

SM&A  
Form 10-Q  
November 04, 2002

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**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 Quarter ended September 30, 2002**

**OR**

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

**Commission file number 0-23585**

**SM&A**

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

**California**  
(State or other jurisdiction of  
incorporation or organization)

**33-0080929**  
(I.R.S. Employer  
Identification No.)

**4695 MacArthur Court, 8th Floor, Newport Beach, California 92660**  
(Address of principal executive offices, including zip code)

**(949) 975-1550**  
(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  No

The number of shares outstanding of the registrant's common stock as of October 31, 2002 was 19,685,380.

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(in thousands)

	September 30, 2002	December 31, 2001
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,437	\$ 26,270
Restricted cash		3,265
Accounts receivable, net	9,022	9,022
Prepaid income taxes		1,860
Prepaid expenses and other current assets	550	385
Deferred income taxes	1,703	2,395
	<u>          </u>	<u>          </u>
Total current assets	14,712	43,197
Property and equipment, net	1,005	557
Deferred income taxes	729	729
Other assets	108	118
	<u>          </u>	<u>          </u>
	<u>\$ 16,554</u>	<u>\$ 44,601</u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Trade accounts payable	\$ 1,353	\$ 1,487
Accrued compensation and related benefits	2,134	3,479
Income taxes payable	3,599	3,351
Current portion of long-term debt and capital lease obligations, net	70	22,232
Interest payable		695
Net liabilities of discontinued operations	3,100	7,483
	<u>          </u>	<u>          </u>
Total current liabilities	10,256	38,727
Deferred rent	220	215
Interest rate swap, at fair value		1,786
Capital lease obligations, net of current portion	133	188
Commitments and contingencies		
Shareholders' equity:		
Preferred stock		
Common stock	49,325	48,754
Accumulated deficit	(43,380)	(45,069)
	<u>          </u>	<u>          </u>
Total shareholders' equity	5,945	3,685
	<u>          </u>	<u>          </u>
	<u>\$ 16,554</u>	<u>\$ 44,601</u>

See accompanying notes to consolidated financial statements

**Table of Contents****SM&A****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue	\$ 14,315	\$ 11,391	\$ 40,521	\$ 33,927
Cost of revenue	8,361	6,844	23,933	19,748
Gross margin	5,954	4,547	16,588	14,179
Selling, general and administrative expenses	2,985	2,837	8,878	8,826
Operating income	2,969	1,710	7,710	5,353
Other income (expense):				
Interest expense, net	(150)	(333)	(890)	(1,216)
Unrealized gain (loss) on interest rate swap	(86)	(690)	5	(974)
Other income (expense), net	(236)	(1,023)	(885)	(2,190)
Income from continuing operations before income taxes	2,733	687	6,825	3,163
Income tax expense	1,122	227	2,637	1,231
Income from continuing operations	1,611	460	4,188	1,932
Loss from discontinued businesses, net of income taxes		(4,706)		(6,267)
Loss on disposal of discontinued businesses, net of income taxes		(14,431)		(14,431)
Extraordinary loss from early extinguishment of debt, net of income taxes			(2,499)	
Cumulative effect of adoption of FASB Statement No. 133, net of income taxes				(668)
Net income (loss)	\$ 1,611	\$ (18,677)	\$ 1,689	\$ (19,434)
Income per share from continuing operations:				
Basic	\$ 0.08	\$ 0.02	\$ 0.22	\$ 0.11
Diluted	\$ 0.08	\$ 0.02	\$ 0.21	\$ 0.11
Loss per share from discontinued operations:				
Basic	\$	\$ (1.00)	\$	\$ (1.09)
Diluted	\$	\$ (1.00)	\$	\$ (1.09)
Loss per share from early extinguishment of debt:				
Basic	\$	\$	\$ (0.13)	\$
Diluted	\$	\$	\$ (0.12)	\$
Loss per share from cumulative effect of change in accounting:				
Basic	\$	\$	\$	\$ (0.04)
Diluted	\$	\$	\$	\$ (0.04)
Net income (loss) per share:				
Basic	\$ 0.08	\$ (0.98)	\$ 0.09	\$ (1.02)
Diluted	\$ 0.08	\$ (0.98)	\$ 0.08	\$ (1.02)

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Shares used in calculating net income (loss) per share:				
Basic	19,602	19,137	19,483	18,993
Diluted	20,510	19,152	20,447	19,027

See accompanying notes to consolidated financial statements.

