INNOVEX INC
Form 10-Q
February 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
Quarterly Report Under Section 13 or 15 (d)
of the Securities Exchange Act of 1934

[x] Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934.

For the Period ended December 31, 2001.

OR

[ ] Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934.

Commission File Number: 0-13143

INNOVEX, INC.
(Exact name of registrant as specified in its charter)

Minnesota	41-1223933
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
5540 Pioneer Creek Drive, Maple Plain, Minnesota	55359-9003
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (763) 479-5300

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

As of February 2, 2002, 15,053,349 shares of the registrant's common stock, $.04 par value per share, were outstanding.

Exhibit Index, page 12

PART 1: ITEM 1 FINANCIAL INFORMATION

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(unaudited)

	December 31, 2001	September 30, 2001
ASSETS		
Current assets:		
Cash and equivalents	$ 2,422,027	$ 1,798,272
Accounts receivable, net	17,368,364	19,315,306
Inventories	14,815,267	13,782,195
Other current assets	6,283,489	6,465,201
Total current assets	40,889,147	41,360,974
Property, plant and equipment, net of accumulated depreciation of $30,887,000 and $27,534,000	84,140,375	86,738,970
Intangible and other assets, net of accumulated amortization of $1,316,000 and $1,316,000	3,000,971	3,000,971
Deferred income taxes	9,602,867	9,602,867
Other assets	2,130,794	1,962,759
	$139,764,154	$142,666,541
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 8,953,492	$ 9,467,354
Line of credit	14,427,221	11,900,000
Accounts payable	16,869,262	16,438,885
Accrued compensation	1,678,390	1,617,672
Other accrued liabilities	4,472,167	7,819,837
Total current liabilities	46,400,532	47,243,748
Other long-term liabilities	845,000	845,000
Long-term debt, less current maturities	24,623,841	26,403,021
Stockholders' equity:		
Common stock, $.04 par value; 30,000,000 shares authorized, 15,053,349 and 15,044,249 shares issued and outstanding	602,134	601,770
Capital in excess of par value	17,753,017	17,736,455
Retained earnings	49,539,630	49,836,547
Total stockholders' equity	67,894,781	68,174,772
	$139,764,154	$142,666,541

See accompanying notes to condensed consolidated financial statements.

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended December 31, 2001	2000
Net sales	$ 37,842,859	$ 38,576,884
Costs and expenses:		
Cost of sales	32,069,495	32,550,180
Selling, general and administrative	4,228,609	4,205,031
Engineering	1,393,783	1,695,565
Net interest (income) expense	769,746	919,023
Net other (income) expense	(200,587)	90,109
Income (loss) before taxes	(418,187)	(883,024)
Income taxes	(121,270)	(256,077)
Net income (loss)	$ (296,917)	$ (626,947)
Net income (loss) per share:		
Basic	($ 0.02)	($ 0.04)
Diluted	($ 0.02)	($ 0.04)
Weighted average shares outstanding:		
Basic	15,051,849	14,960,126
Diluted	15,051,849	14,960,126

See accompanying notes to condensed consolidated financial statements.

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended	
	2001	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (296,917)	$
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,375,000	3
Other non-cash items	(154,116)	
Changes in operating assets and liabilities:		
Accounts receivable	1,946,942	6
Inventories	(1,033,072)	(1
Other current assets	181,712	
Accounts payable	430,377	(3
Other liabilities	(3,186,617)	
Income taxes payable	(100,335)	
Net cash provided by (used in) operating activities	1,162,974	3
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(791,943)	(4
Proceeds from sale of assets	1,619	
Net cash provided by (used in) investing activities	(790,324)	(4
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(2,292,389)	(1
Issuance of long-term debt	--	1
Net activity on line of credit	2,526,568	
Proceeds from exercise of stock options	16,926	
Net cash provided by (used in) financing activities	251,105	1
Increase (decrease) in cash and equivalents	623,755	
Cash and equivalents at beginning of year	1,798,272	1
Cash and equivalents at end of period	$ 2,422,027	$ 2

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:
Cash paid for interest was $911,000 and $1,029,000 in fiscal 2002 and 2001.

