CTI INDUSTRIES CORP
Form 10QSB
May 15, 2002

FORM 10-QSB

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

For the quarterly period ended March 31, 2002

Commission File No. 000-23115

CTI INDUSTRIES CORPORATION
(Exact name of registrant as specified in its charter)

Illinois	36-2848943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

22160 North Pepper Road, Barrington, Illinois 60010
(Address of principal executive offices) (Zip Code)

(847) 382-1000
(Registrant's telephone number, including area code)

Registrant 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 and has been subject to such filing requirements for the past 90 days.

APPLICABLE ONLY TO CORPORATE ISSUERS:

COMMON STOCK, no par value, 841,644 outstanding Shares and CLASS B COMMON STOCK, no par value, 366,300 outstanding Shares, as of March 31, 2002.

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

The following consolidated financial statements of the Registrant are attached to this Form 10-QSB:

1. Interim Balance Sheet as of March 31, 2002 and Balance Sheet as of December 31, 2001.

2. Interim Statements of Operations for the three-month periods ending March 31, 2002, and March 31, 2001.

3. Interim Statements of Cash Flows for the three-month periods ending March 31, 2002 and March 31, 2001.

The Financial Statements reflect all adjustments, which are, in the opinion of management, necessary to a fair statement of results for the periods presented.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Results of Operations

Net Sales. For the three months ended March 31, 2002, net sales were $9,738,000, as compared to sales of $6,081,000 for the three months ended March 31, 2001, and increase of 60.1%. The increase in sales is primarily due to an increase in commercial film sales of approximately $3,000,000.

Cost of Sales. For the three months ended March 31, 2002, cost of sales increased to 73.8% of net sales as compared to 73.3% of net sales for the same period in 2001. The increase was primarily the result of lower than expected margins in the production and sales of latex balloons.

Administrative. For the three months ended March 31, 2002, administrative expenses were $1,002,000 or 10.3% of sales as compared to $747,000 or 12.3% of sales for the same period in 2001. The majority of the increase in administrative expense dollars came from the increase in salaries required to hire more administrative staff and increases in legal and audit expense.

Selling. For the three months ended March 31, 2002, selling expenses were $375,000 or 3.9% of sales as compared to $426,000 or 7.0% of sales for the same period in 2001. The decline in selling expense is primarily related to a drop in commissions and royalty expenses.

Advertising and Marketing. For the three months ended March 31, 2002 advertising and marketing expenses were $393,000 or 4% of net sales as compared to $271,000 or 4.5% of net sales for the same period in 2001. The increase in advertising and marketing expense dollars came from several items, principally increased salary costs and increased costs of producing artwork and films for a major new customer.

Other Income or Expense. Interest expense decreased to $173,000 for the three months ended March 31, 2002, as compared to $300,000 for the three month period ended March 31, 2001. The decrease in interest expense is due to the Company's refinancing of its debt in the first quarter of 2001.

Net Income or Loss. For the three months ended March 31, 2002, the Company had net income before taxes and minority interest of $648,000 as compared to a net loss before taxes and minority interest of $148,000 for the same three-month period in 2001. The provision for income taxes for the three-month period ended March 31, 2002 was $247,000 resulting in net income of $377,000. The provision for income taxes for the three-month period ended March 31, 2001 was $9,000, resulting in a net loss of $133,000

Financial Condition

Liquidity and Capital Resources. Cash flow provided by operations during the three months ended March 31, 2002 was $22,000, which was primarily caused by an increase in accounts receivable and accounts payable, resulting from an increased sales volume, and an increase in inventory. During the three month period ended March 31, 2001, cash flow used in operations was $1,085,000, which was primarily caused by an increase in accounts receivable.

Investment Activities. During the three months ended March 31, 2002, cash flow used in investing activities for the purchase of machinery and equipment was $319,000. In the three month period ended March 31, 2001, $82,000 was used in investing activities, primarily for the purchase of machinery and equipment.

Financing Activities. For the three months ended March 31, 2002, cash flow provided by financing activities was $273,000. The primary source of this cash flow was the change in the balance of the Company's revolving line of credit. Cash flow provided by financing activities for the three-month period ending March 31, 2001 was $1,208,000. The two primary sources of this cash flow were the refinancing of the Company's debt, which netted additional cash of approximately $800,000, and cash flow provided by the Company's short-term revolving line of credit.

