

Edgar Filing: ECC INTERNATIONAL CORP - Form 10-Q

ECC INTERNATIONAL CORP  
Form 10-Q  
May 15, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended MARCH 31, 2001  
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or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-8988  
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ECC INTERNATIONAL CORP.

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

23-1714658  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

2001 WEST OAK RIDGE ROAD, ORLANDO, FL

32809-3803  
-----

(Address of principal executive offices)

(Zip Code)

(407) 859-7410  
-----

(Registrant's telephone number, including area code)

NOT APPLICABLE  
-----

(Former name, former address and former fiscal year,  
if changed since last report)

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 twelve 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  No

As of May 10, 2001 there were 7,823,785 shares of the Registrant's  
Common Stock, \$.10 par value per share outstanding.

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PART I. FINANCIAL STATEMENTS  
 ITEM 1. FINANCIAL STATEMENTS  
 ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF OPERATIONS  
 NINE MONTHS ENDED MARCH 31, 2001 AND 2000  
 (In Thousands Except Per Share Data)  
 (Unaudited)

	Nine Months Ended 3/31/01 -----	Nine Months Ended 3/31/00 -----
Sales	\$ 20,768	\$ 31,134
Cost of Sales	17,352 -----	20,573 -----
Gross Profit	3,416 -----	10,561 -----
Expenses:		
Selling, General & Administrative	6,755	6,677
Independent Research and Development	537	286
Total Expenses	7,292 -----	6,963 -----
Operating (Loss)/Income	(3,876) -----	3,598 -----
Other Income/(Expense):		
Interest Income	59	29
Interest Expense	(275)	(597)
Other - Net	145	(88)
Total Other Income/(Expense)	(71) -----	(656) -----
(Loss)/Income Before Income Taxes	(3,947)	2,942
Provision for Income Taxes	120 -----	-- -----
Net (Loss)/Income	\$ (4,067) =====	\$ 2,942 =====
(Loss)/Income Per Common Share - Basic and Assuming Dilution:		
Net (Loss)/Income Per Common Share-Basic	\$ (0.49) =====	\$ 0.35 =====
Net (Loss)/Income Per Common Share-Dilutive	\$ (0.49) =====	\$ 0.35 =====

See accompanying notes to the consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
THREE MONTHS ENDED MARCH 31, 2001 AND 2000  
(In Thousands Except Per Share Data)  
(Unaudited)

	Three Months Ended 3/31/01 -----	Three Months Ended 3/31/00 -----
Sales	\$ 5,749	\$ 9,888
Cost of Sales	4,886 -----	5,958 -----
Gross Profit	863 -----	3,930 -----
Expenses:		
Selling, General & Administrative	2,444	2,334
Independent Research and Development	305 -----	137 -----
Total Expenses	2,749 -----	2,471 -----
Operating (Loss)/Income	(1,886) -----	1,459 -----
Other Income/(Expense):		
Interest Income	2	5
Interest Expense	(170)	(158)
Other - Net	(1) -----	4 -----
Total Other Expense	(169) -----	(149) -----
(Loss)/Income Before Income Taxes	(2,055)	1,310
Provision for Income Taxes	-- -----	-- -----
Net (Loss)/Income	\$ (2,055) =====	\$ 1,310 =====
(Loss)/Income Per Common Share - Basic and Assuming Dilution:		
Net (Loss)/Income Per Common Share-Basic	\$ (0.26) =====	\$ 0.16 =====
Net (Loss)/Income Per Common Share-Dilutive	\$ (0.26) =====	\$ 0.15 =====

See accompanying notes to the consolidated financial statements.

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(In Thousands)

	(Unaudited) 3/31/01 -----	(Audited) 6/30/00 -----
ASSETS		
Current Assets:		
Cash	\$ --	\$ 2,406
Accounts Receivable	5,405	7,359
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	9,899	10,455
Inventories	3,315	2,559
Prepaid Expenses and Other	558	449
	-----	-----
Total Current Assets	19,177	23,228
	-----	-----
Property, Plant and Equipment - Net	13,718	15,476
Other Assets	158	531
	-----	-----
Total Assets	\$33,053 =====	\$39,235 =====

Continued...

