALL TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-2551470**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1029 Corporation Way, Palo Alto, California	**94303**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(650) 962-9111**

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 ý No o

As of August 3, 2001 there were 8,187,722 shares of the Registrant's Common Stock outstanding

SOUTHWALL TECHNOLOGIES INC.

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PART I FINANCIAL INFORMATION

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Item 1 Financial Statements:

SOUTHWALL TECHNOLOGIES INC.
CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	July 1, 2001	December 31, 2000
	(Unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 558	$ 61
Restricted cash	391	1,849
Accounts Receivable, net of allowance for bad debts of $469 and $640	12,315	13,317
Inventories, net	6,391	10,174
Other current assets	2,004	2,008
Total current assets	$ 21,659	$ 27,409
Property, plant and equipment, net	48,128	49,884
Other assets	3,173	3,169
Total assets	$ 72,960	$ 80,462
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank line of credit	$ 7,247	$ 8,719
Accounts payable	12,800	16,857
Accrued compensation	2,000	1,915
Other accrued liabilities	5,094	4,551

Government grants advanced	889	1,085
Current portion long-term debt	7,150	5,806
Long-term debt reclassified to current	16,443	20,624
Total current liabilities	51,623	59,557
Other	753	767
Total liabilities	52,376	60,324
Stockholders' equity:		
Common stock, $0.001 par value, 20,000 shares authorized; issued and outstanding 8,311 and 7,889	8	8
Capital in excess of par value	52,623	51,764
Less cost of treasury stock, 123 and 166 shares outstanding	(620)	(839)
Notes receivable	(107)	(99)
Other Comprehensive Income		
Translation loss on subsidiary	(828)	(151)
Accumulated deficit	(30,492)	(30,545)
Total stockholders' equity	20,584	20,138
Total liabilities and stockholders' equity	$ 72,960	$ 80,462

See accompanying notes to consolidated financial statements.

SOUTHWALL TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2001	July 2, 2000	July 1, 2001	July 2, 2000
Net revenues	$ 21,946	$ 20,928	$ 39,659	$ 38,037
Costs and expenses				
Cost of sales	16,320	16,922	31,169	31,705
Research and development	1,184	1,578	2,609	3,089
Selling, general and administrative	3,057	3,102	5,713	5,094
Legal settlement		402		402
Total costs and expenses	20,561	22,004	39,491	40,290

Income (loss) from operations		1,385		(1,076)		168		(2,253)
Interest (expense), net		(781)		(607)		(1,538)		(1,020)
Other Income (expense), net		500		77		1,364		20
Income (loss) before provision for income taxes		1,104		(1,606)		(6)		(3,253)
Provision for income taxes		(80)		41		(59)		77
Net income (loss)	$	1,184	$	(1,647)	$	53	$	(3,330)
Net income (loss) per share:								
Basic	$	0.15	$	(0.22)	$	0.01	$	(0.44)
Diluted	$	0.15	$	(0.22)	$	0.01	$	(0.44)
Weighted average shares of common stock and dilutive common stock equivalents:								
Basic		8,066		7,631		7,904		7,599
Diluted		8,086		7,631		7,918		7,599

See accompanying notes to consolidated financial statements.

SOUTHWALL TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

	Six Months Ended,			
		July 1, 2001		July 2, 2000
Cash flows (used in) or provided by operating activities:				
Net (loss)	$	53	$	(3,330)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization		2,779		2,413
Decrease (increase) in accounts receivable, net		1,003		(1,791)
Decrease (increase) in inventories, net		3,783		(4,054)
Decrease (increase) in other current and non-current assets		4		58
Increase (decrease) in accounts payable, and accrued liabilities		(3,443)		5,793
Cash provided by operating activities		4,179		(911)
Cash flows from investing activities:				

(Increase) decrease in restricted cash	1,458	(465)
Expenditures for property, plant and equipment and other assets	(1,032)	(8,985)
Net cash used in investing activities	426	(9,450)
Cash flows from financing activities:		
Proceeds from borrowings	-	7,109
Proceeds from sale of stock	970	-
Principal payments on borrowings	(4,309)	-
Repayment of stockholder's note receivable	(7)	724
Issuance of common stock upon exercise of stock options, net	(80)	-
Issuance (purchase) of treasury stock, net	190	805
Net cash provided by (used in) financing activities	(3,236)	8,638
Foreign exchange fluctuation	(872)	-
Net increase (decrease) in cash and cash equivalents	497	(1,723)
Cash and cash equivalents, beginning of year	61	1,772
Cash and cash equivalents, end of period	$ 558	$ 49

See accompanying notes to consolidated financial statements.