At March 31, 2002, the Company had a cash balance of $85,000. The Company's current cash management strategy includes maintaining minimal cash balances and utilizing its revolving line of credit for liquidity. At December 31, 2001, the Company had cash and cash equivalents of $110,000. At March 31, 2002, the Company had working capital of $1,466,000, and at December 31, 2001, working capital was $1,026,000.

The Company believes that existing capital resources and cash generated from operations will be sufficient to meet the Company's requirements for at least 12 months.

Seasonality. In the metalized balloon product line, sales have historically been seasonal, with approximately 22% to 25% of annual sales of metalized balloons being generated in December and January and 11% to 13% of annual metalized sales being generated in June and July in recent years. The sale of latex balloons and laminated film products have not historically been seasonal. As sales of latex balloons and laminated film products have increased in relation to sales of metalized balloons, the effect of this seasonality has been reduced.

Safe Harbor Provision of the Private Securities Litigation Act of 1995 and Forward Looking Statements. The Company operates in a dynamic and rapidly changing environment that involves numerous risks and uncertainties. The market for metallized and latex balloon products is generally characterized by intense competition, frequent new product introductions and changes in customer tastes, which can render existing products unmarketable. The statements contained in Item 2 (Management's Discussion and Analysis of Financial Condition and Results of Operation) that are not historical facts may be forward-looking statements (as such term is defined in the rules promulgated pursuant to the Securities Exchange Act of 1934) that are subject to a variety of risks and uncertainties more fully described in the Company's filings with the Securities and Exchange Commission including, without limitation, those described under "Risk Factors" in the Company's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997. The forward-looking statements are based on the beliefs of the Company's management, as well as assumptions made by, and information currently available to the Company's management. Accordingly, these statements are subject to significant risks, uncertainties and contingencies which could cause the Company's actual growth, results, performance and business prospects and opportunities in 2002 and beyond to differ materially from those expressed in, or implied by, any such forward-looking statements. Wherever possible, words such as "anticipate," "plan," "expect," "believe," "estimate," and similar expressions have been used to identify these forward-looking statements, but are not the exclusive means of identifying such statements. These risks, uncertainties and contingencies include, but are not limited to, the Company's limited operating history on which expectations regarding its future performance can be based, competition from, among others, national and regional balloon, packaging and custom film product manufacturers and sellers that have greater financial, technical and marketing resources and distribution capabilities than the Company, the availability of sufficient capital, the maturation and success of the Company's strategy to develop, market and sell its products, risks inherent in conducting international business, risks associated with securing licenses, changes in the Company's product mix and pricing, the effectiveness of the Company's efforts to control operating expenses, general economic and business conditions affecting the Company and its customers in the United States and other countries in which the Company sells and anticipates selling its products and services and the Company's ability to (i) adjust to changes in technology, customer preferences, enhanced competition and new competitors; (ii) protect its intellectual property rights from infringement or misappropriation; (iii) maintain or enhance its relationships with other businesses and vendors; and (iv) attract and retain key employees. There can be no assurance that the Company will be able to identify, develop, market, sell or support new products successfully, that any such new

products will gain market acceptance, or that the Company will be able to respond effectively to changes in customer preferences. There can be no assurance that the Company will not encounter technical or other difficulties that could delay introduction of new or updated products in the future. If the Company is unable to introduce new products and respond to industry changes or customer preferences on a timely basis, its business could be materially adversely affected. The Company is not obligate to update or revise these forward-looking statements to reflect new events or circumstances.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

On March 12, 2001, the Company was joined as a third party defendant in a pending action filed by Real Fresh, Inc., a California Corporation, against Packaging Systems, LLC, ("PSI") an Illinois limited liability company. The action was filed in the United States District Court for the Eastern District of California. In the action, Real Fresh seeks damages from PSI for losses it claims it incurred by reason of PSI supplying defective packaging materials. The Company was a supplier to PSI of certain laminated films utilized by PSI in these packaging materials. PSI initiated a third-party claim against the Company for indemnity, contribution and breach of contract. The Company has filed an answer to the third-party complaint denying the claim and asserting a number of defenses. In addition, on July 27, 2001, the Company cross-claimed against the supplier of the base film, Honeywell International, Inc. for indemnity, contribution and breach of contract. On August 20, 2001, Honeywell International, Inc., filed a counterclaim against the Company seeking to recover for film claimed to be sold to the Company and the Company has filed an answer and affirmative defenses denying such counterclaim. The Company has notified its insurance carrier of the claims. Final outcome of these matters is uncertain and a range of loss (beyond any claims that may be covered by insurance) cannot be estimated at this time.

