DIXON TICONDEROGA CO
Form 10-Q
February 14, 2002

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 31, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-8689

DIXON TICONDEROGA COMPANY
Incorporated pursuant to the Laws of Delaware State

Internal Revenue Service - Employer Identification No. 23-0973760

195 International Parkway, Heathrow, FL 32746
(407) 829-9000

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 [ ]

The total number of shares of the registrant's Common Stock, $1 par value, outstanding on December 31, 2001, was 3,177,462.

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

Item 1.

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2001	September 30, 2001
ASSETS:		

CURRENT ASSETS:		
Cash and cash equivalents	$ 871,975	$ 844,299
Receivables, less allowance for doubtful accounts of $1,504,595 at December 31, 2001 and $1,482,524 at September 30, 2001	25,629,616	31,647,950
Inventories	35,703,381	35,583,082
Other current assets	2,480,959	2,227,785
Total current assets	64,685,931	70,303,116
PROPERTY, PLANT AND EQUIPMENT:		
Land and buildings	11,278,873	10,608,980
Machinery and equipment	17,467,897	17,155,371
Furniture and fixtures	1,748,796	1,741,811
	30,495,566	29,506,162
Less accumulated depreciation	(19,513,101)	(19,022,674)
	10,982,465	10,483,488
OTHER ASSETS	5,554,460	5,625,771
	$ 81,222,856	$ 86,412,375

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

	December 31, 2001	September 30, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY:		
CURRENT LIABILITIES:		
Notes payable	$ 7,511,462	$ 6,294,268
Current maturities of long-term debt	31,226,989	32,598,531
Accounts payable	7,275,997	9,321,957
Accrued liabilities	6,466,709	9,132,057
Total current liabilities	52,481,157	57,346,813
LONG-TERM DEBT	1,995,742	2,018,125
DEFERRED INCOME TAXES AND OTHER	700,619	984,492

MINORITY INTEREST	604,799	577,241
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, par $1, authorized 100,000 shares, none issued	--	--
Common stock, par $1, authorized 8,000,000 shares; issued 3,710,309 shares	3,710,309	3,710,309
Capital in excess of par value	3,670,135	3,670,135
Retained earnings	24,893,066	25,667,675
Accumulated comprehensive loss	(3,372,237)	(4,101,681)
	28,901,273	28,946,438
Less - treasury stock, at cost (532,847 shares)	(3,460,734)	(3,460,734)
	25,440,539	25,485,704
	$81,222,856	$86,412,375

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

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DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED DECEMBER 31,	
	2001	2000
REVENUES	$17,902,150	$17,241,882
COST AND EXPENSES:		
Cost of goods sold	11,309,007	11,575,318
Selling and administrative expenses	6,766,713	6,456,694
Provision for restructuring and related costs	174,850	--
	18,250,570	18,032,012
OPERATING LOSS	(348,420)	(790,130)
INTEREST EXPENSE	874,501	1,011,403
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAX BENEFIT AND MINORITY INTEREST	(1,222,921)	(1,801,533)

INCOME TAX BENEFIT	(453,914)	(644,807)
	(769,007)	(1,156,726)
MINORITY INTEREST	5,604	(12,011)
LOSS FROM CONTINUING OPERATIONS	(774,611)	(1,144,715)
LOSS FROM DISCONTINUED OPERATIONS, NET OF APPLICABLE INCOME TAXES	--	(165,542)
NET LOSS	$ (774,611)	$(1,310,257)
LOSS PER COMMON SHARE (BASIC):		
Continuing operations	$ (.24)	$ (.36)
Discontinued operations	--	(.05)
Net loss	$ (.24)	$ (.41)
LOSS PER COMMON SHARE (DILUTED):		
Continuing operations	$ (.24)	$ (.36)
Discontinued operations	--	(.05)
Net loss	$ (.24)	$ (.41)
SHARES OUTSTANDING:		
BASIC	3,177,462	3,168,047
DILUTED	3,177,462	3,168,047