Income tax payments were $24,000 and $-0- in fiscal 2002 and 2001.

See accompanying notes to condensed consolidated financial statements.

INNOVEX INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements

NOTE 1 - FINANCIAL INFORMATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions on Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of Innovex, Inc. and its subsidiaries (the "Company") after elimination of all significant intercompany transactions and accounts. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of operating results have been made. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole. The Company utilizes a fiscal year that ends on the Saturday nearest to September 30. For clarity of presentation, the Company has described all periods as if they end at the end of the calendar quarter. For further information, refer to the consolidated financial statements and footnotes included in the Company's annual report on Form 10-K for the year ended September 30, 2001.

Preparation of the Company's condensed consolidated financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and related revenues and expenses. Actual results could differ from these estimates.

NOTE 2 - RESTRUCTURING CHARGES

Manufacturing operations restructuring-

The fiscal 2001 second quarter included asset impairment and restructuring charges of $9,754,000 and $10,124,000 related to the restructuring of the Company's manufacturing operations. The restructuring is primarily related to moving manufacturing operations from the Company's Chandler, Arizona facility to the Company's Minnesota locations. The charges were recorded pursuant to a plan announced in January 2001. The charge included approximately $6,380,000 related to asset impairment of property and equipment and $3,374,000 for the impairment of the remaining unamortized balance of the goodwill recorded at the time of the Company's September 1999 acquisition of ADFlex Solutions, Inc. The charge also includes $1,636,000 of inventory written off related to discontinued product lines and accrued liabilities of $2,156,000 for employee severance and benefits and $6,332,000 for facility abandonment costs. The restructuring is substantially complete with the exception of the costs accrued to maintain the leased Chandler facility through the June 2003 lease termination.

The fiscal 2000 first quarter includes a $13,785,000 restructuring charge related to restructuring the Company's manufacturing operations. The restructuring is primarily related to closing the Company's Agua Prieta, Mexico facility and moving operations to its facility in Lamphun, Thailand. The charge was recorded pursuant to a plan announced in November 1999. The charge included approximately $6,605,000 related to asset impairment of property and equipment, $356,000 for the write off of inventory and supplies, $176,000 for increasing the accounts receivable reserve, and accrued liabilities of $2,101,000 for facility abandonment costs and $4,547,000 in employee severance and benefits. A change in estimate was recorded in the quarter ending September 2000 increasing the facility abandonment accrual by $1,435,000 and decreasing the accrued employee severance by $1,485,000. The estimate changes were due to higher costs than expected to discontinue the operation of the Mexican facility and higher turnover than expected prior to the payment of severance. The restructuring was substantially complete as of September 2000 with the exception of completing the disposition of the Mexican facility. During the quarter ending March 31, 2001, the Company had a $495,000 increase in the estimate of the facility abandonment charges relating to the length of time required to complete the disposition of the facility located in Agua Prieta, Mexico.

The remaining restructuring accrual as of December 31, 2001 totaled $1,858,000. Selected information regarding the restructuring follows (in thousands):

	Manufacturing Operations Restructuring - Arizona		Manufacturing Operations Restructuring -Mexico		
	Facility Abandonment Charges	Employee Termination Benefits	Facility Abandonment Charges	Employee Termination Benefits	T
Accrual at October 1, 2001	$2,193	$ 824	$ 386	$ 136	$
Payments	(1,240)	(439)	(2)	--	
Accrual at December 31, 2001	$ 953	$ 385	$ 384	$ 136	$

NOTE 3 - EARNINGS PER SHARE

The Company's basic net loss per share is computed by dividing net loss by the weighted average number of outstanding common shares. The Company's diluted net loss per share is computed by dividing net loss by the weighted average number of outstanding common shares and common share equivalents relating to stock options when dilutive. Options to purchase 1,470,673 shares of common stock with a weighted average exercise price of $10.89 were outstanding during the three month period ending December 31, 2001, but were excluded from the computation of common share equivalents because they were not dilutive. Options to purchase 805,250 shares of common stock with a weighted average exercise price of $14.97 were outstanding during the three month period ending December 31, 2000, but were excluded from the computation of common share equivalents because they were not dilutive.