SOUTHWALL TECHNOLOGIES INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands) (Unaudited)

Note 1 Interim Period Reporting:

While the information presented in the accompanying consolidated financial statements is unaudited, it includes all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the Company's financial position and results of operations, and changes in financial position as of the dates and for the periods indicated.

Certain information and footnote disclosures normally contained in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the financial statements contained in the Company's Form 10-K\A for the year ended December 31, 2000 filed on April 11, 2001. The results of operations for the interim periods presented are not necessarily indicative of the operating results of the full year.

Note 2 Balance Sheet:

Restricted Cash

Restricted cash consists of the unapplied portion of grants received from the German government to co-finance the costs of the construction of the Company's German facility. In the event the Company fails to meet certain conditions related to the grants, the German government has the right to reclaim the grant. (See Note 6)

Inventories, net

Inventories are stated at the lower of cost (determined by the first-in- first-out method) or market. Inventories consisted of the following:

	July 1, 2001	December 31, 2000
Raw Materials	$ 3,220	$ 4,394
Work-in-progress	2,570	4,799
Finished goods	601	981
Total inventories	$ 6,391	$ 10,174

Note 3 Net income (loss) per share:

Basic net income (loss) per share is computed by dividing income available to common shareholders (numerator) by the weighted average number of common shares outstanding (denominator) for the period. Diluted net income (loss) per share gives effect to all dilutive potential common shares outstanding during the period. The computation of diluted earnings per share uses the average market prices during the period. During each of the periods presented there were no differences between the numerators used for calculation of basic and diluted net income (loss) per share. The total amount of the difference in the basic and diluted weighted average shares of common stock and common stock equivalents in the periods where there is net income is attributable to the effect of dilutive stock options. In net loss periods, the basic and diluted weighted average shares of common stock and common stock equivalents are the same because inclusion of stock options would be anti-dilutive.

Note 4 Financing Line of Credit:

The Company has a $10 million receivable financing line of credit with a bank. Availability under the line of credit is based on 80% of the approved account receivable balance and bears a finance fee of 0.088% per month of the average daily account balance outstanding during the settlement period. In connection with the line of credit, the Company has granted the bank, a continuing lien upon and security interest in, and right of set off with respect to all of the Company's rights, title and interest in all accounts receivable, inventory, monies, remittances and fixed assets. There was $7.2 million of borrowings outstanding under this line of credit at July 1, 2001. (See Note 9 Going Concern and Loan Covenants)

Note 5 Long-term debt:

The Company's long-term debt consisted of the following at July 1, 2001:

Description	Rate	Balance at July 1, 2001	Remaining Annual Principal Amortization
Financing Line of Credit		$ 7,247	-
Long-term debt			
Promissory note dated May 6, 1997	LIBOR +.4375	8,750	$ 1,250
Sales-leaseback agreement dated July 19, 1999	13.0%	2,321	711
Sales-leaseback agreement dated October 19, 1999	13.0%	2,446	1,374
German bank loan dated May 12, 1999	6.1%	2,450	144
German bank loan dated May 28, 1999	7.1%	2,114	-
German bank loan dated May 28, 1999	3.8%	1,328	121
German bank loan dated December 1, 1999	7.2%	1,794	50
German bank loan dated August 14, 1999	5.8%	1,427	-
German bank loan dated June 29, 2000	5.8%	548	84
German bank loan dated July 20, 2000	7.1%	396	72
Other equipment financings		19	3
Total long-term debt		23,593	3,809

Less current portion		7,150
Less long-term portion-reclassified to current		16,443
Long-Term Debt	$	0

The promissory note dated May 6, 1997 is payable to a Sanwa Bank. The note payments are guaranteed by Teijin Limited in Japan (Teijin), a stockholder and supplier of the Company. The Teijin guarantee is collateralized by certain equipment located in the Company's Tempe manufacturing facility and inventory, to the extent necessary to provide 120% net book value coverage of the outstanding loan balance. The interest rate on the loan is re-set semi-annually at LIBOR plus 0.4375% (5.25% and 7.45% at July 1, 2001 and July 2, 2000 respectively). The Company is also subject to certain financial covenants. A loan guarantee service fee is payable to Teijin semi-annually on the outstanding balance at the rate of 0.5625%. The note provides for semi-annual payments of interest only during the first four years, followed by semi-annual installments plus interest for the four year term. The remaining scheduled principal payments for 2001 are $1.25 million. Teijin also received warrants in 1997 to purchase 158,000 shares of the Company's common stock at $9 per share. These warrants were not exercised and expired on May 30, 2000. At July 1, 2001 the Company was not in compliance with certain of the financial covenants with Teijin, the guarantor, pertaining to this promissory note. The Company received a waiver from Teijin through October 1, 2001. Teijin did not agree to extend the waiver beyond this date. Accordingly, the Company has reclassified the balance from long-term debt to current liabilities in the balance sheet. (See Note 9 - GOING CONCERN AND LOAN COVENANTS)

