INDUSTRIAL DISTRIBUTION GROUP INC
Form 10-Q
May 15, 2003

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FORM 10-Q
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003
	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 001-13195

INDUSTRIAL DISTRIBUTION GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	58-2299339
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

950 East Paces Ferry Road, Suite 1575 Atlanta, Georgia 30326

(Address of principal executive offices and zip code)
(404) 949-2100

(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 the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Outstanding at April 30, 2003
Common Stock, $.01 par value	8,909,011

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INDUSTRIAL DISTRIBUTION GROUP, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INDUSTRIAL DISTRIBUTION GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	MARCH 31, 2003	DECEMBER 31, 2002
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and Cash Equivalents	$ 488	$ 452
Accounts Receivable, net	63,017	57,630
Inventory, net	56,597	57,565
Deferred Tax Assets	5,323	5,489
Prepaid and Other Current Assets	4,251	3,916
TOTAL CURRENT ASSETS	129,676	125,052
Property and Equipment, net	10,883	11,274
Intangible Assets, net	337	355
Deferred Tax Assets	885	911
Other Assets	1,004	1,117
TOTAL ASSETS	$ 142,785	$ 138,709
LIABILITIES & STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current Portion of Long-term Debt	$ 572	$ 642
Accounts Payable	41,432	40,251
Accrued Compensation	1,051	1,879
Current Portion of Management Liability Insurance	0	930
Other Accrued Liabilities	5,290	6,111
TOTAL CURRENT LIABILITIES	48,345	49,813
Long-Term Debt, net of Current Portion	41,017	35,721
Other Long-Term Liabilities	422	515
TOTAL LIABILITIES	89,784	86,049
STOCKHOLDERS EQUITY:		
Common Stock, par value $.01 per share, 50,000,000 shares authorized; 8,963,353 shares issued and 8,883,353 outstanding in 2003; 8,940,073 shares issued and 8,860,073 outstanding in 2002	89	89
Additional Paid-In Capital	98,111	98,052
Unearned Compensation	(179)	(201)
Accumulated Deficit	(45,020)	(45,280)
TOTAL STOCKHOLDERS EQUITY	53,001	52,660

TOTAL LIABILITIES & STOCKHOLDERS EQUITY	$ 142,785	$ 138,709

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

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INDUSTRIAL DISTRIBUTION GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2003	**2002**
NET SALES	$ 123,077	$ 119,968
COST OF SALES	95,760	93,554
Gross profit	27,317	26,414
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	26,066	25,274
Operating income	1,251	1,140
INTEREST EXPENSE	763	819
OTHER INCOME	(4)	(11)
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE AND INCOME TAXES	492	332
PROVISION FOR INCOME TAXES	232	177
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	260	155
CUMULATIVE EFFECT OF ACCOUNTING CHANGE	0	(50,347)
NET INCOME (LOSS)	$ 260	$ (50,192)
EARNINGS (LOSS) PER COMMON SHARE:		
Basic:		
Earnings before cumulative effect of accounting change	$ 0.03	$ 0.02
Cumulative effect of accounting change	0.00	(5.74)
Net earnings (loss)	$ 0.03	$ (5.72)
Diluted:		
Net earnings before cumulative effect of accounting change	$ 0.03	$ 0.02
Cumulative effect of accounting change	0.00	(5.72)
Net earnings (loss)	$ 0.03	$ (5.70)
WEIGHTED AVERAGE SHARES:		
Basic	8,902,620	8,769,670
Diluted	9,062,062	8,801,319

