COMPEX TECHNOLOGIES INC
Form 10-Q
November 14, 2003

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly period Ended September 30, 2003

OR

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 No. 0-9407

COMPEX TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**41-0985318**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1811 Old Highway 8
New Brighton, Minnesota 55112
(Address of principal executive offices)

(651) 631-0590
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. (Yes X No _)

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of November 4, 2003 was:

Common Stock, $.10 par value	**11,102,925 Shares**

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CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains a number of forward-looking statements where we indicate that we anticipate, believe, expect or estimate or use similar words to indicate what might happen in the future. These forward looking statements represent our expectations about future events, including anticipated product introductions; changes in markets, customers and customer order rates; changes in third party reimbursement rates; expenditures for research and development; growth in revenue; taxation levels; and the effects of pricing decisions. When used in this 10-Q, the words anticipate, believe, expect, estimate and similar expressions are generally intended to identify forward-looking statements. You should evaluate these forward-looking statements in the context of a number of factors that may affect our financial condition and results of operations, including the following:

Like many medical device companies that rely on third party reimbursement entities for payment, we have a large balance of uncollected accounts receivable. We also have a reserve for the portion of those receivables that we estimate will not be collected based on our historical experience. The uncollectible portion of receivables includes both sales allowances for contracted or negotiated selling prices and rental rates and bad debts. If we cannot collect an amount of receivables that is consistent with historical collection rates, we might be required to increase our reserve and charge off the portion of receivables we cannot collect. This additional provision for uncollectible accounts could significantly impact our operating results.

In the United States, our products are subject to reimbursement by private and public healthcare reimbursement entities that generally impose limits on reimbursement and strict rules on applications for reimbursement. Changes in the rates, eligibility or requirements for reimbursement, or failure to comply with reimbursement requirements, could cause a reduction in our income from operations.

We maintain significant amounts of finished goods inventory on consignment at clinics for distribution to patients. We may not be able to completely control losses of this inventory and, if inventory losses are not consistent with historical experience, we might be required to write off a portion of the carrying value of inventory.

The clinical effectiveness of our electrotherapy products has periodically been challenged and the effectiveness of electrotherapy products such as those offered by Compex SA for fitness and health applications has sometimes been questioned. Publicity about the effectiveness of electrotherapy for pain relief or other clinical applications and continued questions about the effectiveness of electrotherapy for conditioning could negatively impact revenue and income from operations.

We operate in both the medical and consumer fitness markets, both of which are subject to a significant amount of regulation that affects the way we can advertise our products, sell our products, bill customers for our products and collect payment for our products.

The products we sell in our United States medical products business may only be sold on physician prescription and, for most of those products where there is a government sponsored payer, only if we receive detailed documentation from the physician indicating the medical necessity of the product together with forms which we must submit to the paying agency. In most cases, the reimbursement agency, including Medicare, requires strict adherence to the requirements of the form and the failure to properly obtain and maintain the documentation can result in significant fines, penalties, and civil litigation. For example, we were subject to a Medicare whistleblower suit that we settled in 2000 for approximately $1.6 million. Although we believe we have implemented a compliance program designed to detect errors in complying with these regulations, if our program fails, our operations and results could be adversely affected.

The manufacture of medical products, and the labeling of those products for sale in the United Sates, requires compliance with quality assurance and labeling regulations of the Food and Drug Administration. Although we believe our manufacturing facilities and operations comply with such regulations, a failure to comply could result in our inability to manufacture and refurbish products until compliance is achieved.

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The marketing of our consumer products is subject to regulations and oversight by both the FDA and the Federal Trade Commission relating to misleading advertising. The FTC has commenced several enforcement actions against advertisers of abdominal belts during the past few years based on unsubstantiated claims. Although we have attempted to limit the claims made in our advertisements to matters that can be substantiated, if the FTC were to disagree with our conclusions, it could enjoin our marketing of these products for a period of time and impose fines and penalties. Any such actions would have a significant adverse impact on our operations.