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS (Continued)  
(In Thousands Except Share and Per Share Data)

	(Unaudited) 3/31/01 -----	(Audited) 6/30/00 -----
LIABILITIES & STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current Portion of Long-Term Debt	\$ 2,520	\$ --
Accounts Payable	1,456	1,438
Accrued Expenses and Other	2,123	3,869
	-----	-----
Total Current Liabilities	6,099	5,307
Other Long-Term Liabilities	133	239
	-----	-----
Total Liabilities	6,232	5,546
	-----	-----

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COMMITMENTS AND CONTINGENCIES

Stockholders' Equity:

Preferred Stock, \$.10 par; 1,000,000 shares authorized; none issued and outstanding	--	--
Common Stock, \$.10 par; 20,000,000 shares authorized; 8,550,785 (8,481,067 at 6/30/00) shares issued and 7,823,785 (8,481,067 at 6/30/00) shares outstanding	855	848
Note Receivable from Stockholder	(168)	(146)
Capital in Excess of Par	25,418	25,211
Retained Earnings	3,625	7,776
Treasury Stock, at cost (727,000 shares)	(2,909)	--
	-----	-----
Total Stockholders' Equity	26,821	33,689
	-----	-----
Total Liabilities & Stockholders' Equity	\$ 33,053	\$ 39,235
	=====	=====

See accompanying notes to the consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
NINE MONTHS ENDED MARCH 31, 2001 AND 2000  
(In Thousands)  
(Unaudited)

	Nine Months Ended 3/31/01	Nine Months Ended 3/31/00
	-----	-----
Cash Flows From Operating Activities:		
Net (Loss)/Income	\$ (4,066)	\$ 2,942
Items Not Requiring Cash:		
Depreciation	2,058	2,979
Amortization	113	311
(Gain)/Loss on Disposal of Equipment	(135)	5
Changes in Certain Assets and Liabilities:		
Accounts Receivable	1,933	(4,386)
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	556	2,497
Inventories	(756)	951
Prepaid Expenses and Other	151	(279)
Accounts Payable	17	(2,232)
Accrued Expenses and Other Long-Term Liabilities	(1,843)	(2,793)
	-----	-----
Net Cash Used In Operating Activities	(1,972)	(5)
	-----	-----

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Cash Flows From Investing Activities:		
Proceeds from Sales of Assets	149	--
Additions to Property, Plant and Equipment	(314)	(917)
	-----	-----
Net Cash Used In Investing Activities	(165)	(917)
	-----	-----
Cash Flows From Financing Activities:		
Proceeds From Issuance of Common Stock and Options Exercised	205	67
Purchase of Treasury Stock	(2,909)	--
Dividends Paid	(85)	--
Debt Issue Cost for Revolving Credit Facility	--	(87)
Borrowings Under Revolving Credit Facility	10,833	30,542
Repayments Under Revolving Credit Facility	(8,313)	(31,085)
	-----	-----
Net Cash Used In Financing Activities	(269)	(563)
	-----	-----
Net Decrease in Cash	(2,406)	(1,485)
Cash at Beginning of the Period	2,406	1,485
	-----	-----
Cash at End of the Period	\$ --	\$ --
	=====	=====

Continued....

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
THREE MONTHS ENDED MARCH 31, 2001 AND 2000 (Continued)  
(In Thousands)  
(Unaudited)

	Nine Months Ended 3/31/01	Nine Months Ended 3/31/00
	-----	-----
Supplemental Disclosure of Cash Flow Information:		
Cash Paid During the Year For:		
Interest	\$262	\$555
Supplemental Schedule of Non Cash Financing Activities:		
Issuance of Director Equity Compensation	\$ 12	\$ 71
Purchase of Fixed Assets Through Capital Leases	\$ --	\$254

See accompanying notes to the consolidated financial statements.

ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)

1. The accompanying consolidated financial statements are unaudited and have been prepared by ECC International Corp. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. The June 30, 2000 consolidated balance sheet was derived from audited consolidated financial statements but does not include all disclosures required by generally accepted accounting principles. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations, comprehensive income and cash flows for the interim presented. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2000.

The Company has no other Comprehensive Income other than Net Income.