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

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	THREE MONTHS ENDED DECEMBER 31, 2001	2000
NET LOSS	$ (774,611)	$(1,310,257)
OTHER COMPREHENSIVE LOSS:		
Cumulative effect adjustment to recognize fair value of cash flow hedges	--	(54,205)
Current period adjustment to recognize fair value of cash flow hedges	71,263	(157,715)
Foreign currency translation adjustments	658,178	(580,343)
COMPREHENSIVE LOSS	$ (45,170)	$(2,102,520)

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

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED DECEMBER 31,	
	2001	2000
Cash flows from operating activities:		
Net loss from continuing operations	$ (774,611)	$(1,144,715)
Net loss from discontinued operations	--	(165,542)
Adjustment to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	587,642	628,689
Provision for doubtful accounts receivable	109,935	111,828
Loss (gain) attributable to foreign currency exchange	(36,929)	57,760
Income (loss) attributable to minority interest	5,604	(12,011)
Changes in assets [(increase) decrease] and liabilities [increase (decrease)]:		
Receivables, net	6,303,861	5,601,811
Inventories	246,541	(54,790)
Other current assets	(244,939)	(314,919)
Accounts payable and accrued liabilities	(4,893,783)	(3,207,098)
Other assets	(59,744)	(109,591)
Net cash provided by operations	1,243,577	1,391,422
Cash flows from investing activities:		
Purchases of plant and equipment, net	(511,381)	(853,037)
Cash flows from financing activities:		
Principal reductions of notes payable	(212,595)	(101,455)
Principal reductions of long-term debt	(409,817)	(441,088)
Other non-current liabilities	(6,692)	64,719
Net cash used in financing activities	(629,104)	(477,824)
Effect of exchange rate changes on cash	(75,416)	(40,044)
Net increase in cash and cash equivalents	27,676	20,517
Cash and cash equivalents, beginning of period	844,299	448,452
Cash and cash equivalents, end of period	$ 871,975	$ 468,969

Supplemental Disclosures:		
Cash paid during the period:		
Interest	$1,487,510	$1,548,489
Income taxes	282,025	717,777

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

DIXON TICONDEROGA COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of presentation:

The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and 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 that the disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K. In the opinion of the Company, all adjustments (solely of a normal recurring nature) necessary to present fairly the financial position of Dixon Ticonderoga Company and subsidiaries as of December 31, 2001, and the results of their operations and cash flows for the three months ended December 31, 2001 and 2000, have been included. The results of operations for such interim periods are not necessarily indicative of the results for the entire year.

2. Inventories:

Since amounts for inventories under the LIFO method are based on annual determinations of quantities and costs as of the end of the fiscal year, the inventories at December 31, 2001 (for which the LIFO method of accounting are used) are based on certain estimates relating to quantities and costs as of year end.

Inventories consist of (in thousands):

	December 31, 2001	September 30, 2001
Raw materials	$ 14,159	$ 13,328
Work in process	3,374	3,572
Finished goods	18,170	18,683
	$ 35,703	$ 35,583

3. RECENT ACCOUNTING PRONOUNCEMENTS:

In July 2001, the FASB issued Statement No. 141 "Business Combinations" and Statement No. 142 "Goodwill and Other Intangible Assets". Statement No. 141 requires business combinations initiated after June 30, 2001 to be accounted

for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Statement No. 142 requires the use of a nonamortization approach to account for purchased goodwill and indefinite lived intangibles. Under a nonamortization approach, goodwill and indefinite lived intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and indefinite lived intangibles is more than its fair value. The provisions of Statement No. 141 are effective currently. The provisions of Statement No. 142 will be effective for the Company in fiscal 2003. Management does not expect these standards, when implemented, to have a material effect on its future results of operations or financial position.

In June 2001, the FASB issued Statement No. 143 "Accounting for Asset Retirement Obligations". The statement addresses financial accounting and

reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement is effective for the Company in fiscal 2003. The Company does not expect the adoption of Statement No. 143 to have a material impact on the Company's future results of operations or financial position.

In August 2001, the FASB issued Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supersedes Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of APB Opinion 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. The statement is effective for the Company in fiscal 2003. The Company does not expect the adoption of Statement No. 144 to have a material impact on the Company's future results of operations or financial position.