Approximately 35% of our revenue for the three months ended September 30, 2003 was generated by Compex SA, a subsidiary headquartered in Switzerland that does business primarily in Europe. There are risks in doing business in international markets which could adversely affect our business, including:

- regulatory requirements;
- export restrictions and controls, tariffs and other trade barriers;
- difficulties in staffing and managing international operations;
- fluctuations in currency exchange rates;
- reduced protection for intellectual property rights;
- seasonal reductions in business activity; and
- potentially adverse tax assessments.

We have not sold substantial volumes of consumer products in the United States, but intend to devote significant resources to market consumer products for health and fitness applications. The consumer market for electrical stimulation products is new and developing, and our success in this market will depend on a number of factors, including:

- our ability to obtain clearance from the FDA and other regulatory authorities to market the products for all relevant consumer applications;
- our ability to maintain distribution rights with, and to obtain adequate quantities of product from, the manufacturers of consumer products for which we serve as distributors;
- our ability to establish consumer demand with a limited marketing budget;
- our ability to secure contracts and shelf space in the United States with significant retailers;
- the effectiveness of our products for their intended applications.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Included herein is the following unaudited condensed financial information:

Consolidated Balance Sheets as of September 30, 2003 and June 30, 2003

Consolidated Statements of Operations for the three months ended September 30, 2003 and 2002

Consolidated Statements of Cash Flows for the three months ended September 30, 2003 and 2002

Notes to Consolidated Financial Statements

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COMPEX TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2003	September 30, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 5,056,007	$ 4,674,944
Receivables, less reserve of $15,200,590 and $14,900,164	24,955,130	24,317,021
Inventories		
Raw materials	1,393,470	1,249,798
Work in process	33,670	32,032
Finished goods	10,301,198	12,090,921
Deferred tax assets	4,675,394	4,675,394
Prepaid expenses	2,378,044	1,972,670
Total current assets	48,792,913	49,012,780
Property, plant and equipment, net	4,536,804	4,519,099
Goodwill, net	10,583,287	14,976,777
Other intangible assets, net	883,634	817,535
Deferred tax assets	750,926	761,292
Other assets	104,743	122,261
	$65,652,307	$70,209,744
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt	$ 5,363,850	$ 7,049,168
Note payable	4,500,000	4,100,000
Accounts payable	4,028,608	3,799,021
Accrued liabilities		
Payroll	692,710	271,368
Commissions	427,326	406,456
Income taxes	2,725,341	1,867,359
Other	4,476,675	6,206,638
Total current liabilities	22,214,510	23,700,010
Long-Term Liabilities:		
Long-term debt	1,217,268	3,510,050
Deferred tax liabilities	675,885	687,297
Total liabilities	24,107,663	27,897,357
Stockholders Equity:		
Common stock, $.10 par value; 30,000,000 shares authorized; issued and outstanding 10,948,469 and 11,084,175 shares, respectively	1,094,847	1,108,417
Preferred stock, no par value; 5,000,000 shares authorized; none issued and outstanding		
Additional paid-in capital	21,650,978	22,029,428
Accumulated other non-owner changes in equity	1,870,183	1,891,749
Retained earnings	16,928,636	17,282,793
Total stockholders equity	41,544,644	42,312,387
	$65,652,307	$70,209,744

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COMPEX TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30	
	2002	**2003**
Net sales and rental revenue	$17,737,740	$19,156,266
Cost of sales and rentals	5,447,427	6,437,246
Gross profit	12,290,313	12,719,020
Operating expenses:		
Selling, general and administrative	9,949,975	11,403,242
Research and development	524,073	628,477
Total operating expenses	10,474,048	12,031,719
Income from operations	1,816,265	687,301
Other income (expense):		
Interest expense	(112,468)	(153,743)
Other	(2,790)	55,599
Income before income taxes	1,701,007	589,157
Income tax provision	714,000	235,000
Net income	$ 987,007	$ 354,157
Net income per common and common equivalent share		
Basic	$ 0.09	$ 0.03
Diluted	$ 0.09	$ 0.03
Weighted average number of shares outstanding		
Basic	10,940,243	11,025,140
Diluted	11,063,557	11,800,286