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(in thousands)

	Nine Months Ended September 30,	
	2002	2001
	(unaudited)	(unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 1,689	\$(19,434)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Loss from discontinued operations, net of tax		20,698
Cumulative effect of adoption of FASB 133, net of tax		668
Change in fair value of interest rate swap	(5)	974
Depreciation and amortization	190	193
Deferred income taxes	692	(1,209)
Amortization of debt issuance costs	4,165	393
Changes in operating assets and liabilities:		
Decrease (Increase) in accounts receivable		(1,866)
Decrease in prepaid income taxes	1,860	1,287
(Increase) Decrease in prepaid expense and other assets	(155)	365
Decrease in trade accounts and interest payable	(829)	(259)
Decrease in accrued compensation and related benefits	(1,345)	(448)
Increase in income taxes payable	248	776
Increase (Decrease) in other liabilities	5	1,309
	<u>6,515</u>	<u>3,447</u>
Net cash provided by operating activities	6,515	3,447
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(638)	(47)
Disposal of property and equipment		440
Decrease in restricted cash	3,265	
	<u>2,627</u>	<u>393</u>
Net cash provided by (used in) investing activities	2,627	393
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of subordinated notes	(25,000)	
Payment of early payment penalty on subordinated notes	(1,250)	
Payments on termination of interest rate swap agreement	(1,781)	
Proceeds from issuance of common stock	571	415
Repayments under revolving line of credit facility		(4,750)
Repayments under capital lease obligations	(132)	
	<u>(27,592)</u>	<u>(4,335)</u>
Net cash used in financing activities	(27,592)	(4,335)
Net decrease in cash from continuing operations	(18,450)	(495)
Net cash provided by (used in) discontinued operations	(4,383)	401
	<u>(22,833)</u>	<u>(94)</u>
Net decrease in cash	(22,833)	(94)
Cash and cash equivalents at beginning of period	26,270	1,548



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Cash and cash equivalents at end of period

\$ 3,437

\$ 1,454

See accompanying notes to consolidated financial statements.

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**SM&A**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Three and Nine Months Ended September 30, 2002 and 2001**  
**(unaudited)**

**NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly our consolidated financial position at September 30, 2002 and the consolidated results of our operations and our cash flows for the three and nine months ended September 30, 2002 and 2001.

It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three and nine months ended September 30, 2002 are not necessarily indicative of the results to be expected for the full fiscal year.

The accompanying unaudited condensed consolidated financial statements do not include all footnotes and certain financial presentations normally required under generally accepted accounting principles. Therefore, these financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2001, included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2002.

*Cash and Cash Equivalents.* We consider all highly-liquid investments with an original maturity of three months or less to be cash equivalents.

*Recent Accounting Pronouncements.* We adopted Financial Accounting Standards Board (FASB) Statement No. 141, *Business Combinations* ( Statement No. 141 ), and No. 142, *Goodwill and Other Intangible Assets* ( Statement No. 142 ), effective January 1, 2002. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with Statement Nos. 141 and 142. Other intangible assets will continue to be amortized over their useful lives. The adoption of Statement Nos. 141 and 142 did not have a material effect on our results of operations, financial position or cash flows.

We also adopted FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, effective January 1, 2002. Statement No. 144 supersedes Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and portions of Accounting Principles Bulletin Opinion 30, *Reporting the Results of Operations*. This Statement provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of fair value and carrying amount. This Statement also requires expected future operating losses from discontinued operations to be displayed in the period(s) in which the losses are incurred, rather than as of the measurement date as presently required. The adoption of Statement 144 did not have a material effect on our results of operations, financial position or cash flows.

*Reclassifications.* Certain items in the 2001 financial statements have been reclassified to conform to the current period presentation.

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**NOTE 2. NET INCOME (LOSS) PER SHARE**

The following table illustrates the number of shares used in the computation of basic and diluted net income (loss) per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Denominator for basic income (loss) per common share weighted average shares outstanding during the period	19,602	&nb		