4. RESTRUCTURING AND RELATED COSTS:

In the first quarter of fiscal 2002, the Company continued its efforts towards completion of Phase 2 of its Restructuring and Cost Reduction Program, including the further consolidation of certain U.S. manufacturing processes with its Mexico operations as well as additional personnel reductions at its new Mexico facility. The restructuring and related costs (severances and lease settlement expense) and utilization since September 30, 2001 are summarized below (in thousands):

	Employee severance and related costs	Losses from the impairment, sale or abandonment of property and equipment	Total
Reserve balances at September 30, 2001	$ 339	$ --	$ 339
Quarter ended December 31, 2001 restructuring and impairment related charges	99	76	175

Payments in quarter ended December 31, 2001	(190)	--	(190)
Reserves balances at December 31, 2001	$ 248	$ 76	$ 324

5. LINE OF BUSINESS REPORTING:

Effective with the Company's 2001 plan to exit the Industrial Segment (Note 6), the Company's continuing operations consist only of one principal business segment - its Consumer Group. The following information sets forth certain additional data pertaining to its operations for the three-month periods ended December 31, 2001 and 2000 (in thousands).

	Revenues	Operating Profit (Loss)
2001:		
United States	$11,017	$ (558)
Canada	1,878	124
Mexico	4,757	65
United Kingdom	232	(6)
China	18	27
	$17,902	$ (348)
2000:		
United States	$11,870	$(294)
Canada	1,825	25
Mexico	3,226	(429)
United Kingdom	214	(16)
China	107	(76)
	$17,242	$ (790)

The United States operating loss in each period includes unallocated corporate expenses.

6. DISCONTINUED OPERATIONS:

In September 2001, the Company formalized its decision to offer for sale its New Castle Refractories division, the last business of its Industrial Group. Accordingly, related operating results of the Industrial Group have been reported as discontinued operations in the accompanying consolidated financial statements. The Company expects to complete the sale of this division by August 2002.

Net revenues and income (loss) from discontinued operations in the accompanying financial statements are as follows (in thousands):

	Three Months Ended December 31,	
	2001	2000
Net revenues	$ --	$ 2,555
Income (loss) rom discontinued operations before income taxes	$ --	$ (249)
Income tax benefit	--	83
Income (loss) from discontinued operations	$ --	$ (166)
Earnings (loss) per share (basic)	$ --	$ (0.05)
Earnings (loss) per share (diluted)	$ --	$ (0.05)

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Income (loss) from discontinued operations includes allocated interest expense of $108 in the period ended December 31, 2000, based upon the identifiable assets of such operations. In September 2001, the Company provided $670 for anticipated operating losses and $432 for the wind-up of certain pension plans. Losses from discontinued operations during the December 31, 2001 period were $265 (including $84 in allocated interest expense). In addition, the Company paid $432 for the wind-up of pension plans.

Assets and liabilities relating to discontinued operations and included in the accompanying consolidated balance sheets are as follows (in thousands):

	December 31, 2001	September 30, 2001
Current assets	$ 4,299	$ 4,619
Property, plant and equipment, net	448	473
Current liabilities	(1,046)	(1,448)
Long-term liabilities and other, net	(766)	(743)
Net assets of discontinued operations	$ 2,935	$ 2,901

7. LIQUIDITY AND CAPITAL RESOURCES:

On September 15, 2001, a waiver of compliance with one provision of the Company's primary lending agreement expired and shortly thereafter its senior lenders prohibited the payment of $5.5 million in principal due to senior subordinated noteholders on September 26, 2001. The payment due date was later extended by the noteholders until November 14, 2001 and the aforementioned waiver from the Company's senior lenders was also extended through that date. These extensions expired on November 15, 2001. The senior lenders again blocked any payment to the subordinated noteholders and the

Company has continued to negotiate with its various lenders since then. As of December 31, 2001, the Company was not in compliance with one financial covenant under its subordinated note agreement. The Company has received an additional extension and a waiver of default under its senior debt agreements through May 3, 2002 to allow the Company more time to address its debt issues to the mutual satisfaction of all parties involved. The Company has asked both its senior and subordinated lenders to amend various provisions of their debt agreements until at least October 2002 to allow the Company time to pursue a longer-term solution.

