ENTERTAINMENT DISTRIBUTION CO INC
Form 10-Q
May 09, 2008

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

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

For the quarterly period ended March 31, 2008

o **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 0-15761

ENTERTAINMENT DISTRIBUTION COMPANY, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**98-0085742**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
825 8th Avenue, 23rd Floor, NY, NY	**10019**
(Address of Principal Executive Offices)	(Zip Code)

(212) 333-8400

(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 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 þ Noo

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of Exchange Act) Yes o No þ

The number of shares outstanding of the Registrant s common stock, par value $.02 per share, at May 7, 2008 was 68,658,052 shares.

Entertainment Distribution Company, Inc. and Subsidiaries

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PART I FINANCIAL INFORMATION
ITEM 1. Financial Statements
Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Entertainment Distribution Company, Inc.

We have reviewed the condensed consolidated balance sheet of Entertainment Distribution Company, Inc. and subsidiaries as of March 31, 2008, and the related condensed consolidated statements of operations for the three month periods ended March 31, 2008 and 2007, the condensed consolidated statement of stockholders equity and comprehensive loss for the three month period ended March 31, 2008, and the condensed consolidated statements of cash flows for the three month periods ended March 31, 2008 and 2007. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Entertainment Distribution Company, Inc. and subsidiaries as of December 31, 2007, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended not presented herein and in our report dated March 11, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Indianapolis, Indiana
May 5, 2008

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2008 (unaudited)	December 31 2007
	(In thousands, except share data)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 63,200	$ 63,850
Restricted cash	2,003	1,940
Investments	21,401	29,589
Accounts receivable, net of allowances for doubtful accounts of $3,873 and $3,328 for 2008 and 2007, respectively	29,913	35,577
Current portion of long-term receivable	477	515
Inventories, net	7,981	9,111
Prepaid expenses and other current assets	19,381	16,180
Deferred income taxes	287	277
Total Current Assets	144,643	157,039
Restricted cash	27,540	26,015
Property, plant and equipment, net	54,350	55,245
Long-term receivable	4,471	4,244
Intangible assets	44,691	44,604
Deferred income taxes	1,817	1,934
Other assets	7,191	6,940
TOTAL ASSETS	$ 284,703	$ 296,021
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 25,963	$ 33,287
Accrued expenses and other liabilities	35,313	37,503
Income taxes payable	193	3,697
Deferred income taxes	126	126
Loans from employees	1,281	1,267
Current portion of long-term debt	25,143	24,364
Total Current Liabilities	88,019	100,244
Other non-current liabilities	13,677	12,185
Loans from employees	2,628	3,646
Long-term debt	21,726	21,589
Pension and other defined benefit obligations	39,315	36,155
Deferred income taxes	10,766	10,195
Total Liabilities	176,131	184,014
Minority interest in subsidiary company	5,621	5,771

Commitments and contingencies		
Stockholders Equity:		
Preferred stock, $.01 par value; authorized: 5,000,000 shares, no shares issued and outstanding		
Common stock, $.02 par value; authorized: 200,000,000 shares, issued: March 31, 2008 70,158,052 shares; December 31, 2007 70,155,940 shares	1,403	1,403
Additional paid in capital	369,705	369,665
Accumulated deficit	(279,553)	(273,333)
Accumulated other comprehensive income	12,071	8,501
Treasury stock at cost: March 31, 2008 1,500,000 shares; December 31, 2007 0 shares	(675)	
Total Stockholders Equity	102,951	106,236
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 284,703	$ 296,021

See Notes to Condensed Consolidated Financial Statements.

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2008	2007
	(In thousands, except per share amounts)	
REVENUES:		
Product revenues	$ 62,328	$ 64,469
Service revenues	20,802	19,541
Total Revenues	83,130	84,010
COST OF REVENUES:		
Cost of product revenues	56,203	57,763
Cost of service revenues	15,690	15,403
Total Cost of Revenues	71,893	73,166
GROSS PROFIT	11,237	10,844
OPERATING EXPENSES:		
Selling, general and administrative expense	12,727	15,232
Amortization of intangible assets	2,383	2,034
Total Operating Expenses	15,110	17,266
OPERATING LOSS	(3,873)	(6,422)
OTHER INCOME (EXPENSE):		
Interest income	1,112	1,157
Interest expense	(1,119)	(1,299)
Loss on currency swap, net	(2,625)	(357)
Gain (loss) on currency transaction, net	(561)	109
Other income, net	12	11
Total Other Income (Expense)	(3,181)	(379)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST	(7,054)	(6,801)
Income tax expense (benefit)	483	(86)
Minority interest income	(150)	
LOSS FROM CONTINUING OPERATIONS	(7,387)	(6,715)
DISCONTINUED OPERATIONS, NET OF TAX:		
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	1,167	(304)
GAIN ON SALE OF MESSAGING BUSINESS		1,088
NET LOSS	$ (6,220)	$ (5,931)

