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ECC INTERNATIONAL CORP
Form 10-Q
February 07, 2001

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 December 31, 2000

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

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 January 31, 2001 there were 8,545,705 shares of the Registrant's Common Stock, \$.10 par value per share, issued and outstanding.

PART I. FINANCIAL STATEMENTS
ITEM 1. FINANCIAL STATEMENTS
ECC INTERNATIONAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(In Thousands Except Per Share Data)
(Unaudited)

	Six Months Ended 12/31/00 -----	Six Months Ended 12/31/99 -----
Sales	\$ 15,019	\$ 21,246
Cost of Sales	12,466 -----	14,615 -----
Gross Profit	2,553 -----	6,631 -----
Expenses:		
Selling, General & Administrative	4,311	4,342
Independent Research and Development	232	150
Total Expenses	4,543 -----	4,492 -----
Operating (Loss)/Income	(1,990) -----	2,139 -----
Other Income/(Expense):		
Interest Income	57	24
Interest Expense	(105)	(440)
Other - Net	147	(92)
Total Other Income/(Expense)	99 -----	(508) -----
(Loss)/Income Before Income Taxes	(1,891)	1,631
Provision for Income Taxes	120 -----	- -----
Net (Loss)/Income	\$ (2,011) =====	\$ 1,631 =====
(Loss)/Income Per Common Share - Basic and Assuming Dilution:		
Net (Loss)/Income Per Common Share-Basic	\$ (0.24) =====	\$ 0.19 =====
Net (Loss)/Income Per Common Share-Dilutive	\$ (0.24) =====	\$ 0.19 =====

See accompanying notes to the consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED DECEMBER 31, 2000 AND 1999
(In Thousands Except Per Share Data)
(Unaudited)

	Three Months Ended 12/31/00 -----	Three Months Ended 12/31/99 -----
Sales	\$ 7,548	\$ 11,058
Cost of Sales	7,154 -----	7,390 -----
Gross Profit	394 -----	3,668 -----
Expenses:		
Selling, General & Administrative	2,112	2,318
Independent Research and Development	162 -----	109 -----
Total Expenses	2,274 -----	2,427 -----
Operating (Loss)/Income	(1,880) -----	1,241 -----
Other Income/(Expense):		
Interest Income	20	12
Interest Expense	(61)	(231)
Other - Net	21 -----	36 -----
Total Other Expense	(20) -----	(183) -----
(Loss)/Income Before Income Taxes	(1,900)	1,058
Provision for Income Taxes	120 -----	- -----
Net (Loss)/Income	\$ (2,020) =====	\$ 1,058 =====
(Loss)/Income Per Common Share - Basic and Assuming Dilution:		
Net (Loss)/Income Per Common Share-Basic	\$ (0.25) =====	\$ 0.13 =====
Net (Loss)/Income Per Common Share-Dilutive	\$ (0.25) =====	\$ 0.12 =====

See accompanying notes the consolidated financial statements.

ECC INTERNATIONAL CORP. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 (In Thousands)

	(Unaudited) 12/31/00 -----	(Audited) 6/30/00 -----
ASSETS		
Current Assets:		
Cash	\$ -	\$ 2,406
Accounts Receivable	3,975	7,359
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	12,833	10,455
Inventories	3,094	2,559
Prepaid Expenses and Other	601	449
Total Current Assets	20,503 -----	23,228 -----
Property, Plant and Equipment - Net	14,240	15,476
Other Assets	350 -----	531 -----
Total Assets	\$ 35,093 =====	\$ 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) 12/31/00 -----	(Audited) 6/30/00 -----
LIABILITIES & STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current Portion of Long-Term Debt	\$ 1,462	\$ --

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Accounts Payable	1,849	1,438
Accrued Expenses and Other	2,749	3,869
	-----	-----
Total Current Liabilities	6,060	5,307
Deferred Income Taxes	80	80
Other Long-Term Liabilities	85	159
	-----	-----
Total Liabilities	6,225	5,546
	-----	-----
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; issued and outstanding, 8,545,705 and 8,481,067	854	848
Note Receivable from Stockholder	(146)	(146)
Capital in Excess of Par	25,389	25,211
Retained Earnings	5,680	7,776
Treasury Stock, at cost (727,000 shares)	(2,909)	--
	-----	-----
Total Stockholders' Equity	28,868	33,689
	-----	-----
Total Liabilities & Stockholders' Equity	\$ 35,093	\$ 39,235
	=====	=====

See accompanying notes to the consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(In Thousands)
(Unaudited)

	Six Months Ended 12/31/00	Six Months Ended 12/31/99
	-----	-----
Cash Flows From Operating Activities:		
Net Income	\$ (2,011)	\$ 1,631
Items Not Requiring Cash:		
Depreciation	1,411	1,994
Amortization	38	171
(Gain)/Loss on Disposal of Equipment	(137)	5
Changes in Certain Assets and Liabilities:		
Accounts Receivable	3,384	37
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	(2,378)	1,598