The Company believes it has sufficient lines of credit available under its senior debt and other agreements to fulfill all current and anticipated operating requirements of its business. Moreover, the senior lenders have consistently supported the Company by continuing normal funding under their agreements throughout the ongoing negotiations. However, the Company does not believe it will have excess cash flow to retire the total $16.5 million in subordinated notes by their due date in 2003. The Company has asked the subordinated noteholders and they have expressed a willingness to consider restructuring their scheduled principal payments to allow the Company sufficient time to retire the notes through the infusion of some form of new equity capital, new secondary financing and/or the sale of assets. However, the Company cannot assure that its efforts will be successful, that the subordinated noteholders will amend their scheduled payments and/or that it will maintain and/or secure new sources of capital. Moreover, in light of the current circumstances regarding the Company's various debt arrangements, the report of the Company's independent accountants (with respect to its fiscal 2001 financial statements) includes an explanatory paragraph as to substantial doubt about the Company's ability to continue as a going concern.

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The Company's Mexico subsidiary presently has outstanding approximately $10 million under its lines of credit ($2 million unused) expiring at various dates. The Company is awaiting approval on $5 to $10 million of additional Mexico lines of credit with various financial institutions. The Company's subsidiary cannot assure that these lines of credit will continue to be available after their respective expiration dates, or that additional lines of credit will be secured.

The Company has retained Wachovia Securities (formerly First Union Securities) and certain other outside consultants to advise and assist it in evaluating certain strategic alternatives, including capital restructuring, mergers and acquisitions, and/or other measures designed to resolve the Company's issues with its lenders while maximizing shareholder value.

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

REVENUES for the quarter ended December 31, 2001, increased $660,000 from the prior year. The changes are detailed below:

	Increase (Decrease) (in thousands)	% Increase (Decrease)		
		Total	Volume	Price/Mix
U.S. Consumer	$ (852)	(7)	(6)	(1)
Foreign Consumer	1,512	28	21	7

U.S. Consumer revenue decreased primarily due to lower demand in the educational and commercial markets. Foreign revenue increased primarily in Mexico due to increased demand in the mass retail market as well as certain price increases.

While the Company has operations in Canada, Mexico and the U.K., historically only the operating results in Mexico have been materially impacted by currency fluctuations. There has been a significant devaluation of the Mexican peso at least once in each of the last three decades, the last one being in August, 1998. In the short term after such a devaluation, consumer confidence has been shaken, leading to an immediate reduction in revenues in the months following the devaluation. Then, after the immediate shock, and as the peso stabilizes, revenues tend to grow. Selling prices tend to rise over the long term to offset any inflationary increases in costs. The peso, as well as any currency value, depends on many factors including international trade, investor confidence, and government policy, to name a few. These factors are impossible for the Company to predict, and thus, an estimate of potential effect on results of operations for the future cannot be made. This currency risk in Mexico is presently managed through occasional foreign currency hedges, local currency financing and by export sales denominated in U.S. dollars.

OPERATING LOSS decreased $442,000 from last year. In the quarter ended December 31,2001, the Company incurred additional restructuring costs of $175,000 in connection with its consolidation of operations in Mexico. These costs were more than offset by higher operating profits in Foreign Consumer from higher revenues and labor efficiencies and overhead expense reductions from the consolidation activities (see Note 4). These efficiencies as well as manufacturing savings in the U.S. contributed to significantly lower costs of goods sold during the period (63.2% of sales as compared to 67.1% in the prior year period). Consolidated selling and administrative expenses increased due to higher U.S. selling expenses and financing costs, partially offset by approximately $250,000 in import duty rebates, reflected in this category.

INTEREST EXPENSE decreased $137,000 from last year due to lower overall borrowing rates, despite the additional interest charges under the Company's debt agreements described below.

INCOME TAX benefit decreased $191,000 from last year due to lower pre-tax losses.

MINORITY INTEREST represents approximately 3% of the net results from operations of the Company's Mexico subsidiary.

