CLARION TECHNOLOGIES INC/DE/
Form 10-Q
August 15, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 2006

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 0-24690

CLARION TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1407411**
(State of Incorporation)	(I.R.S. Employer Identification No.)

5041 68th Street SE, Caledonia, Michigan 49316
(Address of principal executive offices)
(Zip Code)
(616) 698-6630
(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. þ Yes o No

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. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell corporation (as defined by Rule 12b-2 of the Exchange Act.) o Yes þ No

The number of shares outstanding of registrant s common stock was 45,406,367 as of August 15, 2006.

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Second Quarter Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Net sales	$ 29,197	$ 38,980	$ 65,033	$ 71,254
Cost of sales	28,304	36,550	63,383	68,700
Gross profit	893	2,430	1,650	2,554
Operating expenses:				
Selling, general and administrative expenses	1,713	1,806	3,497	3,483
Operating income (loss)	(820)	624	(1,847)	(929)
Interest expense	(1,453)	(1,284)	(2,806)	(2,591)
Other income, net	5	20	10	31
Loss before income taxes	(2,268)	(640)	(4,643)	(3,489)
Provision for income taxes				
Net loss	$ (2,268)	$ (640)	$ (4,643)	$ (3,489)
Basic and Diluted EPS calculation:				
Numerator:				
Net loss	$ (2,268)	$ (640)	$ (4,643)	$ (3,489)
Preferred stock dividends declared	(3,303)	(2,724)	(6,494)	(5,503)
Accretion of preferred stock to mandatory redemption value	(245)	(235)	(487)	(485)
Net loss attributable to common shareholders	$ (5,816)	$ (3,599)	$ (11,624)	$ (9,477)
Denominator:				
Average common shares outstanding (basic and diluted)	45,406	45,391	45,406	45,342
Loss per share attributable to common shareholders (basic and diluted)	$ (0.13)	$ (0.08)	$ (0.26)	$ (0.21)

See accompanying notes to condensed consolidated financial statements.

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CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	July 1, 2006 (UNAUDITED)	December 31, 2005 (AUDITED)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 53	$ 97
Accounts receivable, net of allowance of $99 and $162	14,873	14,916
Inventories	5,615	4,430
Prepaid expenses and other current assets	1,421	576
Total current assets	21,962	20,019
Property, plant and equipment, net	23,312	23,482
Other assets:		
Goodwill	24,521	24,521
Deferred financing costs, net of accumulated amortization of $806 and $750	97	153
Other long-term assets	149	270
	24,767	24,944
	$ 70,041	$ 68,445
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current liabilities:		
Revolving line of credit	$ 10,750	$ 9,375
Accounts payable	20,386	17,240
Accrued liabilities	3,162	2,236
Accrued interest	9,112	7,483
Accrued dividends	23,332	
Mandatorily redeemable common stock	2,550	
Current portion of long-term debt	23,346	24,480
Total current liabilities	92,638	60,814
Long-term debt, net of current portion	717	400
Mandatorily redeemable common stock		2,550
Accrued dividends	17,087	33,924
Other liabilities	228	202
Total liabilities	108,120	97,890
Redeemable Series A preferred stock	37,664	36,227

Redeemable Series B preferred stock		19,301		19,251
Shareholders deficit:				
Common stock		45		45
Additional paid-in capital		32,158		32,590
Accumulated deficit		(129,461)		(118,273)
Accumulated other comprehensive loss		(336)		(285)
Total shareholders deficit		(97,594)		(85,923)
	$	70,041	$	68,445

See accompanying notes to condensed consolidated financial statements.