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Inventories	(535)	165
Prepaid Expenses and Other	(9)	(18)
Accounts Payable	411	(1,704)
Accrued Expenses and Other Long-Term Liabilities	(1,186)	(2,407)
	-----	-----
Net Cash (Used In)/Provided By Operating Activities	(1,012)	1,472
	-----	-----
Cash Flows From Investing Activities:		
Proceeds from Sales of Assets	148	--
Additions to Property, Plant and Equipment	(186)	(792)
	-----	-----
Net Cash Used In Investing Activities	(38)	(792)
	-----	-----
Cash Flows From Financing Activities:		
Proceeds From Issuance of Common Stock and Options Exercised	176	67
Purchase of Treasury Stock	(2,909)	--
Dividends Paid	(85)	--
Debt Issue Cost for Revolving Credit Facility	--	(87)
Borrowings Under Revolving Credit Facility	1,955	21,585
Repayments Under Revolving Credit Facility	(493)	(23,730)
	-----	-----
Net Cash Used In Financing Activities	(1,356)	(2,165)
	-----	-----
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
SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999 (Continued)
(In Thousands)
(Unaudited)

	Six Months Ended 12/31/00 -----	Six Months Ended 12/31/99 -----
Supplemental Disclosure of Cash Flow Information:		
Cash Paid During the Year For:		
Interest	\$ 99	\$ 377
Supplemental Schedule of Non Cash Financing Activities:		
Issuance of Director Equity Compensation	\$ 8	\$ 52
Purchase of Fixed Assets Through Capital Leases	\$ --	\$ 254

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See accompanying notes to the consolidated financial statements.

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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

	12/31/00	6/30/00
	-----	-----
	(In Thousands)	
Work in Process	\$ 686	\$ 89
Raw Materials	4,633	4,635
	-----	-----
Total Gross Value	5,319	4,724
Reserves	(2,225)	(2,165)
	-----	-----
Net Value	\$ 3,094	\$ 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 \$5.8 million at December 31, 2000. The outstanding balance under the Credit Facility as of December 31, 2000 was approximately \$1.5 million.

The Credit Facility includes a subjective acceleration clause as well as a lockbox requirement under the control of the lender, whereby all

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collections of trade receivables are used to immediately reduce any outstanding balance under the Credit Facility.

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

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resolved the first quarter non-compliance issue by obtaining a waiver for the financial defaults from Mellon Bank, N.A. The Company is currently negotiating with Mellon Bank, N.A. to amend the Credit Facility and the December 31, 2000 covenants and anticipates that any such amendment will result in a revision to the financial covenants such that the Company will be in compliance with such revised financial covenants. However, there can be no assurance that the Company will be successful in negotiating revised covenants under the Credit Facility.

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 two 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 Wayne Office in the Consolidated Balance Sheet at June 30, 2000 and December 31, 2000 (in thousands).

Balance at 6/30/00	\$	142
Cash Reduction Payments		(93)
Non-Cash Activity		(2)

Balance at 12/31/00	\$	47
		=====

On November 1, 2000, the Company reduced its operating costs by eliminating approximately 60 employee positions throughout the Company. This reduction in force affected approximately 24% of all employees and represents approximately \$2.8 million in annual compensation costs. The

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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 following table sets forth the details and the cumulative activity associated with the accrual of these termination costs.

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Termination Benefits Incurred	\$	901
Cash Reduction Payments		(300)

Balance at 12/31/00	\$	601
		=====

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

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

	Six Months Ended		Three Months Ended	
	12/31/00	12/31/99	12/31/00	12/31/99
	-----	-----	-----	-----
	(In Thousands)			
U.S. Department of Defense				
Direct	\$ 5,765	\$ 3,262	\$ 3,504	\$ 1,260
Subcontract	9,254	17,984	4,044	9,798
	-----	-----	-----	-----
Total Sales	\$ 15,019	\$ 21,246	\$ 7,548	\$11,058
	=====	=====	=====	=====

Export Sales from the U.S. were not material for the three-month and six-month periods ended December 31, 2000 and December 31, 1999. Export sales do not include Foreign Military Sales through U.S. Government agencies and prime contractors of \$219,000 and \$416,000 for the three-month and six-month periods ended December 31, 1999, respectively. There were no Foreign Military Sales for the three-month and six-month periods ended December 31, 2000.

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.

Sales by Geographic Area

All of the Company's Revenues, Operating Income and Long-Lived Assets

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are within the United States.

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7. Earnings Per Share

Basic earnings per common share is computed by dividing net earnings available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings 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 per share does not assume the exercise of options that would have an antidilutive effect on earnings per share.