CURRENT ECONOMIC ENVIRONMENT AND EVENTS

Although not directly impacted by recent events in the U.S. and abroad, softening economic conditions could affect the retail mass or other markets served by the Company's Consumer Group and thus could lead to reduced overall revenues. In addition, certain expenses (such as insurance and financing costs) could be significantly higher in the coming years due to tightening in the various financial markets in light of recent events.

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LIQUIDITY AND CAPITAL RESOURCES

The Company generated approximately $1.2 million in cash flows from operating activities in the first quarter of fiscal 2002. In the prior year period, cash flows from operating activities amounted to $1.4 million. Lower fiscal 2002 operating losses, increased accounts receivable collections and improved inventory control were offset by higher cash flows used to extinguish certain trade liabilities.

The Company's fiscal 2002 investing activities included approximately $511,000 in net purchases of property and equipment, compared to $853,000 in the prior year period. The prior year reflects a higher level of purchases as compared with recent years, due to the Company's expansion of its Mexico manufacturing and consolidation into its newly leased 300,000 square-foot facility. Generally, all major capital projects are discretionary in nature and thus no material purchase commitments exist. Capital expenditures are usually funded from operations and existing financing or new leasing arrangements.

The Company's primary financing arrangements are with a consortium of lenders, initially providing a total of up to $42.5 million in financing through September 2004. The financing agreements, as amended, include a revolving line of credit facility in the amount of $30 million, which bears interest at either the prime rate plus 1.15%, or the prevailing LIBOR rate plus 2.65%, through September 2004. The agreements also provide for the payment of various bank fees approximating $14,000 per month. Borrowings under the revolving credit facility are based upon eligible accounts receivable and inventories of the Company's U.S. and Canada operations, subject to reserves for anticipated subordinated debt payments and certain other items, as defined. The Company has executed an interest rate swap agreement that effectively fixed the rate of interest on $8 million of these borrowings at 8.98% through August 2005. The loan and security agreements also include a term loan in the initial amount of $7.5 million. The term loan is payable in monthly installments of $125,000, plus interest, through September 2004. The loan bears interest based upon the same prevailing rate described above in connection with the revolving credit facility. The Company entered into the aforementioned interest rate swap agreement to balance and manage overall interest rate exposure and minimize overall cost of borrowings.

These financing arrangements are collateralized by the tangible and intangible assets of the U.S. and Canada operations (including accounts receivable, inventories, property, plant and equipment, patents and trademarks) and a pledge of the capital stock of the Company's subsidiaries. The loan and security agreement contains provisions pertaining to the maintenance of certain financial ratios and annual capital expenditure levels, as well as restrictions as to payment of cash dividends. On September 15, 2001, a waiver of compliance with one provision of the Company's primary lending agreement expired and shortly thereafter its senior lenders prohibited the payment of $5.5 million in principal due to senior subordinated noteholders on September 26, 2001. The payment due date was later extended by the noteholders until November 14, 2001 and the aforementioned waiver from the Company's senior lenders was also extended through that date. These extensions expired on November 15, 2001. The senior lenders again blocked any payment to the subordinated noteholders and the Company has continued to negotiate with its various lenders since then. The Company has received an additional extension and waiver of certain existing defaults under its senior debt agreements through May 3, 2002 to allow the Company more time to address its debt issues to the mutual satisfaction of all parties involved. The Company has asked both its senior and subordinated lenders to amend various provisions of their debt agreements until at least October 2002 to allow time for the Company to pursue a longer-term solution. As of December 31, 2001, the Company had approximately $11 million outstanding under the revolving credit facility. In addition, the Company's Mexico subsidiary currently has approximately $10 million in bank lines of credit ($2 million unused) expiring at various dates that bear interest at a rate based upon either a floating U.S. bank rate or the rate of certain Mexican government securities. The Company is awaiting approval on $5 to $10 million of additional Mexico lines of credit with various financial institutions. The Company relies heavily on the availability of the lines of credit in the U.S. and Mexico for liquidity in its operations.