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CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Six Months Ended	
	July 1, 2006	July 2, 2005
OPERATING ACTIVITIES**:**		
Net loss	$ (4,643)	$ (3,489)
Depreciation and amortization	2,110	1,958
Changes in operating assets and liabilities	3,823	2,116
Loss on sale of property, plant, and equipment	2	181
Other, net	4	
Cash provided by operating activities	1,296	766
INVESTING ACTIVITIES:		
Capital expenditures	(1,139)	(1,550)
Proceeds from sale of property, plant, and equipment	2	1,499
Cash used in investing activities	(1,137)	(51)
FINANCING ACTIVITIES:		
Net change in revolving credit borrowings	1,375	650
Proceeds from issuance of long-term debt		1,731
Repayments of long-term debt	(1,578)	(3,120)
Proceeds from issuance of capital stock		14
Cash used in financing activities	(203)	(725)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(44)	(10)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	97	109
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 53	$ 99

See accompanying notes to condensed consolidated financial statements.

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CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. OPERATIONS AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Clarion Technologies, Inc. and Subsidiaries (collectively referred to as Clarion or the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and other adjustments) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K for the fiscal year ended December 31, 2005. Due to fiscal 2005 being comprised of a 53 week year, the first six months of fiscal 2005 included 27 weeks of activity, compared to 26 weeks in the first six months of fiscal 2006.

The Company operates in a single geographic location, North America, and in a single reportable business segment, plastic injection molding. The accounting policies of this reportable business segment are described in the summary of significant accounting policies in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Share-Based Compensation

In the first quarter of fiscal 2006, the Company adopted SFAS 123(R), *Share-Based Payment,* and began expensing options issued under the 1998 and 1999 Stock Option Plans, which are shareholder approved. Options under the plans are granted for compensation to both employees and non-employee Directors as well as to outside vendors for services rendered; all option issuances must be approved by the Board of Directors. Options are granted at the current market price on date of grant, vest immediately to five years, and have lives from five to ten years. During the first six months of fiscal 2006, the Company recorded approximately $5,000 of compensation expense which was calculated using the Black-Scholes -Merton Model.

In addition to the two stock option plans discussed above, the Company issues nonqualified stock options from time to time that fall outside of these approved plans. The Board of Directors determines the terms of the options at the time of issuance. As of July 1, 2006, a total of 300,000 options were outstanding relating to these separate issuances.

The following table (in thousands, except per share data) illustrates the effect on net loss and net loss per share attributable to common shareholders as if the Company had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), to stock-based employee compensation and non-employee Director compensation in prior fiscal years.

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	Second Quarter Ended July 2, 2005	Six Months Ended July 2, 2005
Net loss attributable to common shareholders	$(3,599)	$ (9,477)
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	6	17
Pro forma net loss attributable to common shareholders	$(3,605)	$ (9,494)
Earnings per share:		
Basic and diluted, as reported	$ (0.08)	$ (0.21)
Basic and diluted, pro forma	$ (0.08)	$ (0.21)

The fair value of each option award is estimated on the date of grant using an intrinsic value method that uses the assumptions noted in the following table. Because intrinsic valuation models incorporate ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on implied volatilities historical volatility of the Company s stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2006	2005
Expected dividends	0.0%	0.0%
Volatility, as a percent	69% to 149%	69% to 102%
Weighted average volatility	116%	85%
Risk-free interest rate	4.3% to 5.3%	4.3% to 5.0%
Expected life in years after vest	9	9

A summary of option activity under the Stock Option Plans as of July 1, 2006, and changes during the six months then ended is presented below:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2006	1,196,000	$ 1.36
Granted	42,000	0.07
Outstanding at July 1, 2006	1,238,000	1.32

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A summary of the status of the Company s nonvested shares as of July 1, 2006, and changes during the six months ended July 1, 2006, is presented below:

Nonvested Shares	**Shares**	**Weighted-Average Grant-Date Fair Value**
Nonvested at January 1, 2006	84,000	$ 0.13
Granted	42,000	0.07
Vested	(42,000)	0.06
Forfeited		
Nonvested at July 1, 2006	84,000	$ 0.09

As of July 1, 2006 the Company had $5,381 of unrecognized compensation costs related to non-vested share based payment awards that are expected to be recognized over a weighted average period of one year.