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

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INDUSTRIAL DISTRIBUTION GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2003	**2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 260	$ (50,192)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	628	716
Gain on sale of assets	(2)	(1)
Amortization of unearned compensation	22	0
Deferred taxes	192	188
Impairment of goodwill	0	50,347
Changes in operating assets and liabilities:		
Accounts receivable, net	(5,387)	(3,150)
Inventories, net	968	2,315
Prepaid assets and other assets	(319)	458
Accounts payable	1,181	2,953
Accrued compensation	(828)	2
Other accrued liabilities	(907)	(592)
Total adjustments	(4,452)	53,236
Net cash (used in) provided by operating activities	(4,192)	3,044
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment, net	(130)	(132)
Proceeds from the sale of property and equipment	3	16
Net cash used in investing activities	(127)	(116)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net of issuance costs	59	51
Net borrowings (repayments) on credit facilities and other lines	5,400	(1,200)
Long-term debt repayments	(174)	(154)
Premium payments on management liability insurance	(930)	(930)
Deferred loan costs and other	0	(16)
Net cash provided by (used in) financing activities	4,355	(2,249)
NET INCREASE IN CASH AND CASH EQUIVALENTS	36	679
CASH AND CASH EQUIVALENTS, beginning of period	452	476
CASH AND CASH EQUIVALENTS, end of period	$ 488	$ 1,155
Supplemental Disclosures:		
Interest paid	$ 503	$ 231
Net income taxes paid (refunded)	$ 109	$ (91)

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

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INDUSTRIAL DISTRIBUTION GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2003 (Unaudited)

Industrial Distribution Group, Inc. (IDG or the Company), a Delaware corporation, was formed on February 12, 1997 to create a nationwide supplier of cost-effective, flexible procurement solutions for manufacturers and other users of maintenance, repair, operating, and production (MROP) products. The Company conducts business in 49 states and two foreign countries, providing product expertise in the procurement and application of MROP products to a wide range of industries.

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements are prepared pursuant to the Securities and Exchange Commission s rules and regulations for reporting on Form 10-Q. Accordingly, certain information and footnotes required by accounting principles generally accepted in the United States for complete financial statements are not included herein. The Company believes all adjustments necessary for a fair presentation of these interim statements have been included and are of a normal and recurring nature.

Certain amounts in the 2002 financial statements have been reclassified to conform to the 2003 presentation. The effects of the reclassifications on the overall financial statement presentation are not significant, except for the items discussed below. In the 2002 statement of cash flows, the Company reclassified $646,000 from changes in book overdraft classified as financing activities to changes in accounts payable classified as operating activities. In addition, the Company reclassified $90,000 of amortization expense, related to deferred loan costs, to interest expense in the 2002 income statement.

These interim statements should be read in conjunction with the Company s financial statements and notes thereto, included in its Annual Report on Form 10-K, for the fiscal year ended December 31, 2002.

2. NEWLY ADOPTED ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. SFAS No. 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. 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 the Statement. Other intangible assets will continue to be amortized over their remaining useful lives.

The Company adopted SFAS No. 142 on January 1, 2002. The Company tested goodwill for impairment using the two-step process prescribed in SFAS No. 142. The first step was a screen for potential impairment, while the second step measured the amount of the impairment, if any. Based on an independent appraisal firm s valuation of the enterprise fair value using a combination of discounted cash flows, market multiples, and comparable transactions, which reflect changes in certain assumptions since the date of the acquisitions, and the identification of qualifying intangibles, the Company recorded a non-cash charge of $50,347,000 as a cumulative effect of accounting change in the first quarter of 2002 associated with the adoption of SFAS No. 142. The Company recorded a full valuation reserve of $3,148,000 against the tax benefit resulting from this charge.

The write-off of goodwill results from the use of a combination of fair value methods in assessment of fair value as required by SFAS No. 142. According to SFAS No. 142, the goodwill impairment loss is measured as the excess of the carrying amount of goodwill over the implied fair value of goodwill.