Item 2. Changes in Securities

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits*

	No.
Statement re: Computation of Per Share Earnings (contained in the Notes to Financial Statements)	11

(b) The Company has not filed a Current Report on Form 8-K during the quarter covered by this report.

* Also incorporated by reference the Exhibits filed as part of the SB-2 Registration Statement of the Registrant, effective November 5, 1997, and subsequent periodic filings.

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.

Dated: May 15, 2002

CTI INDUSTRIES CORPORATION

By: /s/ Stephen M. Merrick

Stephen M. Merrick
Chief Financial Officer

CTI Industries Corporation and Subsidiaries
Consolidated Balance Sheets

March 31, 2002 Dec

	(Unaudited)
ASSETS	
Current assets:	
Cash	$ 85,298
Accounts receivable (less allowance for doubtful accounts of $249,600 and $375,755 at March, 2002 and December 31, 2001, respectively)	6,069,072
Inventories	9,129,061
Deferred tax assets	290,816
Other	885,853
Total current assets	16,460,100
Property and equipment:	
Machinery and equipment	14,814,041
Building	2,517,839
Office furniture and equipment	1,740,244
Land	250,000
Leasehold improvements	161,885
Fixtures and equipment at customer locations	2,232,285
Projects under construction	377,972
	22,094,266
Less: accumulated depreciation	(13,317,120)
Total property and equipment, net	8,777,146
Other assets:	
Deferred financing costs, net	100,206
Goodwill associated with acquisition of CTI Mexico, net	1,113,108
Deferred tax assets	118,250
Other assets	258,928
Total other assets	1,590,492
TOTAL ASSETS	26,827,738

See accompanying notes

LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	7,164,975
Line of credit	6,090,817
Notes payable - current portion	318,443
Accrued liabilities	1,419,902
Total current liabilities	14,994,137
Long-term liabilities:	
Other liabilities	2,422,844
Notes payable	3,608,088
Subordinated debt	486,640

Total long-term liabilities	6,517,572
Minority interest	204,538
Stockholders' equity:	
Common stock - no par value with a stated par value of $.195, 5,000,000 shares authorized, 966,327 shares issued, 841,644 shares outstanding	188,434
Class B Common stock - no par value with a stated par value of $2.73, 500,000 shares authorized, 366,300 shares issued and outstanding	1,000,000
Paid-in-capital	5,554,332
Warrants issued in connection with subordinated debt	228,360
Accumulated deficit	(1,181,898)
Accumulated other comprehensive earnings	(45,897)
Less:	
Treasury stock - 124,683 shares	(575,384)
Notes receivable from stockholders	(56,456)
Total stockholders' equity	5,111,491
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 26,827,738

See accompanying notes

CTI Industries Corporation and Subsidiaries
Consolidated Statements of Operations

	Qtr Ended 03/31/02 (Unaudited)	Qtr Ended 03/31/01 (Unaudited)
Net Sales	$ 9,738,097	$ 6,080,573
Cost of Sales	7,183,845	4,457,778
Gross profit on sales	2,554,252	1,622,795
Operating expenses:		
Administrative	1,001,900	746,925
Selling	375,277	425,581
Advertising and marketing	393,222	271,199
Total operating expenses	1,770,399	1,443,705
Income from operations	783,853	179,090
Other income (expense):		
Interest expense	(173,115)	(299,904)

Interest income	227	741
(Loss) gain on sale of assets	(10,694)	7,512
Other	48,035	(35,072)
Total other income (expense)	(135,547)	(326,723)
Income (loss) before income taxes and minority interest	648,306	(147,633)
Income tax expense (benefit)	247,293	9,123
Income (loss) before minority interest	401,013	(156,756)
Minority interest in income (loss) of subsidiary	(23,707)	(23,487)
Net Profit (Loss)	$ 377,306	$ (133,269)
Income (loss) applicable to common shares	$ 377,306	$ (133,269)
Basic income (loss) per common and common equivalent shares	$ 0.31	$ (0.11)
Diluted income (loss) per common and common equivalent shares	$ 0.29	$ (0.11)
Weighted average number of shares and equivalent shares of common stock outstanding:		
Basic	1,207,944	1,207,944
Diluted	1,295,864	1,207,944

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

CTI Industries Corporation and Subsidiaries
Consolidated Statements of Cash Flows

	Quarter Ended March 31, 2002	March 31, 2001
Cash flows from operating activities:		
Net income (loss)	$ 377,306	$ (133,269)
Adjustment to reconcile net loss to cash provided by (used in) operating activities:		
Depreciation and amortization	345,484	390,936
Minority interest in gain (loss) of subsidiary	23,707	(23,487)
Gain (loss) on sale of fixed assets	0	(7,512)