Comprehensive Loss

The Company s total comprehensive loss is comprised of all changes in shareholders deficit during the period other than from transactions with shareholders. Comprehensive loss consists of the following (in thousands):

	Six Months Ended	
	July 1, 2006	July 2, 2005
Net loss	$(4,643)	$(3,489)
Other comprehensive income (loss):		
Market valuation adjustment of interest rate swap, net of tax	(51)	(63)
Comprehensive loss	$(4,694)	$(3,552)

Interest Rate Swap Agreement

The Company is exposed to various market risks, which include changes in interest rates. In accordance with the terms of the Senior Credit Agreement discussed in Note 3, the Company has entered into an interest rate swap agreement to reduce the impact of changes in interest rates on its debt and revolving credit facility. Interest rate swap agreements are contracts to exchange floating rates for fixed rate interest payments over the life of the agreements without the exchange of the underlying notional amounts. The notional amounts of interest rate swap agreements are used to measure interest to be paid or received and do not represent the amount of exposure to credit loss. The differential paid or received on interest rate swap agreements is recognized as an adjustment to interest expense. The Company does not use derivative financial instruments for trading purposes.

The interest rate swap agreement essentially fixes the interest rate on a notional amount of principal ($13,791,000 at July 1, 2006), which decreases with each monthly settlement at a rate corresponding to the Company s actual principal payments on the related debt. The interest rate swap agreements expire in 2008 and 2010 and management currently has no intent to renew those agreements or enter into similar agreements in the near future. The net fair value of the swap agreement at July 1, 2006 was approximately $(336,000) and is recorded as a current liability on the balance sheet. Changes in the fair value of the swap agreement are reported as a component of other comprehensive loss.

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The counterparty to the Company s interest rate swap agreement is a commercial bank with which the Company has other financial relationships. While the Company is exposed to credit loss in the event of nonperformance by the counterparty, the Company does not anticipate nonperformance by the counterparty, and no material loss would be expected from such nonperformance. Fluctuations in interest rates are similarly not expected to have a material impact on the Company s future operating results.

The Company has formally documented the relationship between the interest rate swap and the term debt and revolving credit facility, as well as its risk-management objective and strategy for undertaking the hedge transaction. This process includes linking the derivative that has been designated as a cash flow hedge to the specific liability on the balance sheet. The Company also assesses, both at the hedge s inception and on an ongoing basis, whether the derivative used in the hedging transaction is highly effective in offsetting changes in the cash flows of the hedged item. If the Company determines that the derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company will discontinue hedge accounting prospectively.

New Accounting Pronouncement

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in the financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of this statement is not expected to have a material impact on the Company s consolidated financial position or results of operations.

Reclassifications

Certain amounts previously reported in prior fiscal years in the condensed consolidated balance sheets of the Company have been reclassified to conform with the presentation of the current quarter.

2. INVENTORIES

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method. The components of inventories are as follows (in thousands):

	July 1, 2006	December 31, 2005
Raw materials	$ 3,387	$ 2,830
Work in process	463	595
Finished goods	1,765	1,005
Total	$ 5,615	$ 4,430

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3. DEBT

Debt consists of the following obligations (in thousands):

	July 1, 2006	December 31, 2005
Senior credit facility:		
Revolving credit facility	$ 10,750	$ 9,375
Term debt	9,184	10,578
Senior and other subordinated term notes, net of unaccreted discount of $249 and $373	9,751	9,627
Other subordinated promissory notes	3,937	3,928
Capital lease obligations	1,190	747
	34,812	34,255
Less current portion	34,095	33,855
Long term portion	$ 717	$ 400

On March 31, 2006, the Company defaulted on certain financial covenants contained in the Company s Senior Loan Agreement as well as certain financial covenants contained in the Company s Senior Subordinated Loan Agreement. Those defaults and subsequent defaults are ongoing. The Company s debt has not been accelerated but substantially all of it, including accrued interest, is classified as current due to the covenant violations. In conjunction with the July 27, 2006 transaction described below and generally, the Company continues to negotiate with its lenders to obtain default waivers and amendments to both credit facilities. The Company believes it will reach a solution acceptable to all parties.