During 1999, the Company entered into two equipment sale-leaseback agreements with a leasing company ("Lessor"). Because the Company has an option to purchase the equipment at a price to be determined between the Company and the Lessor at the end of the lease period, the sale-leaseback agreements have been treated as financing. One lease agreement has a lease term of three years and the other lease agreement has an initial lease term of two years with an option to extend it for an additional year. At July 1, 2001, the Company had a total of $4.8 million outstanding under these leases. The leases are collateralized by the leased equipment and certain other production equipment of the Company. The effective interest rate of both leases is approximately 13% per annum and they are repayable over their lease term commencing in May 2000. Additionally, the Company has provided the Lessor an irrevocable standby letter of credit in the amount of $0.5 million to collateralize all of the Company's obligations under these agreements. The letter of credit shall not expire before January 1, 2002. In addition, $1 million of the amounts due from the Lessor was not funded, but will be released upon the Company satisfying certain financial conditions. Due to the uncertainty of compliance with these financial conditions, the Company has classified this amount under non-current "Other Assets." However, the amount payable to the Lessor under the capitalized leases includes the unfunded amount of $1.0 million. (See Note 9 GOING CONCERN AND LOAN COVENANTS)

On May 12, 1999, the Company entered into a loan agreement with a German bank that provides for borrowings up to $2.9 million (DM 6.0 million). Under the terms of this agreement, the funds were used solely for the purpose of capital investment by the German subsidiary. The term of the loan is for a period of 10 years and the principal is repayable in Deutschemarks after the end of one year in 36 quarterly payments. The loan bears interest at 6.1% per annum for the first five years, and will be adjusted to the prevailing rate at the end of the fifth year. At July 1, 2001, the amount outstanding under this bank loan was $2.4 million. (See Note 9 - GOING CONCERN AND LOAN COVENANTS)

On May 28, 1999, the Company entered into a general loan agreement with a German bank. Under the terms of the loan agreement, funds are available in three tranches, and shall be used solely for the purpose of capital investment by the German subsidiary. The first tranche provides for borrowings of $2.2 million (DM 4.89 million) for a term of twenty years. The principal is repayable after ten years in ten equal, semi-annual payments. The loan bears fixed interest of 7.1% per annum for the first ten years. At July 1, 2001, the amount outstanding was $2.1 million. The second tranche provides for borrowings of $1.5 million (DM 3.35 million) for a term of seven years and the principal is repayable after one year in twelve equal, semi-annual payments. The loan bears fixed interest at 3.8% per annum for the period of seven years. At July 1, 2001, the amount outstanding was $1.3 million. The third tranche, dated December 1, 1999, provides for borrowings of $1.87 million (EURO 2.121 million) for a term of ten years, and the principal is repayable after one year, in thirty six equal quarterly payments. The loan bears fixed interest of 7.15% per annum for the first five years. At July 1, 2001, the amount outstanding was $1.8 million. All of the proceeds from the loans were received during 1999. (See Note 9 - GOING CONCERN AND LOAN COVENANTS)

On August 14, 1999, the Company entered into a loan agreement with a German bank that provides for borrowings up to $1.7 million (DM 3.3 million). Under the terms of this agreement, the funds will be used solely for the purpose of capital investment by the German subsidiary. The principal balance is due in a single payment on June 30, 2009 and bears interest at a rate of 5.8% per annum. The interest is payable quarterly in Deutschemarks. 50% of the loan proceeds are restricted in an escrow account for the duration of the loan period and are classified as non-current "Other Assets." At July 1, 2001, the amount outstanding under this bank loan was $1.4 million. (See Note 9 - GOING CONCERN AND LOAN COVENANTS)

On June 29, 2000, the Company entered into a loan agreement with a German bank that provides for borrowings up to $481 (DM 1.0 million). Under the terms of this agreement, the funds will be used solely for the purpose of capital investment by the German subsidiary. The principal balance is repayable in 12 quarterly payments beginning June 2001 and bears interest at a rate of 5.8% per annum. The interest is payable quarterly in Deutschemarks. At July 1, 2001, the amount outstanding under this bank loan was $0.5 million. (See Note 9 - GOING

CONCERN AND LOAN COVENANTS)

On July 20, 2000, the Company entered into a loan agreement with a German bank that provides for borrowings up to $480 (EU 511). Under the terms of this agreement, the funds will be used solely for the purpose of capital investment by the German subsidiary. The principal balance is repayable in 12 quarterly payments beginning June 2001 and bears interest at a rate of 7.1% per annum. The interest is payable quarterly in EURO dollars. At July 1, 2001, the amount outstanding under this bank loan was $0.4 million. (See Note 9 - GOING CONCERN AND LOAN COVENANTS)

The preceding German bank loans are collateralized by the production equipment, building and land owned by the German subsidiary.