2. Inventories

	3/31/01	6/30/00
	-----	-----
	(In Thousands)	
Work in Process	\$ 937	\$ 89
Raw Materials	4,563	4,635
	-----	-----
Total Gross Value	5,500	4,724
Reserves	(2,184)	(2,165)
	-----	-----
Net Value	\$ 3,316	\$ 2,559
	=====	=====

Work in process inventory is valued using the specific identification cost method, but not in excess of net realizable value. Raw materials are valued at the lower of average cost or market. Reserve balances are provided for excess and obsolete inventories.

3. Debt

On June 24, 1999, the Company entered into a revolving Credit Facility ("Credit Facility") with Mellon Bank, N.A. totaling \$12.5 million and expiring on June 24, 2003. Available borrowings are based on a formula of accounts receivables and property, as defined in the Credit Facility, and were approximately \$4.8 million at March 31, 2001. The outstanding balance under the Credit Facility as of March 31, 2001 was approximately \$2.5 million.

The Credit Facility includes a subjective acceleration clause as well as a lockbox requirement under the control of the lender, whereby all collections of trade receivables are used to immediately reduce outstanding balances under the Credit Facility.

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The Company was not in compliance with certain financial covenants required under the Credit Facility for the periods ended September 30, 2000, December 31, 2000, and March 31, 2001. The Company resolved the

non-compliance issue for the first and second quarters by obtaining amendments from Mellon Bank, N.A. The Company is currently negotiating with Mellon Bank, N.A., to amend the Credit Facility in order to resolve the March 31, 2001 non-compliance issue and expects to complete negotiations before the end of May 2001.

4. Income Taxes

During the second quarter of fiscal year 2001, the Company recorded a tax provision of \$120,000. This provision was recorded due to a valuation allowance for an alternative minimum tax credit which is necessary due to the uncertainty as to the ultimate realization of the tax credit. In addition, the Company has approximately \$5.4 million of cumulative federal net operating loss carryforwards, which expire in 2013 and 2018. This amount is prior to any potential net operating losses generated in the current year.

5. Unusual Expenses

During fiscal year 1999, the Company implemented various cost reduction initiatives and changes in management including the relocation of the corporate headquarters and Instructional System Development Group from Wayne, Pennsylvania to the Company's principal System Design and Production Center in Orlando, Florida. The relocation was completed in September 1998. In addition, as a result of recurring net losses in the UK operations, the Board of Directors announced, during the first quarter of fiscal year 1999, the approval of a plan to wind-down and discontinue the UK operations, which was completed in May 1999. Charges totaling \$3.2 million in 1999 related primarily to employee termination benefits and lease termination costs. There were no additional charges during fiscal year 2000 or the first three quarters of fiscal year 2001.

The following table sets forth the details and the cumulative activity in the remaining accrual associated with the wind-down of the UK operations and relocation of the Pennsylvania office in the Consolidated Balance Sheet at June 30, 2000 and March 31, 2001 (in thousands):

Facility Lease Obligations	
-----	
Balance at 6/30/00	\$ 142
Cash Reduction Payments	(140)
Non-Cash Activity	(2)
	-----
Balance at 9/30/00	\$ --
	=====

On November 1, 2000, the Company reduced its operating costs by eliminating approximately 60 employee positions throughout the Company.



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This reduction affected approximately 24% of all employees and represents approximately \$2.8 million in annual compensation costs. The employee termination benefits associated with the reduction in force totaled approximately \$901,000 of which approximately \$839,000 and \$62,000 were recorded to cost of sales and selling, general and administrative expenses, respectively.

The balance of the accrued termination benefits is included in Accrued Expenses and Other. In addition to the November reduction in force, the Company previously terminated approximately 45 employees on July 14, 2000 affecting approximately 15% of all employees and approximately \$1.5 million in annual compensation costs. The employee termination

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benefits associated with the July reduction in force totaled approximately \$517,000 and were paid primarily during the first quarter of fiscal year 2001.

The following table sets forth the details and the cumulative activity associated with the accrual of these termination costs (in thousands):

Termination Benefits Incurred	\$ 1,418
Cash Reduction Payments	(1,239)
	-----
Balance at 3/31/01	\$ 179
	=====

6. Business Segment Information

The Company operates in one segment—training. This segment includes the design and manufacture of training simulators.