On July 27, 2006, the senior lenders to the Company entered into a Modification and Consent Agreement (Consent Agreement) with the Company, certain of its subsidiaries, William Blair Mezzanine Capital Fund III, L.P. (Blair), and Crown Realty Holdings, LLC (Crown). Pursuant to the Consent Agreement, Blair and Crown loaned the Company an aggregate $1,375,000 (Loan), the principal of which Loan is due and payable on December 31, 2006 (Blair: $1,000,000; Crown: $375,000). The Loan is pre-payable at the Company s and the holders option, subject to certain restrictions. The Loan is *pari passu* with the Company s debt to its senior lenders, except that it is unsecured. If the Loan is not repaid as of December 31, 2006, the unpaid amount of the Loan will become additional subordinated debt under the terms of the Senior Subordinated Loan Agreement pursuant to which Blair and Crown are already parties.

As consideration for the Loan, Blair and Crown will receive (a) on July 31, 2006, their pro rata share of 250 shares of Class A Preferred Stock of the Company, and (b) on November 1, 2006, up to 750 additional shares of Class A Preferred Stock of the Company, adjusted pro rata for the amount of unpaid principal of the Loan as of such date. To the extent the Loan is not paid in full as of December 31, 2006, Blair and Crown will receive, as additional consideration, their pro rata portion of 1,000 shares of Class A Preferred Stock of the Company.

The Company refinanced its senior debt on April 14, 2003 and increased the limits on its revolving credit facility on March 12, 2004. The revolving credit facility is scheduled to mature on December 31, 2006, and allows for aggregate borrowings of $12,000,000 at the prime rate plus 0.50% (8.25% at July 1, 2006) or, at the Company s option, 1, 2, 3 or 6-month LIBOR plus 3.25%, subject to certain borrowing base limitations related to accounts receivable and inventory. On July 1, 2006, there were $1,250,000 of available borrowings under this revolving credit facility. In addition, an unused facility fee of 0.375% per annum is payable on the unused portion of the credit line. The term debt is scheduled to mature on April 15, 2007 and bears interest at the prime rate plus 0.75% or, at the Company s option, 1, 2, 3 or 6-month LIBOR plus 3.5% plus an applicable margin. The interest rate on the term debt at July 1, 2006 was 8.52%. On December 15, 2005, the Company refinanced its capital expenditure line of credit into a term note. At July 1, 2006, the balance of this term note was $2,550,000 and it is schedule to mature on April 15, 2007. The

Company is required to pay $183,333 monthly on the capital expenditure term debt until maturity.

On December 27, 2002, the Company s senior subordinated debt and related accrued interest were restructured and replaced with 37,770 shares of Series A Preferred Stock of the Company and new senior subordinated debt of $10,000,000. The restructured senior subordinated debt is scheduled to mature on June 30, 2007, and is currently accruing interest at 15% because interest payments are precluded under the terms of the Senior Loan Agreement. According to the terms of these notes as amended in April 2004, payment of that interest is deferred until the

Company maintains the fixed charge ratio stipulated in the amendment for four consecutive quarters. Interest and dividends, therefore, have been accrued through July 1, 2006. The Senior Credit Facility and Senior Subordinated Loan Agreement also prohibit the payment of dividends on common stock.

On December 16, 2005, the Company obtained an additional $2,000,000 senior revolving line of credit that is secured by $2,000,000 in letters of credit provided by certain of its senior subordinated lenders. If the letters of credit that secure the line are drawn upon, upon the occurrence of an event of default, any borrowings under this line of credit convert to senior subordinated debt and are owed to the particular senior subordinated lenders that provided the letters of credit, Mr. Craig Wierda and Blair. If the letters of credit are drawn upon, the Company must issue those senior subordinated lenders 150 shares of its Series A Preferred Stock and if the newly created $2,000,000 of senior subordinated debt is not paid by January 7, 2007, the Company must issue those senior subordinated lenders an additional 250 shares of its Series A Preferred Stock. The letters of credit have not been drawn upon, despite the Company s ongoing defaults.

