

K TEL INTERNATIONAL INC  
Form 10-Q  
September 18, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 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 December 31, 2004

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: 1-07115

**K-TEL INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of  
incorporation or organization)

**41-0946588**

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

**2655 Cheshire Lane North, Suite 100, Plymouth, Minnesota**  
(Address of principal executive offices)

**55447**  
(Zip Code)

Registrant's telephone number, including area code: **(763) 559-5566**

Securities registered pursuant to Section 12(b) of the Act:

**None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$0.01**

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(Title of class)

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  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.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of September 15, 2006, the registrant had 13,653,738 shares of common stock outstanding.

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**K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES**

**FORM 10-Q**

**FOR THE THREE AND SIX MONTH PERIODS**

**ENDED DECEMBER 31, 2004**

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**SAFE HARBOR STATEMENT UNDER THE**

**PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

Certain statements of a non-historical nature under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Form 10-Q constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may be identified by the use of terminology such as "may," "will," "expect," "anticipate," "estimate," "should," or "continue" or the negative thereof or other variations thereon or comparable terminology. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or from those results currently anticipated or projected. Such factors include, among other things, the following: changes in consumer purchasing; demand for and market acceptance of new and existing products; the impact from competition for recorded music; the outcome of legal proceedings; dependence on suppliers and distributors; success of marketing and promotion efforts; technological changes and difficulties; availability of financing; foreign currency variations; general economic, political and business conditions; and other matters. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements, except as required by law.



**K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED***(in thousands except share data)*

	December 31, 2004	June 30, 2004
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 126	\$ 147
Accounts receivable, net of allowance for doubtful accounts of \$4 and \$4	3,715	2,691
Inventories	526	561
Royalty advances	38	50
Prepaid expenses and other	269	308
Total Current Assets	4,674	3,757
Property and equipment, net of accumulated depreciation and amortization of \$1,125 and \$1,506	106	83
Owned catalog masters, net of accumulated amortization of \$3,030 and \$2,942	583	656
	\$ 5,363	\$ 4,496
<b>LIABILITIES AND SHAREHOLDERS DEFICIT</b>		
Current Liabilities:		
Notes payable to affiliate and other	\$ 11,527	\$ 11,165
Accounts payable	1,576	1,432
Accrued royalties	2,099	1,907
Reserve for returns	151	133
Net liabilities of discontinued operations	34	30
Total Current Liabilities	15,387	14,667
Shareholders' Deficit:		
Common stock 50,000,000 shares authorized; par value \$.01; 13,653,738 issued and outstanding	136	136
Additional paid-in capital	21,292	21,292
Accumulated deficit	(31,429)	(31,466)
Accumulated other comprehensive loss	(23)	(133)
Total Shareholders' Deficit	(10,024)	(10,171)
	\$ 5,363	\$ 4,496

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

**K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED***(in thousands - except per share data)*

	Three Months Ended December 31,		Six Months Ended December 31,	
	2004	2003	2004	2003
Net Sales	\$ 1,695	\$ 1,759	\$ 3,531	\$ 3,381
Costs and Expenses:				
Cost of goods sold	772	857	1,693	1,513
Advertising	40	32	67	75
Selling, general and administrative	873	910	1,790	1,748
Total Costs and Expenses	1,685	1,799	3,550	3,336
Operating Income (Loss)	10	(40 )	(19 )	45
Other Expense:				
Interest expense	(157 )	(120 )	(302 )	(237 )
Other	125		147	(11 )
Total Other Expense	(32 )	(120 )	(155 )	(248 )
Loss from Continuing Operations	(22 )	(160 )	(174 )	(203 )
Income (loss) from Discontinued Operations, net of taxes	212	(20 )	211	(61 )
Net Income (Loss)	\$ 190	\$ (180 )	\$ 37	\$ (264 )
Income (Loss) per Share Basic and Diluted:				
Continuing Operations	\$	\$ (.01 )	\$ (.01 )	\$ (.02 )
Discontinued Operations	.02		.02	
Net Income (Loss)	\$ .02	\$ (.01 )	\$ .01	\$ (.02 )
Shares used in the calculation of loss per share - Basic and Diluted	13,654	13,654	13,654	13,654
Comprehensive Income (Loss):				
Net income (loss)	\$ 190	\$ (180 )	\$ 37	\$ (264 )
Translation adjustment	65	76	110	76
Comprehensive Income (Loss)	\$ 255	\$ (104 )	\$ 147	\$ (188 )