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COMPEX TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended September 30	
	2002	**2003**
Operating Activities:		
Net income	$ 987,007	$ 354,157
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	399,508	356,452
Amortization of unearned compensation	27,188	0
Change in deferred taxes	(32)	(1,690)
Change in current assets and liabilities, net of amounts acquired in acquisition		
Receivables	1,402,515	358,710
Inventories	170,073	179,852
Prepaid expenses	960,739	1,107,607
Accounts payable	(410,088)	(1,275,277)
Accrued liabilities	(3,406,599)	(762,456)
Net cash provided by operating activities	130,311	317,355
Investing Activities:		
Purchases of property and equipment	(557,403)	(130,679)
Cash paid in asset acquisition, net of cash received		(3,389,912)
Change in other assets, net	(12,793)	(258,448)
Net cash used in investing activities	(570,196)	(3,779,039)
Financing Activities:		
Proceeds from new Debt financing		3,835,501
Principal payments on long-term obligations	(631,221)	(645,054)
Proceeds from (Payments on) line of credit, net	1,000,000	(400,000)
Proceeds from exercise of stock options	114,975	295,603
Proceeds from employee stock purchase plan	20,909	96,417
Net cash provided by financing activities	504,663	3,182,467
Effect of exchange rates on cash and cash equivalents	30,470	(101,846)
Net increase(decrease) in cash and cash equivalents	95,248	(381,063)
Cash and Cash Equivalents at Beginning of Period	2,086,650	5,056,007
Cash and Cash Equivalents at End of Period	$ 2,181,898	$ 4,674,944
Supplemental Cash Flow Information:		
Interest paid	$ 107,788	$ 153,743
Income taxes paid	$ 1,240,000	$ 959,000

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COMPEX TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTH PERIOD ENDED SEPTEMBER 30, 2003

The Company used a new term loan and a credit line to finance a business acquisition accounted for under the purchase method during the first quarter of fiscal 2004. The fair value of the assets and liabilities of the acquired company are presented as follows:

	As of September 30, 2003
Accounts Receivable	$ 2,193,589
Inventories	1,775,876
Prepaid Expenses	681,888
Property and equipment, net	135,748
Intangible assets	4,103,298
Other long-term assets	39,821
Accounts payable	(1,007,062)
Accrued liabilities	(1,179,090)
Liabilities forgiven	(2,563,870)
Long-term liabilities	(790,286)
Net assets acquired	$ 3,389,912

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COMPEX TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2003

1. Accounting Policies

The amounts set forth in the preceding financial statements are unaudited as of and for the periods ended September 30, 2003 and 2002 but, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the results for the periods presented. Such results are not necessarily indicative of results for the full year. The accompanying financial statements of the Company should be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2003 included in the Company s Annual Report on Form 10-K.

Stock-Based Compensation

The Company has adopted the disclosure-only provisions of SFAS No. 123, as amended by SFAS No. 148. Accordingly, the Company continues to account for stock-based compensation using the intrinsic value method as prescribed under Accounting Principles Board Opinion (APB) No. 25 and related Interpretations.

Had compensation expense for the Company s stock-based compensation plans been determined based on the fair value at the grant dates consistent with the method of SFAS No. 123, the Company s net income and earnings per share would have been reduced to the pro forma amounts indicated below:

		For the Three Months Ended September 30	
		2002	**2003**
Net Income	As reported	$ 987,007	$ 354,157
	Pro forma option expense, net of tax	(100,476)	(162,875)
	Pro forma	$ 886,531	$ 191,282
Basic earnings per share	As reported	$ .09	$ .03
	Pro forma	.08	.02
Diluted earnings per share	As reported	.09	.03
	Pro forma	.08	.02

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2003 and 2004: dividend yield of 0%; expected volatility of 57.6% and 57.7%; risk-free interest rate of 2.94% and 3.07%; and expected lives of 5 years.