In 2003, the Company and the former owners of Drake (now known as A&M Holdings, Inc.) entered into a settlement. In conjunction with this settlement, Blair and Mr. Craig Wierda purchased Company notes payable to A&M Holdings, Inc. in the principal amount of $2,067,500 along with related accrued interest of $670,000. The purchased notes and related accrued interest were replaced with two new subordinated promissory notes (Settlement Notes), each in the principal amount of $1,379,000. These Settlement Notes bear interest at 18% and are due February 28, 2007. In September 2003, Blair and Wierda transferred $136,000 in principal amount of these notes to Thomas Wallace, a former officer of the Company. Mr. Wallace s Settlement Note has matured, however, the Company is precluded from paying principal and interest under the terms of its Senior Loan Agreement. The settlement also included a provision requiring the Company to issue a total of 800 shares of Series A Preferred Stock to the holders of the Settlement Notes because they were not paid in full by September 2, 2003; accordingly, the Company issued these preferred shares pro rata and recognized expense of $368,000.

Other subordinated promissory notes at July 1, 2006 consisted principally of: (i) the Settlement Notes described above and (ii) an unsecured note in the original principal amount of $1,000,000 issued in connection with the acquisition of Drake Products Corporation that requires periodic payments of interest only at 12% and matures on August 1, 2007.

Based on the contractual terms of all debt agreements (as amended), principal maturities and capital lease obligations for the twelve-month period ended July 1 are as follows: 2007 $34,096,000; 2008 $279,000; 2009 $245,000; 2010 $154,000; 2011 $39,000

4. COMMITMENTS AND CONTINGENCIES

The Company is involved in certain claims and litigation arising in the normal course of business, including certain other litigation involving claims alleging damages under various contractual arrangements. After taking into consideration legal counsel s evaluation of these claims and actions, the Company is currently of the opinion that their outcome will not have a significant effect on the Company s consolidated financial position or future results of operations and cash flows.

5. OPERATING CONSIDERATIONS AND MANAGEMENT PLANS

As shown in the financial statements, the Company incurred a significant net loss in the first six months of fiscal 2006 and is highly leveraged. The Company is also experiencing liquidity constraints and has a deficit position in working capital and shareholders equity.

The Company has been negotiating with its lenders to obtain default waivers and amendments to both loan agreements. As of the date of these financial statements, the Company and its lenders have been unable to agree upon the terms of those waivers and amendments. The Company believes it will reach a solution that is acceptable to all parties.

Nevertheless, if the Company cannot reach agreement with its lenders, such defaults allow the lenders to discontinue lending or declare all borrowings outstanding to be due and payable. If any of these events occur, there is no

assurance that the Company will have sufficient funds available to pay in full the total amount of obligations that become due as a result of any such acceleration, or that the Company will be able to find additional or alternative financing to refinance any such accelerated obligations.

Also, on June 30, 2007, the Company is obligated to pay its senior subordinated debt and redeem its Series A Preferred Stock. Based upon current and anticipated operations, cash flows and capital resources, the Company does not expect to satisfy these obligations without further restructuring of its capital and debt obligations. As of the date of these financial statements, the Company can make no assurances that it will successful in effecting such a restructuring.

The Company has been proactively addressing its current liquidity and operational issues in an effort to improve cash flows. On April 14, 2003, the Company refinanced its senior debt and modified the terms of certain portions of its subordinated debt. The term loan portion of the Senior Loan Agreement is scheduled to mature on April 15, 2007 and the line of credit is scheduled to mature on December 31, 2006. The terms of the Senior Loan Agreement allow the Company to make payments on its subordinated debt, subject to certain limitations. In addition, since fiscal 2001, subordinated debt holders and preferred shareholders have agreed to defer interest and dividend payments through the maturity date of the senior debt, unless approved by the Company s senior lender. The Company s senior lender is allowing payments on the Company s Drake note. See Note 3 herein.