LOSS PER WEIGHTED AVERAGE COMMON SHARE (1):				
Loss from continuing operations	$	(0.11)	$	(0.10)
Discontinued Operations:				
Income (loss) from discontinued operations		0.02		
Gain on sale of Messaging business				0.02
Net loss per weighted average common share	$	(0.09)	$	(0.09)
LOSS PER DILUTED COMMON SHARE:				
Loss from continuing operations	$	(0.11)	$	(0.10)
Discontinued Operations:				
Income (loss) from discontinued operations		0.02		
Gain on sale of Messaging business				0.02
Net loss per diluted weighted average common share	$	(0.09)	$	(0.09)

(1) Loss per weighted average common share amounts are rounded to the nearest $.01; therefore, such rounding may impact individual amounts presented.

See Notes to Condensed Consolidated Financial Statements.

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock Shares	Treasury Stock Amount	Comprehensive Loss
Balances, January 1, 2008	70,156	$ 1,403	$ 369,665	$ (273,333)	$ 8,501		$	
Net loss				(6,220)				$ (6,220)
Foreign currency translation					3,571			3,571
Post-retirement and pension benefit obligation adjustment					(3)			(3)
Net unrealized investment losses					2			2
Comprehensive loss								$ (2,650)
Shares issued for ESP Plan, other awards and option exercises	2		40					
Acquisition of treasury stock						1,500	(675)	
Balances, March 31, 2008	70,158	$ 1,403	$ 369,705	$ (279,553)	$ 12,071	1,500	$ (675)	

See Notes to Condensed Consolidated Financial Statements.

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (6,220)	$ (5,931)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on sale of messaging business		(1,088)
Depreciation and amortization	5,882	5,268
Stock compensation expense	42	348
Compensation expense on profit interest in EDC, LLC		270
Unrealized loss on currency swap	2,625	357
Foreign currency transaction (gain) loss	561	(109)
Gain on adjustment to discontinued operations tax payable	(1,212)	
Deferred income taxes	(52)	(730)
Non-cash interest expense	370	565
Minority interest income	(150)	
Other	9	11
Changes in operating assets and liabilities, net of effects of business dispositions and acquisitions:		
Restricted cash	431	(472)
Accounts receivable	6,492	(3,527)
Inventories	1,420	(65)
Prepaid and other current assets	(2,311)	(379)
Long-term receivables	152	958
Other assets	(107)	(69)
Accounts payable	(8,289)	(6,087)
Accrued liabilities and income taxes payable	(7,426)	(6,809)
Other liabilities	599	632
NET CASH USED IN OPERATING ACTIVITIES	(7,184)	(16,857)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(822)	(1,274)
Purchase of available-for-sale securities	(8,930)	
Proceeds from the sale of short-term securities	17,179	
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	7,427	(1,274)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of employee loans	(1,273)	(1,267)
Repayment of capital lease obligations	(104)	(117)
Acquisitions of treasury stock	(675)	
Issuance of common stock under our stock-based compensation and stock purchase plans		304
NET CASH USED IN FINANCING ACTIVITIES	(2,052)	(1,080)

EFFECT OF EXCHANGE RATE CHANGES ON CASH		1,159		20
NET DECREASE IN CASH AND CASH EQUIVALENTS		(650)		(19,191)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		63,850		96,088
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	63,200	$	76,897

See Notes to Condensed Consolidated Financial Statements.

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular Amounts in Thousands Except per Share Amounts)
(Unaudited)

1. Business and Basis of Presentation

Entertainment Distribution Company, Inc., together with its wholly owned and controlled majority owned subsidiaries (EDCI or the Company), is a multi-national company in the manufacturing and distribution segment of the entertainment industry. We have one reportable business segment operated by our subsidiary, Entertainment Distribution Company, LLC (EDC). EDC provides pre-recorded products and distribution services to the entertainment industry. The primary customer of EDC is Universal Music Group (Universal).

Our operations formerly included our Wireless Messaging (Paging) business, which we began exiting in May 2001, and our Glenayre Messaging (Messaging) business, substantially all of the assets of which were sold in December 2006. Consequently, the operating results of the Paging and Messaging segments are reported as discontinued operations in the accompanying financial statements.

The accompanying unaudited condensed consolidated financial statements are presented in U.S. dollars in conformity with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. We believe all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The results for the interim periods are not necessarily indicative of results for the full year. These interim financial statements should be read in conjunction with our consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2007, as amended. The financial statements include the accounts of EDCI and its wholly-owned as well as its controlled majority-owned, subsidiaries and have been prepared from records maintained by EDCI and its subsidiaries in their respective countries of operation. The consolidated accounts include 100% of assets and liabilities of its majority owned subsidiaries, and the ownership interest of minority investors are recorded as minority interest. All significant intercompany accounts and transactions are eliminated in consolidation.