Other long-term debt consists of capitalized leases related primarily to certain computer equipment used by the Company.

Scheduled principal reductions of long-term debt for the balance of 2001 and the fours years following and thereafter, are as follows:

Year		Amount
2001	$	3,809
2002		5,606
2003		4,217
2004		3,348
2005		729
Thereafter		5,884
Total	$	23,593

The Company incurred total interest expense of million $0.8 million and $1.26 million in second quarter of 2001 and 2000, respectively. Of these amounts, the Company capitalized $0.0 million and $0.73 million in the second quarter of 2001 and 2000 respectively as part of the costs related to the construction of new production machines and facilities.

Note 6 Government Grant:

The Company has an agreement to receive a grant award (the "Grant"), which was approved by the State Government of Saxony in Germany (the "Grantor") in May 1999. The agreement provides for investment grants to a maximum amount of $9.9 million (DM 20.3 million). As of July 1, 2001, the Company had received approximately $4.9 million (DM 9.7 million) under this Grant and accounted for the Grant by applying the proceeds received against the cost of the German manufacturing facility. During 2000, the Company also received $1.0 million (DM 2.1 million) in investment allowances from the German government and those proceeds were applied against the cost of the German manufacturing facility. The Company expects to receive an additional $1.0 million in investment allowances from the German government in 2001 although no assurances can be given. Those funds will also be applied against the cost of the German manufacturing facility. Additionally, the Company has received $0.9 million of government grants that have been recorded as an advance until the Company earns the grant through future expenditures. The Company s total investment in the German operations at July 1, 2001 was $15.4 million (DM 36.0 million), net of grants received from the German government.

The Grant is subject to the following requirements:

a) The grant is earmarked to co-finance the costs of the construction of a facility to manufacture Heat Mirror XIR® film for the automotive glass industry, located at Grossroehrsdorf, Germany.

b) The construction period for the project is from March 15, 1999 to March 14, 2002.

c) The total investment should be at least $39.2 million (DM 80.3 million).

d) The project must create at least 143 permanent jobs and 7 apprenticeships by March 15, 2002.

In the event that the Company fails to meet the above requirements, the Grantor has the right to reclaim the Grant. The Company does not currently have financing in place to purchase a third machine in Germany and it has postponed the placing of this order until financing can be secured. Presently, the Company can not determine the total investment that will be made in the German facility and is in the process of reviewing the total investment and timing thereof with the Grantor. The Company believes that it will not meet all of the conditions to the Grant due to the lack of availability of the equipment manufacturer to provide the equipment in time to meet the schedule, and the Company's ability to obtain sufficient financing at this time. The Company has had informal discussions with the Saxony government, but is unable to predict the outcome and the impact, if any, on the Company s obligations under the grant.

The Company is eligible for additional investment allowances from the German government amounting to $3.7 million (DM 7.7 million) calculated based on a capital investment of $39.2 million (DM 80.3 million), subject to European Union regulatory approval.

The investment allowance is subject to the following requirements:

a) The movable and immovable assets which acquisition costs are taken into account in determining the investment allowance shall be employed within the subsidized territory for a period of at least five years following the acquisition or production.

b) The movable assets which acquisition costs are taken into account in determining the increased investment allowance shall remain in a business that is engaged in the processing industry, or in a similar production industry for a period of at least five years following the acquisition or production.

In the event that the Company fails to meet the above requirements, the investment allowance must be paid back, with interest.

Note 7 Segment Reporting:

In 1998, the Company adopted Statement of Financial Accounting Standards No. 131 ("SFAS 131"), "Disclosures about Segments of an Enterprise and Related Information." SFAS 131 supercedes SFAS 14, "Financial Reporting for Segments of a Business Enterprise" replacing the "industry segment" approach with the "management" approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments. SFAS 131 also requires disclosures about products and services, geographic areas, and major customers. The Company is organized on the basis of products and services. The Company considers itself to operate in one segment which is in the advanced film coatings. The Company derives revenue from three sources. The total net revenues for the Electronic Display, Automotive Glass and Building product lines were as follows:

	Three Months Ended		Six Months Ended	
	July 1, 2001	July 2, 2000	July 1, 2001	July 2, 2000
Electronic display				