In 2005, the Company adjusted its manufacturing footprint to position itself for improved performance. Specifically, it consolidated the business in the two Pella, Iowa facilities to the Ames, Iowa plant. The two Pella, Iowa plants were leased on a short-term basis and are no longer an obligation. Also, the South Haven, Michigan plant was sold and the business in that facility was transferred to other Michigan facilities. The lease of the South Haven plant ended on December 31, 2005. These moves removed three plants from the manufacturing footprint and will reduce operating expense going forward. In addition, the Juarez, Mexico facility was opened in August to prepare for the transfer of business from the Greenville, Michigan facility.

In 2006, the Company is focused on executing the following key actions:

Execute transfer of business and start-up of Juarez, Mexico facility

The Company has a major customer that has moved its business from Greenville, Michigan to Juarez. The business remains with the Company and will be moved to Juarez. The

Company expects to complete the transfer of business from Greenville to Juarez in 2006. In addition to the transfer of existing business, the Company has also obtained incremental business that will be produced out of the Juarez plant.

Basic and diluted net loss per share (Note 3)	$ (0.77)	$ (0.98)
Shares used in computing basic and diluted net loss per common share	44,712	44,712

(1) Starfish s results of operations for the twelve months ended June 30, 2002 were calculated by adding the results of operations for the six months ended December 31, 2001 to, and deducting the results of operations for the six months ended December 31, 2002 from, the results of operations for the twelve months ended December 31, 2002.

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

Pumatech, Inc.

Notes to the Unaudited Pro Forma Combined Condensed Statements of Operations

1. Basis of Pro Forma Presentation

On March 27, 2003, Pumatech acquired Starfish for a purchase price of approximately $1.8 million for the Starfish common stock outstanding upon the effective date of the acquisition. Pumatech will account for the acquisition under the purchase method of accounting.

The unaudited pro forma combined condensed statement of operations of Pumatech and Starfish for the nine months ended April 30, 2003 is presented as if the transaction had been consummated on August 1, 2002. The unaudited pro forma combined statement of operations for the nine months ended April 30, 2003 combines the results of operations of Pumatech for the nine months ended April 30, 2003 and Starfish s results of operations for the eight months ended February 28, 2003. Since the acquisition took place on March 27, 2003, one month of Starfish results are included in the consolidated Pumatech results for the nine months ended April 30, 2003. The unaudited pro forma combined condensed statement of operations of Pumatech and Starfish for the year ended July 31, 2002 is presented as if the transaction had been consummated on August 1, 2001. The unaudited pro forma combined statement of operations for the twelve months ended July 31, 2002 combines the results of operations of Pumatech for the twelve months ended July 31, 2002 and Starfish s results of operations for the twelve months ended June 30, 2002. Starfish s results of operations for the twelve months ended June 30, 2002 were calculated by adding the results of operations for the six months ended December 31, 2001, and deducting the results of operations for the six months ended December 31, 2002, to the results of operations for the twelve months ended December 31, 2002

The unaudited pro forma combined condensed financial statements reflect an estimated purchase price of approximately $1.8 million. The cash payment was determined based on the book value of assets acquired and liabilities assumed on the date of the acquisition. The cash payment is subject to adjustment as additional information on the fair values of Starfish s assets and liabilities becomes available. The estimated total purchase price is as follows (in thousands):

Cash	$ 1,679
Estimated direct acquisition costs	152
Total estimated purchase price	$ 1,831

Pumatech, Inc.