2. Goodwill and Intangibles

The Company adopted the new rules on accounting for goodwill and other intangible assets effective July 1, 2001. Amounts previously recorded as separately identifiable intangibles for acquired work force and customer list have been subsumed to goodwill in accordance with FAS 141, increasing goodwill by $1.6 million as of the date of adoption. Effective with the adoption of FAS 142, goodwill is no longer amortized but is instead subject to an annual impairment test. Annual impairment tests conducted in connection with the adoption of FAS 142 resulted in no required provision for impairment.

Goodwill and other intangible assets resulting from acquisitions of business and the formation of the Company consist of the following:

	June 30, 2003	September 30, 2003
Goodwill	$12,254,717	$16,648,207
Less accumulated amortization	1,671,430	1,671,430
Net goodwill	10,583,287	14,976,777
Other intangible assets:	1,783,686	1,783,686
Less accumulated amortization	900,052	966,151
Net other intangible assets	883,634	817,535
Total intangible assets, net	$11,466,921	$15,794,312

3. Note Payable and Long Term Debt

The Company has a $20,000,000 U. S. credit facility which provides for both term and revolving borrowings at varying rates based either on the bank s prime rate or LIBOR. As of September 30, 2003, there were borrowings outstanding of $4,497,000 on the long-term note and $4,100,000 on the revolving credit line. The Company currently has $900,000 available under the facility. Borrowings under the U. S. credit facility are secured by substantially all assets of the Company other than those pledged as collateral on existing lease or mortgage obligations. The interest rate on the term loan was 3.125% at September 30, 2003 and the weighted average rate on borrowings under the revolving line of credit was 4.00%.

The Company was in compliance with all financial covenants in its U. S. credit agreement as of September 30, 2003 and for the period then ended.

The Company has a $4,975,000 Swiss credit facility which provides for a three-year term loan at varying rates. As of September 30, 2003, there were borrowings outstanding of $3,495,300 under this credit facility. Borrowings under this credit facility were used to fund the acquisition of Filsport Assistance S.r.l. on July 3, 2003. Borrowings under the Swiss credit facility are secured by all of the equity interest held by the company s Swiss subsidiary in Filsport. The first advance on the loan bears interest at 3.69%, the second advance bears interest at 4.09%, and the third and final advance bears interest at 4.40%.

The company was in compliance with all financial covenants in its Swiss Credit agreement as of September 30, 2003 and for the period then ended.

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4. Business Acquisitions

A. Acquisition of the Assets of BMR Neurotech, Inc.:

On May 15, 2003, the Company acquired certain assets of BMR Neurotech, Inc. for total consideration of approximately $3.6 million. The acquisition was financed using the existing credit line. The acquisition was accounted for using the purchase method of accounting with the purchase price allocated to the fair value of the net assets acquired, which included accounts receivable, inventory and fixed assets. The excess of the purchase price over the fair value of the underlying assets acquired of $1,048,624 has been allocated to goodwill and thus is not amortizable. Pro forma information related to this acquisition is not included as the impact is not deemed to be material.

B. Acquisition of Filsport Assistance S.r.l.:

On July 3, 2003, the Company acquired substantially all the assets of Filsport Assistance S.r.l., an independent distributor of the Compex® brand of consumer products in Italy. The transaction involved an exchange of approximately $4.9 million in cash for stock and provides for additional contingent consideration of up to 950,000 Euros if a certain performance milestone is achieved following the transaction. The acquisition was financed through a newly-established credit facility and with existing funds. Prior to the acquisition, Filsport operated under an exclusive distribution arrangement and accounted for 25% of Compex SA total sales (10% of consolidated sales) in fiscal 2003. The purchase consideration exceeded the net fair value of tangible assets by $4,103,298 and was assigned to goodwill.

Pro forma operating results of the Company as if Filsport had been acquired at the beginning of fiscal 2003 are as follows (unaudited):