Sales by Class of Customer (in thousands):

	Nine Months Ended		Three Months Ended	
	3/31/01	3/31/00	3/31/01	3/31/00
	-----	-----	-----	-----
U.S. Department of Defense				
Direct	\$ 9,268	\$ 4,075	\$3,504	\$ 8,000
Subcontract	11,500	27,059	2,245	9,000
	-----	-----	-----	-----
Total Sales	\$20,768	\$31,134	\$5,749	\$9,800
	=====	=====	=====	=====

Export Sales from the U.S. were not material for the three-month and nine-month periods ended March 31, 2001 and March 31, 2000. Export sales do not include Foreign Military Sales through U.S. Government agencies and prime contractors of \$416,000 for the nine-month period ended March 31, 2000. There were no Foreign Military Sales for the three-month and nine-month periods ended March 31, 2001.

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Since a substantial portion of the Company's revenues are attributable to long-term contracts with various government agencies, any factor affecting procurement of long-term government contracts such as changes in government spending, cancellation of weapons programs and delays in contract awards could have a material impact on the Company's financial condition and results of operations.

### 7. Earnings Per Share

Basic earnings/(loss) per common share is computed by dividing net earnings/(loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings/(loss) per share is computed by dividing net earnings/(loss) available to common stockholders by the weighted-average number of common shares outstanding during the period adjusted for the number of shares that would have been outstanding if the dilutive potential common shares had been issued. The diluted earnings earnings/(loss) per share does not assume the exercise of options that would have an antidilutive effect on earnings earnings/(loss) per share.

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The weighted-average number of common shares outstanding for each period presented is as follows:

	Nine Months Ended		Three Months Ended	
	3/31/01	3/31/00	3/31/01	3/31/00
Basic	8,327,241	8,428,796	7,821,553	8,449,88
Dilutive	8,327,241	8,479,979	7,821,553	8,499,91

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### OVERVIEW

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," and similar expressions are intended to identify forward-looking statements. There are a number of factors that could cause the Company's actual results to differ materially from

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those indicated by such forward-looking statements. These factors include, without limitation, those set forth below under the caption "Certain Factors That May Affect Future Operating Results."

### a) MATERIAL CHANGES IN FINANCIAL CONDITION

During the nine-month period ended March 31, 2001, the Company's principal source of cash was collections on accounts receivable and borrowings on the Credit Facility. The principal uses of these funds were for vendor and payroll payments, lease termination and contract novation payments and treasury stock purchases.

The Company's cash balance decreased since fiscal year end 2000 primarily due to the repurchase of stock in the first two quarters of fiscal year 2001.

Accounts receivable decreased in the nine-month period ended March 31, 2001 primarily as a result of receipts on the Javelin Multi-Year 1 and F-18 programs, which were essentially completed by December 31, 2000.

Property, plant and equipment decreased since fiscal year end 2000 primarily due to disposals of equipment and minimal new assets purchased during fiscal year 2001.

Accrued expenses decreased since fiscal year end 2000 primarily as a result of the payment of incentives earned in fiscal year 2000 as well as novation and lease termination payments associated with the wind down of the UK division. (See Note 5 to the Consolidated Financial Statements.) In addition, accrued wages decreased since fiscal year end 2000 primarily due to the reductions in workforce during the first half of fiscal year 2001.

### LIQUIDITY AND CAPITAL RESOURCES

In April 2001, the Company signed a purchase agreement for the sale of its facilities and is negotiating a long-term lease back of a portion of the space. This transaction may close prior to fiscal 2001 year end.

During the remainder of fiscal year 2001, the Company anticipates spending approximately \$500,000 for refurbishment of the Orlando facility and new machinery and equipment.

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Other than as stated above, the Company currently has no other material commitments for capital expenditures. Assuming that the Company and Mellon Bank, N.A., amend the Credit Facility to resolve the March 31, 2001 non-compliance issue, Management believes that the funds available under the Credit Facility and the Company's projected cash flows (including funds generated from operations) will be sufficient to meet planned capital commitments and working capital requirements for the foreseeable future.

### b) MATERIAL CHANGES IN RESULTS OF OPERATIONS.

Sales decreased 42% or \$4.1 million and 33% or \$10.4 million for the three-month and nine-month periods ended March 31, 2001, respectively, as compared to the same periods ended March 31, 2000. The reduction in sales is primarily due to the completion of the Javelin Multi-Year 1,

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F-18, UK Combined Arms Tactical Trainer (UKCATT) and AGTS contracts, and the delay in the award of the Javelin Multi-Year 2 program.