2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. Reclassifications

Certain items in the prior year consolidated financial statements have been reclassified to conform to the current presentation. Such reclassifications have had no effect on net income (loss) previously reported.

4. Inventories

Inventories related to our continuing operations at March 31, 2008 and December 31, 2007 consisted of:

	March 31, 2008	December 31, 2007
Raw materials	$ 6,042	$ 7,180
Finished goods	466	644
Work in process	1,473	1,287
Total	$ 7,981	$ 9,111

At March 31, 2008 and December 31, 2007, reserves were approximately $1.4 million.

ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular Amounts in Thousands Except per Share Amounts)
(Unaudited)

5. Investments

Investments are comprised of various debt security instruments including corporate bonds, short-term notes, certificates of deposit and auction-rate securities. In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and based on our ability to market and sell these instruments, we classify auction-rate securities (as discussed below) and other investments in debt securities as available-for-sale and carry them at fair market value. Changes in the fair value are included in accumulated other comprehensive income (loss), net of applicable taxes, in the accompanying condensed consolidated financial statements.

In accordance with our investment policy, we have invested in debt securities with issuers who have high-quality credit and limit the amount of investment exposure to any one issuer. We seek to preserve principal and minimize exposure to interest-rate fluctuations by limiting default risk, market risk, and reinvestment risk.

The following table presents the fair market value amounts, by major security types for our investments in debt securities:

	March 31, 2008 Fair Value	December 31, 2007 Fair Value
Auction-rate securities, variable-rate demand notes and asset-backed securities	$ 3,350	$ 10,800
Corporate bonds	7,350	6,913
Short-term notes	8,686	4,889
Certificates of deposit	1,003	2,000
Commercial paper		2,487
Municipal bonds		1,492
Euro dollar bonds	1,012	1,008
Total investments	$ 21,401	$ 29,589

Auction-rate securities represent interests in collateralized debt obligations with high-quality credit ratings, the majority of which are collateralized by bonds and other financial instruments. Liquidity for these auction-rate securities is typically provided by an auction process that resets the applicable interest rate at pre-determined intervals, usually every 7, 28, 35 or 90 days. Because of the short interest rate reset period, we record auction-rate securities as current available-for-sale securities. As of March 31, 2008, we held auction-rate securities which experienced failed auctions in fiscal 2008. All securities that had failed auctions had experienced at least one successful auction in fiscal 2008 and the carrying values were not adversely affected. If the auction process fails in the future for any of our auction-rate securities, our ability to liquidate these instruments as well as the carrying value of the instruments themselves could be adversely affected.

6. Currency Rate Swap

We entered into a cross-currency rate swap agreement with a commercial bank on May 31, 2005. The Company s objective is to manage foreign currency exposure arising from our intercompany loan to our German subsidiary, acquired in May of 2005 and is therefore for purposes other than trading. The loan is denominated in Euros and repayment is due on demand, or by May 31, 2010. In accordance with SFAS No. 52, *Foreign Currency Translation*, and SFAS 133, the currency swap does not qualify for hedge accounting and, as a result, we will report the foreign currency exchange gains or losses attributable to changes in the U.S.$/ exchange rate on the currency swap in earnings. As of March 31, 2008, the swap is carried at its fair value, which is currently in a loss position, of approximately $8.3 million and is included in non-current liabilities in the condensed consolidated balance sheets.

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ENTERTAINMENT DISTRIBUTION COMPANY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular Amounts in Thousands Except per Share Amounts)
(Unaudited)

7. Fair Value Measurements

On January 1, 2008, we adopted the provisions of SFAS No. 157, *Fair Value Measurements*, which defines fair value and establishes a framework for measuring fair value in accounting principles generally accepted in the United States. The adoption did not have a material impact on our condensed consolidated financial statements. The following tables illustrate assets and liabilities measured at fair value on a recurring basis.

		Fair Value Measurements at Reporting Date Using		
Description	March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Available-for-sale securities	$ 21,401	$ 18,051	$ 3,350	$
Deferred Comp Trust Plan	814	814		
Total	$ 22,215	$ 18,865	$ 3,350	$
Liabilities				
Currency swap	$ 8,280	$	$	$ 8,280
Deferred Comp Trust Plan	814	814		
Total	$ 9,094	$ 814	$	$ 8,280

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Currency Swap
Beginning balance	$ 5,575
Total gains or losses (realized/unrealized) included in earnings	2,705
Ending Balance	$ 8,280
The amount of total losses for the period included in earnings attributable to the change in unrealized loss relating to liabilities still held at the reporting date	$ 2,625

The fair value of the currency rate swap was calculated based on mathematical approximations of market values derived from the commercial banks proprietary models as of a given date. These valuations and models rely on certain assumptions regarding past, present and future market conditions and are subject to change at any time. Valuations based on other models or assumptions may yield different results. At March 31, 2008, we are in a net loss position of $8.3 million on the fair value of the currency swap.