The Company also has outstanding $16.5 million of 12% Senior Subordinated Notes valued at their face amount, due 2003. The subordinated note agreement

provides for a total interest rate of 13.5% through June 2002 and 12.25% through maturity in 2003. Due to the Company's noncompliance under its primary lending arrangements discussed above, it was prohibited from making a scheduled subordinated note payment of $5.5 million due in September 2001. The note agreement provides for an additional interest charge of 2% on this amount until payment is made. The note agreement, as amended, contains provisions that limit dividends and other payments, and requires the maintenance of certain financial covenants and ratios, one of which the Company did not comply with as of December 31, 2001.

The Company believes that amounts available under its lines of credit under its senior debt and under lines of credit available to or requested by its Mexican subsidiary, if funded, are sufficient to fulfill all current and anticipated operating requirements of its business. The senior lenders have consistently supported the Company and they, as well as the Company's foreign lenders, have continued funding under their existing agreements throughout the ongoing negotiations. However, the Company does not believe it will have excess cash flow to retire the total $16.5 million in subordinated notes by their due date in 2003. The Company's subordinated noteholders have expressed a willingness to consider restructuring their scheduled principal payments to allow the Company sufficient time to retire the notes through the infusion of some form of new equity capital, new secondary financing and/or the sale of assets. However, the Company cannot assure that its efforts will be successful, that the subordinated noteholders will amend their scheduled payments and/or that it will maintain and/or secure new sources of capital. In addition, the Company's Mexico subsidiary cannot assure that its lines of credit will continue to be available after their respective expiration dates, or that additional lines of credit will be secured.

Due to the defaults described above, the subordinated and senior debts have been classified as current maturities of long-term debt in the accompanying 2001 consolidated balance sheet. Moreover, in light of the current circumstances regarding the Company's various debt arrangements, the report of the Company's independent accountants (with respect to its fiscal 2001 financial statements) includes an explanatory paragraph as to substantial doubt about the Company's ability to continue as a going concern.

The Company has retained Wachovia Securities (formerly First Union Securities) and certain other outside consultants to advise and assist it in evaluating certain strategic alternatives, including capital restructuring, mergers and acquisitions, and/or other measures designed to resolve the Company's issues with its lenders while maximizing shareholder value.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued Statement No. 141 "Business Combinations" and Statement No. 142 "Goodwill and Other Intangible Assets". Statement No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Statement No. 142 requires the use of a nonamortization approach to account for purchased goodwill and indefinite lived intangibles. Under a nonamortization approach, goodwill and indefinite lived intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and indefinite lived intangibles is more than its fair value. The provisions of Statement No. 141 are effective currently. The provisions of Statement No. 142 will be effective for the Company in fiscal 2003. Management does not expect

these standards, when implemented, to have a material effect on its future results of operations or financial position.

In June 2001, the FASB issued Statement No. 143 "Accounting for Asset Retirement Obligations". The statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement is effective for the Company in fiscal 2003. The Company does not expect the adoption of Statement No. 143 to have a material impact on the Company's future results of operations or financial position.

In August 2001, the FASB issued Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supersedes Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for

Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of APB Opinion 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. The statement is effective for the Company in fiscal 2003. The Company does not expect the adoption of Statement No. 144 to have a material impact on the Company's future results of operations or financial position.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. The following accounting policies require management to make estimates and assumptions. These estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary. If actual results differ significantly from management's estimates, the financial statements could be materially impacted.

Accounts receivable is recorded net of allowance for doubtful accounts. The Company regularly reviews the adequacy of its accounts receivable allowance after considering the size of the accounts receivable, the age of each invoice, each customer's expected ability to pay and the collection history with each customer. The Company reviews any invoice greater than 60 days past due to determine if an allowance is appropriate based on the risk category using the factors discussed above. In addition, the Company maintains a general reserve for all other invoices that may become doubtful in the future. The allowance for doubtful accounts represents management's best estimate, but changes in circumstances relating to accounts receivable may result in a requirement for additional allowances in the near future.

Inventories are stated at the lower of cost or market. The inventory valuation policy is based on a review of forecasted demand compared with existing inventory levels. If the estimate of forecasted demand is significantly less than the actual demand, the Company may have excess inventory which may be over-valued.