Notes to the Unaudited Pro Forma Combined Condensed Statements of Operations *(Continued)*

The final purchase price is dependent on the actual assets acquired, liabilities assumed and actual direct acquisition costs. Under the purchase method of accounting, the total estimated purchase price is allocated to Starfish s net tangible and intangible assets based upon their estimated fair value as of the date of completion of the acquisition. Based upon the estimated purchase price and the preliminary valuation, the purchase price allocation, which is subject to change based on Pumatech s final analysis, is as follows (in thousands):

Tangible assets acquired		$ 2,052
Amortizable intangible assets:		
Developed technology	735	
Patents	220	
Trademarks	57	
Customer base	303	
Customer contracts	78	
In-process research and development (expensed)	442	
Total amortizable intangible assets		1,835
Total assets acquired		3,887
Liabilities assumed		(5,357)
Goodwill		3,301
Net assets acquired		$ 1,831

Approximately $1.4 million of the estimated purchase price was allocated to amortizable intangible assets. It is estimated that the developed technology, patents, and customer base will be amortized on a straight-line basis over 4 years; the trademarks will be amortized on a straight-line basis over 3 years; and the customer contracts will be amortized on a straight-line basis over 9 months.

The in-process research and development of $0.4 million is charged to operations on the acquisition date. The in-process research and development charge has not been included in the accompanying unaudited pro forma condensed combined statement of operations as it represents a non-recurring charge directly related to the acquisition. The in-process research and development consisted of technology that had not yet reached technological feasibility and had no alternative future use as of the date of acquisition. The value assigned to the acquired in-process research and development was determined by estimating the projects percentage of completion and future cash flows or revenue contribution. Starfish s project for Mercury platform technology was identified as in-process research and development and deemed to be 70% complete on the date of acquisition. Its net cash flows were discounted utilizing a weighted average cost of capital of 30%, which, among other related assumptions, was believed to be reasonable. This discount rate takes into consideration the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates described above.

Pumatech, Inc.

Notes to the Unaudited Pro Forma Combined Condensed Statements of Operations *(Continued)*

A preliminary estimate of $3.3 million has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets , goodwill will not be amortized and will be tested for impairment at least annually. The preliminary purchase price allocation for Starfish is subject to revision as more detailed analysis is completed and additional information on the fair values of Starfish s assets and liabilities becomes available. Any change in the fair value of the net assets of Starfish will change the amount of the purchase price allocable to goodwill. Final purchase accounting adjustments may therefore differ materially from the pro forma adjustments presented here.

2. Pro Forma Adjustments

Certain reclassifications have been made to conform Starfish s historical amounts to Pumatech s financial statement presentation.

The accompanying unaudited pro forma combined condensed financial statements reflect the following pro forma adjustments:

(a) To reflect the decrease in interest income related to the cash payment for the acquisition of $1.7 million.

(b) To reflect amortization of the amortizable intangible assets resulting from the acquisition. The weighted average life of amortizable intangible assets approximates 4 years.

(c) To reflect the elimination of in-process research and development.

3. Pro Forma Combined Net Loss Per Share

Shares used to calculate unaudited pro forma combined net loss per basic and diluted share were computed using Pumatech s weighted average shares outstanding during the respective periods.

4. Subsequent Event

In March 2003, in full settlement of its $4.5 million line of credit borrowings, the Company assigned without recourse an account receivable to Motorola, Inc. in the amount of approximately $750,000 and granted Motorola a royalty-free right to use the Company s software.

(c) Exhibits.

The following exhibits are filed with this Amended Current Report on Form 8-K/A:

Exhibit Number	Exhibit Description
23.1*	Consent of Independent Accountants
99.1*	Starfish Software, Inc. audited financial statements at December 31, 2002

* Previously filed as an exhibit to the Current Report on Form 8-K/A, filed with the Securities and Exchange Commission on June 10, 2003, and incorporated herein by reference.

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 hereunto duly authorized.

Date: September 8, 2003

PUMATECH, INC.

By: /s/ J. KEITH KITCHEN

J. Keith Kitchen

Vice President of Finance and Administration

and Chief Accounting Officer

(Principal Financial and Accounting Officer)

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