NOTE 4 - INVENTORIES

Inventories are comprised of the following (in thousands):

	December 31, 2001	September 30, 2001
Raw materials and purchased parts	$7,082	$6,155
Work-in-process and finished goods	7,733	7,627
	$14,815	$13,782

NOTE 5 - DERIVATIVE INSTRUMENTS AND HEDGING

The Company adopted SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, on November 1, 2000. These Standards require entities to recognize derivatives in their financial statements as either assets or liabilities measured at fair value. The accounting for changes in the fair value of a derivative is recognized in earnings unless certain criteria are met. These Standards also require formal documentation, designation and effectiveness assessment of transactions receiving hedge accounting. The Company formally documents all relations between hedging instruments and the hedged items, as well as its risk-management objectives and strategy for undertaking various hedge transactions. The Company assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items.

The Company enters into forward exchange contracts, to hedge foreign currency denominated assets or liabilities, that are recorded at fair value with related fair value hedge gains or losses recorded in earnings within the caption other income / expense. Generally, the Company purchases these contracts near the beginning of each quarter while the expiration is near the end of each quarter. The Company does not enter into forward exchange contracts for trading purposes. As of December 31, 2001, the Company had open forward contracts to buy Thai Baht, maturing in January 2002, with notional amounts totaling 600,000,000 Thailand Baht or approximately $13.6 million US dollars.

NOTE 6 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, Business Combinations, and SFAS 142, Goodwill and Intangible Assets. These pronouncements, among other things, eliminate the pooling-of-interest method of accounting for business combinations and require intangible assets acquired in business combinations to be recorded separately from goodwill. The pronouncements also eliminate the amortization of goodwill and other intangible assets with indefinite lives and require negative goodwill be recognized as an extraordinary gain. Goodwill and other intangible assets with indefinite lives will be tested for impairment annually or whenever an impairment indicator arises. The Company adopted these pronouncements as of October 1, 2001 and as a result, has discontinued the amortization of goodwill and any other intangible assets determined to have indefinite useful lives. The Company has determined goodwill relates to one reporting unit for purposes of impairment testing and expects to complete a transitional fair value based impairment test of goodwill by March 31, 2002.

In September 2001, the FASB issued SFAS 144, Accounting for the Impairment or Disposal of long-lived Assets. SFAS 144 clarifies the accounting for disposals of long-lived assets. This statement is effective for the Company beginning October 1, 2002.

PART I: ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE COMPANY

In the fiscal 1999 fourth quarter, Innovex, Inc. and its subsidiaries (the "Company") acquired ADFlex Solutions, Inc. ("ADFlex") for approximately $37 million. At that time, the Company also obtained credit facilities totaling in principal amount $40 million, which were utilized to refinance ADFlex's outstanding debt, pay down current liabilities and pay related transaction costs. Prior to the acquisition, ADFlex was a leading supplier of flexible circuit based solutions to the computer, computer peripheral, communications and consumer electronics industries. Applications for these flex-based interconnects include cellular phones, hard disk drives, other storage systems, high-end consumer products, notebook computers, pagers and personal communication systems. ADFlex's diverse customer and industry base has reduced Innovex's reliance on the disk drive industry.

Prior to the ADFlex acquisition, the Company had one primary operating group, Innovex Precision Components. The Company has combined the ADFlex operation with its existing operations as both operations design and manufacture flexible circuits.