Long-lived assets such as property, plant and equipment, are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. When such events occur, the Company compares the carrying amount of the assets to undiscounted expected future cash flows. Should this comparison indicate that there is an impairment, the amount of the impairment is calculated using discounted expected future cash flows. If the estimate of an asset's future cash flows is significantly different from the asset's actual cash flows, we may over- or under-estimate the value of an asset's impairment. A long-lived asset's value is also dependent upon its

estimated useful life. A change in the useful life of a long-lived asset could result in higher or lower depreciation and amortization expense. If the asset's actual life is different than its estimated life, the asset could be over- or under-valued.

Restructuring and related costs reserves are recorded in connection with the restructuring initiatives as they are announced. These reserves include estimates pertaining to employee severance costs, the settlement of contractual obligations and other matters. Although management does not anticipate significant changes, the actual costs may differ from these estimates, resulting in further charges or reversals of previously recorded charges.

FORWARD-LOOKING STATEMENTS

The statements in this Quarterly Report on Form 10-Q that are not purely historical are "forward-looking statements" within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934, including statements about the Company's expectations, beliefs, intentions or strategies regarding the future. Forward-looking statements include statements regarding, among other things, the effects of the devaluation of the Mexican peso; the sufficiency and continued availability of the Company's lines

of credit and its ability to meet its current and anticipated obligations; management's inventory reduction plan and expectation for savings from the restructuring and cost-reduction program; the Company's ability to increase sales in its core businesses; and its expectations with regards to legal proceedings. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those expressed or implied by such forward-looking statements. Such risks include (but are not limited to) the risk that the Company's lenders will not continue to fund the Company in the future as they have in the past when defaults have occurred; the inability of the Company to successfully negotiate a restructuring of its subordinated debt and the exercise by its lenders of various remedies available to them in the event of continued defaults; the cancellation of the lines of credit available to the Company's Mexico subsidiary; the inability to maintain and/or secure new sources of capital; manufacturing inefficiencies as a result of the inventory reduction plan; difficulties encountered with the consolidation and cost-reduction program; increased competition; U.S. and foreign economic factors; foreign currency exchange risk and interest rate fluctuation risk, among others.

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As discussed elsewhere, the Company is exposed to the following principal market risks (i.e. risks of loss arising from adverse changes in market rates): foreign exchange rates and interest rates on debt.

The Company's exposure to foreign currency exchange rate risk in its international operations is principally limited to Mexico and, to a lesser degree, Canada. Approximately 37% of the Company's fiscal 2001 net revenues were derived in Mexico and Canada, combined (exclusive of intercompany activities). Foreign exchange transaction gains and losses arise from monetary assets and

liabilities denominated in currencies other than the business unit's functional local currency. It is estimated that a 10% change in both the Mexican peso and Canadian dollar exchange rates would impact reported operating profit by approximately $500,000. This quantitative measure has inherent limitations because it does not take into account the changes in customer purchasing patterns or any adjustment to the Company's financing or operating strategies in response to such a change in rates. Moreover, this measure does not take into account the possibility that these currency rates can move in opposite directions, such that gains from one may offset losses from another.

In addition, the Company's cash flows and earnings are subject to changes in interest rates. As of December 31, 2001, approximately 46% of total short and long-term debt is fixed, at rates between 8% and 13.5%. The balance of the Company debt is variable, principally based upon the prevailing U.S. bank prime rate or LIBOR rate. An interest rate swap, which expires in 2005, fixes the rate of interest on $8 million of this debt at 8.98%. A change in the average prevailing interest rates of the remaining debt of 1% would have an estimated impact of $200,000 upon the Company's pre-tax results of operations and cash flows. This quantitative measure does not take into account the possibility that the prevailing rates (U.S. bank prime and LIBOR) can move in opposite directions and that the Company has, in most cases, the option to elect either as the determining interest rate factor.

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PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

1. Financial statements

   See index under Item 8. Financial Statements and Supplementary Data.