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A reconciliation of net income (loss) and earnings (loss) per common share, adjusted to exclude the cumulative effect of accounting change recognized in the period of adoption, is as follows (in thousands, except share data):

	Three Months Ended March 31,	
	2003	**2002**
Net income (loss)	$ 260	$ (50,192)
Cumulative effect of accounting change	0	50,347
Adjusted net income	$ 260	$ 155
Earnings (loss) per common share:		
Basic:		
Net income (loss)	$ 0.03	$ (5.72)
Cumulative effect of accounting change	0.00	5.74
Adjusted earnings	$ 0.03	$ 0.02
Diluted:		
Net income (loss)	$ 0.03	$ (5.70)
Cumulative effect of accounting change	0.00	5.72
Adjusted earnings	$ 0.03	$ 0.02

In January 2003, the Emerging Issues Task Force (EITF) of the FASB issued EITF Issue No. 02-16, Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor. EITF Issue No. 02-16 addresses accounting and reporting issues related to how a reseller should account for cash consideration received from vendors. Generally, cash consideration received from vendors is presumed to be a reduction of the prices of the vendor s products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer s income statement. However, under certain circumstances this presumption may be overcome and recognition as revenue or as a reduction of other costs in the income statement may be appropriate. The Company adopted EITF Issue No. 02-16 on January 1, 2003, and there was no significant impact on the Company s financial position and results of operations as a result of the adoption.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred as opposed to the date of an entity s commitment to an exit plan. SFAS No. 146 also establishes fair value as the objective for initial measurement of the liability. The Company adopted SFAS No. 146 on January 1, 2003, and there was no significant impact on the Company s financial position and results of operations as a result of this adoption.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition to SFAS No. 123 s fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and Accounting Principles Board (APB) Opinion No. 28, Interim Financial Reporting, to require disclosure of the effects of an entity s accounting policy with respect to stock-based employee compensation, regardless of whether they account for that compensation using the fair value method of SFAS No. 123 or the intrinsic value method of APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 148 s amendments of the transition and annual disclosure requirements of SFAS No. 123 are effective for fiscal years ending after December 15, 2002. The Company has adopted SFAS No. 148 through continued application of the intrinsic value method prescribed in APB No. 25, and related interpretations, and enhanced financial statement disclosures of the effect on net income and earnings per share if fair value provisions of SFAS 148 had been applied.

At March 31, 2003, the Company had several stock-based compensation plans, which are described in Note 8 - Capital Stock of the Notes to Consolidated Financial Statements of our Annual Report on Form 10-K for

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fiscal 2002. As discussed above, the Company applies APB No. 25, and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its stock incentive plan and its employee stock purchase plan. Had compensation cost for the Company s stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method established in SFAS No. 123 as amended by SFAS No.148, the Company s net income (loss) and earnings (loss) per common share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data):

	Three Months Ended March 31,	
	2003	**2002**
Net income (loss) as reported	$ 260	$ (50,192)
Deduct: Total stock-based compensation expense determined under fair-value based method for all awards, net of tax	114	109
Pro forma net income (loss)	$ 146	$ (50,301)
Earnings (loss) per common share:		
Basic:		
As reported	$ 0.03	$ (5.72)
Pro forma	$ 0.02	$ (5.74)
Diluted:		
As reported	$ 0.03	$ (5.70)
Pro forma	$ 0.02	$ (5.74)

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model. Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

3. CREDIT FACILITY

In December 2000, the Company entered into a $100,000,000 revolving credit facility with a five financial institution syndicate. The facility, as amended on August 1, 2001, expires on March 31, 2004 and has a first security interest in the assets of the Company. The Company received a commitment from all members of its five financial institution syndicate on May 12, 2003 to amend the facility expiration three years from the amendment execution date. Consequently, obligations on this facility are classified as long-term on the accompanying consolidated balance sheet as of March 31, 2003. The agreement provides that the facility may be used for operations and acquisitions, and provides $5,000,000 for swinglines and $10,000,000 for letters of credit. Amounts outstanding under the credit facility bear interest at either the lead bank s corporate rate or LIBOR, as selected by the Company from time to time, plus applicable margins. This rate was 4.9% and 5.3% at March 31, 2003 and December 31, 2002, respectively. There is an annual commitment fee on the unused portion of the facility equal to between 25 and 37.5 basis points of the average daily unused portion of the aggregate commitment depending on the indebtedness to adjusted EBITDA ratio, as defined.