Prior to fiscal 1999, the Company operated through three divisions, Precision Products (Precision), Litchfield Precision Components (LPC) and Iconovex. Each division had its own administrative, engineering, manufacturing and marketing organizations. During the quarter ending September 30, 1998, the Company combined the operations of its two core operating divisions, Precision and LPC into one operating division, Innovex Precision Components. The combination merged the rapidly growing LPC flexible circuit fabrication and chemical etching operations with Precision's high volume fine wire manufacturing expertise. The combination also allowed Innovex to leverage Precision's disk drive industry market and trade knowledge to disk drive industry flexible circuit applications as the industry transitioned from wire interconnects.

Prior to the divisional combination, the largest division, Precision, developed, engineered and manufactured specialty precision electromagnetic products for original equipment manufacturers ("OEM's"). Lead wire assemblies for the thin film disk drive market were the division's primary product. Lead wire assemblies are fine twisted magnet wires that connect the back end electronics of a disk drive with the inductive or magneto resistive thin film heads that read and write information on the disk. Since the divisional combination, the lead wire assembly revenue declined as anticipated.

LPC, prior to the fiscal 1998 divisional combination, designed and manufactured highly complex flexible circuitry and chemically machined components for computer, computer peripheral, medical and other applications. The Company purchased Litchfield Precision Components, Inc. on May 16, 1996. This acquisition reduced the Company's reliance on the disk drive industry while providing an entry into the large and rapidly growing flexible circuit market. Innovex's flexible circuit operation is one of a limited number of operations in the world able to produce flexible circuits with line and spacing tolerances of less than 2 mils for the high-end portion of the flexible circuit market.

Innovex, Inc. was incorporated under the laws of the State of Minnesota in 1972. Its principal executive offices are located at 5540 Pioneer Creek Drive, Maple Plain, Minnesota 55359-9003 and its telephone number is (763) 479-5300. Products are developed and manufactured through the Company's wholly owned subsidiaries, Innovex Precision Components, Inc., Innovex Southwest, Inc., Innovex (Thailand) Ltd. and Innovex Limited. Innovex Precision Components, Inc. and Innovex Ltd. are Minnesota corporations. Innovex Southwest, Inc. is a Delaware corporation and Innovex (Thailand) Ltd. is a Thailand corporation.

RESULTS OF OPERATIONS

NET SALES

The Company's net sales from operations totaled $37,843,000 for the quarter, down 2% from $38,577,000 reported in fiscal 2001. The small decrease in net sales for the first quarter of fiscal 2002 as compared to fiscal 2001 was due to the increased revenue from the adoption of the Company's FSA product being offset by lower revenue generated by other product lines as a result of economic conditions. Revenue from the disk drive industry generated 77% of the Company's revenue for the quarter as compared to 61% for fiscal 2001. In addition, revenue from consumer applications was 11% versus 14% from the prior year, network system application revenue was 7% versus 16% and revenue from other industry applications was 5% versus 9% from the prior year.

Although revenue growth for the next quarter will be limited as a result of the current economic conditions, the last half of 2002 should benefit from improvements in economic conditions and growth in demand for high technology flexible circuit products including the Company's Flex Suspension Assembly (FSA). Significant progress has been made in gaining customer acceptance of the Company's FSA product that will be integral to increasing revenue in fiscal 2002.

GROSS MARGINS

The Company's gross profit as a percent of sales for the quarter decreased to 15.3% from the 15.6% reported for the fiscal 2001 first quarter. The decrease was due to a change in product mix from the prior year. The reduction in labor and overhead costs as a result of the Company's cost cutting measures was offset by increased material costs primarily due to purchased suspensions required for the FSA product.

The Company anticipates that gross margins in the last half of fiscal 2002 will improve as a result of the refinement of manufacturing processes transferred to the Company's Minnesota and Thailand locations due to closing the Chandler manufacturing facility. Revenue increases during the last half of fiscal 2002 should also have a favorable impact on gross margins.

OPERATING EXPENSES

Operating expenses were 14.9% of sales for the current quarter, as compared to 15.3% in the prior year's first quarter. The decrease in operating expenses as a percent of sales for the current year is primarily due to cost reduction measures taken in fiscal 2001 including the closing of the Company's Chandler facility. Fiscal 2002 operating expenses are expected to decrease as a percent of sales due to cost reductions and anticipated increased revenue in the last half of the year.