Provision for losses on accounts receivable & inventory	75,000	50,000
Deferred income taxes	154,153	
Change in assets and liabilities:		
Accounts receivable	(1,497,995)	(1,338,556)
Inventory	(684,652)	(215,727)
Other assets	(137,437)	204,184
Accounts payable and accrued expenses	1,365,995	(11,642)
Net cash provided by (used in) operating activities	21,561	(1,085,073)
Cash flows from investing activities:		
Purchases of property and equipment	(319,296)	(81,938)
Net cash provided by (used in) investing activities	(319,296)	(81,938)
Cash flows from financing activities:		
Net change in revolving line of credit	393,100	910,770
Proceeds from issuance of long-term debt	0	4,655,035
Proceeds from issuance of short-term debt	0	1,131,819
Repayment of long-term debt	(59,415)	(4,464,216)
Repayment of short-term debt	(61,122)	(1,014,920)
Repayment of subordinated debt	0	(10,000)
Net cash provided by financing activities	272,563	1,208,488
Effect of exchange rate changes on cash	(18)	792
Net (decrease) increase in cash	(25,190)	42,269
Cash and Equivalents at Beginning of Period	110,488	392,534
Cash and Equivalents at End of Period	$ 85,298	$ 434,803

March 31, 2002

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Registrant Company and Subsidiaries' annual report on Form 10-KSB for the year ended December 31, 2001.

Note 2 - Company Debt Restructure

In January 2001, the Company entered into a Loan and Security Agreement with a new lender under which the lender has provided the Company with a credit facility in the amount of $9,500,000, secured by equipment, inventory, receivables, and other assets of the Company. The credit facility includes a term loan of $1,426,000, at an interest rate of prime plus 0.75%, and a revolving line of credit at an interest rate of prime plus 0.50%, the amount of which is based on advances of up to 85% of eligible receivables and 50% of the value of the Company's inventory. The credit facility is secured by substantially all assets of the Company. The term of this credit facility is for a period of three years, which may be extended by either party for an additional year.

Also in January 2001, another lender loaned to the Company the sum of $2,873,000 in a refinance of the Company's principal office building and property situated in Barrington, Illinois. The loan is secured by the aforementioned building and property, and has been made in the form of two notes. The first note is in the principal amount of $2,700,000, bears interest at the rate of 9.75%, and has a term of five years with an amortization period of 25 years. The second note is in the principal amount of $173,000 with an interest rate of 10%, and has a term of three years.

Note 3 - Recent Accounting Pronouncements

SFAS NO. 141 "BUSINESS COMBINATIONS", AND SFAS 142, "GOODWILL AND INTANGIBLE ASSETS"

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, Business Combinations, and SFAS 142, Goodwill and Intangible Assets. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS 142.

Although it is still reviewing the provisions of these Statements, management's preliminary assessment is that these Statements will not have a material impact on the Company's financial position or results of operations.

Note 4 - Earnings Per Share

The Company adopted SFAS No. 128, "Earnings per Share," for the year ended October 31, 1998. Adoption of this pronouncement did not have a material impact on the Company's financial statements.

Basic earnings per share is computed by dividing the income available to common shareholders by the weighted average number of shares of common stock outstanding during each period.

Diluted earnings per share is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents (stock options and warrants), unless anti-dilutive, during each period.

Earnings per share for the periods ended March 31, 2002 and 2001 was computed as follows:

CTI Industries Corporation and Subsidiaries
Consolidated Earnings per Share

	Quarter Ended March 31 2002	2001
Basic		
Average shares outstanding:		
Weighted average number of shares of common stock outstanding during the period	1,207,944	1,207,944
Net income:		
Net income (loss)	$ 377,306	$ (133,269)
Amount for per share computation	$ 377,306	$ (133,269)
Per share amount	$ 0.31	$ (0.11)
Diluted		
Average shares outstanding:		
Weighted average number of shares of common stock outstanding during the period	1,207,944	1,207,944
Net additional shares assuming stock options and warrants exercised and proceeds used to purchase treasury stock	87,920	--
Weighted average number of shares and equivalent shares of common stock outstanding during the period	1,295,864	1,207,944
Net income:		
Net income (loss)	$ 377,306	$ (133,269)
Amount for per share computation	$ 377,306	$ (133,269)
Per share amount	$ 0.29	$ (0.11)