2. Exhibits

   The following exhibits are required to be filed as part of this Quarterly Report on Form 10-Q:

   (2) a. Share Purchase Agreement by and among Dixon Ticonderoga de Mexico, S.A. de C.V., and by Grupo Ifam, S.A. de C.V., and Guillermo Almazan Cueto with respect to the capital stock of Vinci de Mexico, S.A. de C.V., (English translation). 4

   (2) b. Asset Purchase Agreement dated February 9, 1999, by and between Dixon Ticonderoga Company, as Seller and Asbury Carbons, Inc., as Buyer. 6

   (3) (i) Restated Certificate of Incorporation. 2

   (3) (ii) Amended and Restated Bylaws. 1

   (4) a. Specimen Certificate of Company Common Stock. 2

   (4) b. Amended and Restated Stock Option Plan. 3

(10) a. First Modification of Amended and Restated Revolving Credit Loan and Security Agreement by and among Dixon Ticonderoga Company, Dixon Ticonderoga, Inc., First Union Commercial Corporation, First National Bank of Boston and National Bank of Canada. 1

(10) b. 12.00% Senior Subordinated Notes, Due 2003, Note and Warrant Purchase Agreement. 1

(10) c. 12.00% Senior Subordinated Notes, Due 2003, Common Stock Purchase Warrant Agreement. 1

(10) d. License and Technological Agreement between Carborundum Corporation and New Castle Refractories Company, a division of Dixon Ticonderoga Company. 1

(10) e. Equipment Option and Purchase Agreement between Carborundum Corporation and New Castle Refractories Company, a division of Dixon Ticonderoga Company. 1

(10) f. Product Purchase Agreement between Carborundum Corporation and New Castle Refractories Company, a division of Dixon Ticonderoga Company. 1

(10) g. Second Modification of Amended and Restated Revolving Credit Loan and Security Agreement by and among Dixon Ticonderoga Company, Dixon Ticonderoga, Inc., First Union Commercial Corporation, First National Bank of Boston and National Bank of Canada. 5

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(10) h. Third Modification of Amended and Restated Revolving Credit Loan and Security Agreement, Amendment to Loan Documents and Assignment by and among Dixon Ticonderoga Company, Dixon Ticonderoga, Inc., First Union Commercial Corporation, BankBoston, N.A., National Bank of Canada and LaSalle Bank. 7

(10) i. First Modification of Amended and Restated Term Loan Agreement and Assignment by and among Dixon Ticonderoga Company, Dixon Ticonderoga, Inc., First Union Commercial Corporation, BankBoston, N.A., National Bank of Canada and LaSalle Bank. 7

(10) j. Amendment No. 1 to 12.00% Senior Subordinated Notes, Due 2003, Note and Warrant Purchase Agreement.7

(10) k. Fourth Modification of Amended and Restated Revolving Credit Loan and Security Agreement. 8

(10) l. Second Modification of Amended and Restated Term Loan Agreement. 8

(10) m. Amendment No. 2 to Note and Warrant Purchase Agreement. 8

(21) Subsidiaries of the Company 9

1 Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 1996, file number 0-2655, filed in Washington, D.C.

2 Incorporated by reference to the Company's quarterly report on Form 10-Q for

the period ended March 31, 1997, file number 0-2655, filed in Washington, D.C.

3 Incorporated by reference to Appendix 3 to the Company's Proxy Statement dated January 27, 1997, filed in Washington, D.C.

4 Incorporated by reference to the Company's current report on Form 8-K dated December 12, 1997, filed in Washington D.C.

5 Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 1998, file number 0-2615, filed in Washington, D.C.

6 Incorporated by reference to the Company's current report on Form 8-K dated March 2, 1999, filed in Washington D.C.

7 Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 1999, file number 0-2615 filed in Washington, D.C.

8 Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 2000, file number 0-2655 filed in Washington, D.C.

9 Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 2001, file number 1-8689 filed in Washington, D.C.

(b) Reports on Form 8-K:

None.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DIXON TICONDEROGA COMPANY

Dated: February 14, 2002

By: /s/ Gino N. Pala

Gino N. Pala
Chairman of Board and
Co-Chief Executive Officer

Dated: February 14, 2002

By: /s/ Richard A. Asta

Richard A. Asta
Executive Vice President of Finance
Chief Financial Officer

Dated: February 14, 2002

By: /s/ John Adornetto

John Adornetto
Vice President/Corporate Controller and
Chief Accounting Officer