Gross profit as a percentage of net sales was 15% and 16% for the three-month and nine-month periods ended March 31, 2001, respectively, as compared to 40% and 34% for the same periods ended March 31, 2000. The lower margins in fiscal year 2001 are primarily a result of reduced volume and higher overhead absorption rates. The overhead rate increased primarily due to \$1.4 million of severance cost incurred in fiscal year 2001 and a 36% decrease in the projected direct labor base. Also, additional losses were recorded in fiscal year 2001 related to completion of the EST system development.

Independent research and development expenses increased 124% and 88% for the three-month and nine-month periods ended March 31, 2001, respectively, due primarily to research in the area of new simulation technologies.

Interest expense decreased 54% during the nine-month period ended March 31, 2001 as compared to the same period ended March 31, 2000. This decrease is primarily a result of the Company maintaining a positive cash balance for the first five months of fiscal year 2001.

Other-Net increased 265% during the nine-month period ended March 31, 2001 as compared to the same period ended March 31, 2000. This change is primarily a result of gains on the sale of certain fixed assets and translation gains on foreign exchange transactions in fiscal year 2001, whereas the Company suffered translation losses in fiscal year 2000.

The tax provision recorded during the second quarter of fiscal year 2001 is due to a valuation allowance for an alternative minimum tax credit of \$120,000 paid for the fiscal year ended June 30, 2000. This valuation allowance was recorded due to the uncertainty as to the ultimate realization of the tax credit. In addition, the Company has approximately \$5.4 million of cumulative federal net operating loss carryforwards, which expire in 2013 and 2018. This amount is prior to any potential net operating losses generated in the current year.

### c) CERTAIN FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Quarterly Report on Form 10-Q and presented

elsewhere by management from time to time. All forward-looking statements included in this Form 10-Q are based on information available to the Company on the date hereof, and the Company assumes no obligation to update such forward-looking statements.

A number of uncertainties exist that could affect the Company's future operating results including, without limitation, general economic conditions, changes in government spending, borrowing availability under and compliance with the Credit Facility, cancellation of weapons programs, delays in contract awards, delays in the acceptance process of contract deliverables, the Company's continued ability to develop and introduce products, the introduction of new products by competitors, pricing practices of competitors, the cost and

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availability of parts and the Company's ability to control costs.

To date, a substantial portion of the Company's revenues have been attributable to long-term contracts with various government agencies. As a result, any factor adversely affecting procurement of long-term government contracts could have a material adverse effect on the Company's financial condition and results of operations.

Because of these and other factors, past financial performance should not be considered an indication of future performance. The Company's future quarterly operating results may vary significantly. Investors should not use historical trends to anticipate future results and should be aware that the trading price of the Company's Common Stock may be subject to wide fluctuations in response to quarterly variations in operating results and other factors, including those discussed above.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is subject to interest rate risk on its borrowings under the Credit Facility. The Credit Facility has a floating interest rate based on prevailing market rates. Accordingly, the carrying value of the debt is generally not affected by fluctuations in interest rates. However, such changes in interest rates could affect future interest expense and hence earnings and cash flows.

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## PART II. OTHER INFORMATION ECC INTERNATIONAL CORP.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### a. Exhibits

EXHIBIT 99.1 - Purchase and Sale Agreement between ECC International Corp., Panther Oak Ridge, Inc., and Oak Ridge Investment Associates, LLC., signed March 27, 2001.

EXHIBIT 99.2 - Employment Agreement between ECC International Corp., and James C. Garrett dated May 3, 2001.

EXHIBIT 99.3 - Change of Control Contract between ECC International Corp., and James C. Garrett dated, May 3, 2001.

#### b. Reports on Form 8-K

None

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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 thereunto duly authorized.

ECC INTERNATIONAL CORP.

Date

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/s/ MELISSA VAN VALKENBURGH

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Melissa Van Valkenburgh  
Chief Financial Officer

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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 thereunto duly authorized.

ECC INTERNATIONAL CORP.

Date

5-15-01

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/s/ MELISSA VAN VALKENBURGH

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Melissa Van Valkenburgh  
Chief Financial Officer

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