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

	Six Months Ended		Three Months Ended	
	12/31/00	12/31/99	12/31/00	12/31/99
	-----	-----	-----	-----
Basic	8,223,757	8,418,345	8,067,825	8,424,088
Dilutive	8,223,757	8,470,330	8,067,825	8,472,827

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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 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 six-month period ended December 31, 2000, 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 to make vendor and payroll payments, lease termination and contract novation payments and treasury stock purchases.

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The 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 six-month period ended December 31, 2000 primarily as a result of receipts on the Javelin Multi-Year 1 and F-18 programs, which were essentially completed by December 31, 2000.

Costs and estimated earnings in excess of billings increased in the six-month period ended December 31, 2000 primarily due to the timing of billings on the EST program and the start-up of the Javelin Multi-Year 2 program which had significant material purchases during the second quarter of fiscal year 2001.

Inventories increased since fiscal year end 2000 primarily due to unabsorbed overhead, which will be charged to programs during the balance of the year.

Prepaid expenses and other increased primarily due to the pre-payment of certain property taxes.

Other assets decreased since fiscal year 2000 primarily due to the amortization of loan costs and other deferred charges.

Accounts payable increased since fiscal year end 2000 due to increased material purchases primarily on the EST and Javelin Multi-Year 2 programs.

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 made

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associated with the wind down of the UK division. (See Note 5 to the Consolidated Financial Statements.)

Liquidity and Capital Resources

During the remainder of fiscal year 2001, the Company anticipates spending approximately \$300,000 for new machinery and equipment and to continue to refurbish the Orlando facility.

For the periods ended December 31, 2000, and September 30, 2000, the Company was not in compliance with certain financial covenants required under the Credit Facility. The Company resolved the first quarter non-compliance issue by obtaining a waiver for the financial defaults from Mellon Bank, N.A. The Company is currently negotiating with Mellon Bank, N.A. to amend the Credit Facility and the December 31, 2000 covenants and anticipates that any such amendment will result in a revision to the financial covenants such that the Company will be in compliance with such revised financial covenants. In the event the Company is not successful in negotiating revised covenants with its current lender, the debt may become immediately due and payable. In such an event, the Company would seek alternative sources of financing or capital funding to continue to fund operations. However, there can be no assurance that the Company could obtain such financing.

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Other than as stated above, the Company currently has no other material commitments for capital expenditures. Management believes that if it is successful in revising the financial covenants under the Credit Facility such that the Company will be in compliance with such revised financial covenants, 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. However, there can be no assurance that the Company will be successful in negotiating revised covenants under the Credit Facility.

b) Material Changes in Results of Operations.

Sales decreased 32% or \$3.5 million and 29% or \$6.2 million for the three-month and six-month periods ended December 31, 2000, respectively, as compared to the same periods ended December 31, 1999. The reduction in sales is primarily due to the completion of the Javelin Multi-Year 1 and AGTS contracts, and the delay in the award of the Javelin Multi-Year 2 program.

Gross profit decreased 89% and 61% during the three-month and six-month periods ended December 31, 2000, respectively, as compared to the same periods ended December 31, 1999. In addition, gross profit as a percentage of sales decreased to 3% and 17% during the three-month and six-month periods ended December 31, 2000, respectively, as compared to 33% and 31% for the same periods ended December 31, 1999. The decreases are due to reduced volume and higher overhead absorption rates. The overhead rate increased primarily due to the \$1.4 million of severance costs incurred in fiscal year 2001 and a 40% decrease in projected direct labor base. Also, additional losses were recorded in fiscal year 2001 related to the development phase of the EST program.

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Interest expense decreased 74% and 76% during the three-month and six-month periods ended December 31, 2000, respectively, as compared to the same periods ended December 31, 1999. 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 42% and 260% during the three-month and six-month periods ended December 31, 2000, respectively, as compared to the same period ended December 31, 1999. 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.

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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 any 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 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 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.

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

At the Company's Annual Meeting of Stockholders held on November 8, 2000, the following proposals were adopted by the vote specified below:

Proposal	Votes For	Votes Against	Abstain	Broker NonVotes
(1) To elect the Board of Directors				
Julian J. Demora	7,546,921	61,408	-	196,221

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James C. Garrett	7,607,466	863	-	135,676
James R. Henderson	7,602,103	6,226	-	141,039
Jesse L. Krasnow	7,607,084	1,245	-	136,058
Warren G. Lichtenstein	7,548,390	59,939	-	194,752
Merrill A. McPeak	7,517,824	90,505	-	225,318
Robert F. Mehmel	7,601,203	7,126	-	141,939

- (2) To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent certified public accountants for the fiscal year ending June 30, 2001.

7,713,546 19,583 10,013 396,697

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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: February 6, 2001

/s/ Melissa Van Valkenburgh

Melissa Van Valkenburgh
Chief Financial Officer