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

**K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED***(in thousands)*

	<b>Six Months Ended December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Cash flows from Operating Activities:</b>		
Net income (loss)	\$ 37	\$ (264 )
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	123	132
Loss on disposal of property and equipment	(11 )	)
Discontinued operations	4	(6 )
Changes in operating assets and liabilities:		
Accounts receivable, net	(908 )	(30 )
Inventories	47	(54 )
Royalty advances	13	8
Prepaid expenses	43	(197 )
Accounts payable	99	(525 )
Accrued royalties	164	138
Reserve for returns	18	(8 )
Cash used in operating activities	(371 )	(806 )
<b>Cash flows from Investing Activities:</b>		
Purchases of property and equipment	(55 )	(41 )
Other	(13 )	(6 )
Cash used in investing activities	(68 )	(47 )
<b>Cash flows from Financing Activities:</b>		
Borrowings on notes payable	2,320	1,483
Payments on notes payable	(1,958 )	(1,819 )
Cash provided by (used in) financing activities	362	(336 )
Effect of exchange rates on cash	56	19
Net decrease in cash and cash equivalents	(21 )	(1,170 )
Cash and cash equivalents at beginning of period	147	1,219
Cash and cash equivalents at end of period	\$ 126	\$ 49

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

**K-TEL INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. BUSINESS AND LIQUIDITY**

K-tel International, Inc. (the Company, K-tel or the registrant) was incorporated in 1968 and currently has its corporate offices located in Plymouth, Minnesota. Through its operating subsidiaries, K-tel licenses its music catalog internationally and markets entertainment products mainly derived from its catalog through retail and direct response marketing channels in the United States and Europe. The Company has a focused method of distribution that targets the strengths of selected individual retailers and supplies products suited to each retailer's needs. These products are derived mainly from the Company's master recordings music catalog with the objective of realizing more competitive profit margins. K-tel seeks to license its trademarks to other companies in businesses unrelated to K-tel's current operations. Licenses are granted for a royalty or fee, with no cost to the Company.

Discontinued Operations

The Company's consumer products business, which was concentrated in Europe, consisted primarily of housewares, consumer convenience items and exercise equipment. The Company discontinued its consumer products operations in Germany, the United Kingdom and the United States in June 2000, November 2000 and January 2001, respectively. Accordingly, these activities have been presented in the accompanying financial statements as discontinued operations. The accompanying condensed consolidated financial statements have been prepared to reflect the consumer products division as a discontinued operation. The net liabilities of discontinued operations at December 31, 2004 and June 30, 2004, and results from discontinued operations for the three and six months ended December 2004 and 2003, relate primarily to legal matters and completion of statutory reporting requirements for the former operations in Germany.

Liquidity

During the six months ended December 31, 2004 and 2003, the Company incurred net losses from continuing operations of \$304,000 and \$203,000, respectively. Operating activities used \$371,000 and \$806,000 of cash during the six months ended December 31, 2004 and 2003 respectively. Additionally, the Company had a working capital deficit of \$10,713,000 at December 31, 2004.

The Company's ability to continue its present operations and implement future expansion plans successfully is contingent mainly upon its ability to maintain its line of credit arrangements with K-5 Leisure Products, Inc. (See Note 3), increase its revenues and profit margins, and ultimately attain and sustain profitable operations. Without increased revenues and sustained profitability, the cash generated from the Company's current operations will likely be inadequate to fund operations and service its indebtedness on an ongoing basis. Management is focusing its efforts on music licensing, music downloads and limited music distribution. However, there can be no assurance that the Company will achieve profitable operations through these efforts. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

**2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation The accompanying condensed consolidated unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the six month periods ended December 31, 2004 are not necessarily indicative of the results that may be expected for the year as a whole. The unaudited condensed consolidated balance sheet for June 30, 2004 has been derived from audited consolidated financial statements as of that date. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K/A for the year ended June 30, 2004.





Principles of Consolidation - The accompanying condensed consolidated financial statements include the accounts of K-tel Intern