OPERATING PROFIT

The consolidated operating profit of $151,000 in the current quarter was virtually unchanged from the $126,000 for the prior year first quarter.

NET LOSS

Net loss for the fiscal 2002 first quarter was $(297,000) as compared to $(627,000) for the prior year first quarter. Basic and diluted net loss per share were ($0.02) as compared to ($0.04) for the prior year first quarter.

LIQUIDITY AND CAPITAL RESOURCES

Cash and short-term investments increased to $2.4 million at December 31, 2001 from $1.8 million at September 30, 2001.

Accounts receivable at December 31, 2001 decreased by $1.9 from September 30, 2001 due to the timing of payment receipts. Inventories at December 31, 2001 increased by $1.0 million from September 30, 2001 due a build up of inventory to ensure adequate availability through the holiday period.

Accounts payable at December 31, 2001 increased by $0.4 million primarily due to the increased level of inventory. Other liabilities at December 31, 2001 decreased by $3.2 million primarily due to the payment of restructuring related expenses and severance.

Working capital totaled ($5.5) million and ($5.9) million at December 31, 2001 and September 30, 2001.

Since September 30, 2001, the Company has invested $0.8 million in capital expenditures. Capital expenditures of approximately $3 million are expected during the remainder of fiscal 2002. These expenditures will include technological upgrades and replacement of equipment.

On January 25, 2002, the Company entered into a sale/leaseback transaction that is expected to generate $11.5 million in cash, which funds will be used to reduce bank debt and provide additional working capital for the Company. The transaction is expected to close on or before March 31, 2002, although it is subject to various conditions and, therefore, there can be no assurance that it will close. In addition, the Company is negotiating an expansion of its Thailand credit facilities. The Company believes that with the existing U.S. and Thailand credit facilities, cash generated from operations and cash generated from the sale/leaseback transaction, it will have adequate funds to support projected working capital and capital expenditures for fiscal 2002 and beyond. The Company is considering alternatives for generating additional working capital and will continue to pursue financing opportunities in both Thailand and the U.S to better leverage its assets. The Company's financing needs and the financing alternatives available to it are subject to change depending on, among other things, general economic and market conditions, changes in industry buying patterns, customer acceptance of the FSA product and cash flow from operations. The Company failed to comply with certain covenants under its U.S. credit facility during the current quarter. The attached Sixth Amendment to Credit Agreement includes the bank's waiver of this non-compliance as of December 31, 2001 and a revised second quarter payment schedule.

FORWARD LOOKING STATEMENTS

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this report and in future filings by the Company with the SEC, except for the historical information contained herein and therein, are "forward-looking statements" that involve risks and uncertainties. These risks and uncertainties include the timely availability and acceptance of new products including the FgSA and semiconductor packaging substrates, the impact of

competitive products and pricing, interruptions in the operations of the Company's single source suppliers, changes in manufacturing efficiencies and other risks detailed from time to time in the Company's reports filed with the Securities and Exchange Commission. In addition, a significant portion of the Company's revenue is generated from the disk drive, consumer electronics, computer and data storage industries and the global economic downturn has had and a continued economic downturn will continue to have an adverse impact on the Company's operations. The Company disclaims any obligation subsequently to revise any forward-looking statements to reflect subsequent events or circumstances or the occurrence of unanticipated events.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the Company's market risk during the three-month period ended December 31, 2001.

PART II - OTHER INFORMATION

Responses to Items 1 through 5 are omitted since these items are either inapplicable or the response thereto would be negative.

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits
   10 Sixth Amendment to Credit Agreement.

b) Reports on Form 8-K
   None.

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.

INNOVEX, INC.
Registrant

Date: February 14, 2002

By \s\ William P. Murnane
William P. Murnane
President and Chief Executive Officer

By \s\ Thomas Paulson
Thomas Paulson
Chief Financial Officer

INDEX TO EXHIBITS