The amounts outstanding under the facility at March 31, 2003 and December 31, 2002 were $39,300,000 and $33,900,000 respectively, which have been classified as long-term liabilities. Additionally, the Company had outstanding letters of credit of $1,969,000 under the facility at March 31, 2003 and December 31, 2002. The revolving credit facility contains various covenants pertaining to the maintenance of certain financial ratios. These covenants include requirements for interest coverage, net worth, and capital expenditures, among other restrictions. The covenants also prohibit the payment of cash dividends. The Company was in compliance with these covenants as of March 31, 2003 and December 31, 2002. The commitment to amend the credit facility, discussed above, does not amend the Company s current financial covenant requirements.

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4. CAPITAL STOCK

During the first quarter of 2003, the Company issued 22,780 shares of its common stock, through its employee stock purchase plan.

Options are to be included in the computation of diluted earnings per share (EPS) where the options exercise price is less than the average market price of the common shares during the period. The number of options outstanding during the three months ended March 31, 2003 and March 31, 2002 had a dilutive effect of 159,442 and 31,649 shares to the weighted average common shares outstanding, respectively. During the three months ended March 31, 2003 and 2002, options where the exercise price exceeded the average market price of the common shares totaled 753,719 and 720,865, respectively.

5. DEFERRED TAXES

The Company s net deferred tax assets totaled approximately $6,208,000 and $6,400,000 at March 31, 2003 and December 31, 2002, respectively, and are subject to periodic recoverability assessments. The realization of deferred tax assets is principally dependent upon the Company s ability to generate sufficient future taxable income in certain tax jurisdictions. Factors used to assess the likelihood of realization are the Company s forecast of future taxable income, which is based upon estimates and assumptions, and available tax planning strategies that could be implemented to realize the net deferred tax assets. On the basis of the Company s operating results and projections for future taxable income, management believes it is more likely than not that future operations will generate sufficient taxable income to realize the deferred tax assets. The Company evaluates the realizability and appropriateness of its deferred tax assets and liabilities quarterly and assesses the need for any valuation allowance against such deferred tax assets. In connection with the adoption of SFAS No. 142, future tax benefits associated with deductible goodwill amortization for tax purposes were fully reserved with a valuation allowance totaling $3,148,000. The valuation allowance for net deferred tax assets was $3,156,000 as of March 31, 2003 and December 31, 2002.

6. COMMITMENTS AND CONTINGENCIES

The Company is subject to various claims and legal actions, which arise, in the ordinary course of business. The Company believes that the ultimate resolution of such matters will not have a material adverse effect on the Company s financial position or results of operations.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is based upon our historical financial results. In this discussion, most percentages and dollar amounts have been rounded to aid presentation; as a result, all such figures are approximations. References to such approximations have generally been omitted.

This discussion may contain certain forward-looking statements concerning our operations, performance, and financial condition, including, in particular, the likelihood of our success in developing and expanding our business. These statements are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ, but are not limited to, the operations levels of our customers, the impact of dedicating significant resources to our FPS program, our ability to maintain key personnel, the availability of key personnel for employment by us, our reliance on regional information systems, the continuation of key supplier relationships, our ability to compete successfully in the highly competitive and diverse MROP market, and other factors discussed in more detail under Item 1-Business of our Annual Report on Form 10-K for fiscal 2002.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2003 AND 2002

The following table sets forth certain historical financial data for IDG and shows such data as a percentage of net sales for the periods indicated (dollars in thousands):

	THREE MONTHS ENDED MARCH 31,			
	2003		2002	
Net Sales	$123,077	100.0%	$119,968	100.0%
Cost of Sales	95,760	77.8	93,554	78.0
Gross Profit	27,317	22.2	26,414	22.0
Selling, General, and Administrative Expenses	26,066	21.2	25,274	21.1
Operating Income	$			