CHOLESTECH CORPORATION
Form 10-Q
August 09, 2001
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the quarterly period ended June 29, 2001

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the transition period from ___ to ___

Commission file number: 000-20198

CHOLESTECH CORPORATION

(Exact name of registrant as specified in its charter)

California	**94-3065493**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3347 Investment Boulevard, Hayward, CA 94545
(Address of Principal Executive Offices) (Zip Code)

Registrant s telephone number, including area code: **(510) 732-7200**

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 and Exchange Act of 1934 during the preceding 12 months (or for 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 July 26, 2001, 12,140,366 shares of common stock of the Registrant were outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	June 29, 2001	March 30, 2001 (1)
Assets		
Current assets:		
Cash and cash equivalents	$2,866	$4,052
Marketable securities	4,623	4,697
Accounts receivable, net	4,654	3,014
Inventories, net	4,446	3,658
Prepaid expenses and other current assets	764	717
Total current assets	17,353	16,138
Property and equipment, net	8,423	7,777
Long-term investments	3,566	3,616
Goodwill, net	3,143	3,143
Other assets, net	66	68
Total assets	$32,551	$30,742
Liabilities and Shareholders Equity		
Current liabilities:		

Accounts payable and accrued expenses	$4,386	$3,893
Accrued payroll and benefits	1,872	1,900
Other liabilities	116	91
Total current liabilities	6,374	5,884
Contingencies (Note 6)		
Shareholders equity:		
Preferred stock		
Common stock	72,903	72,819
Accumulated other comprehensive income	59	69
Accumulated deficit	(46,785)	(48,030)
Total shareholders equity	26,177	24,858
Total liabilities and shareholders equity	$32,551	$30,742

(1) The information in this column was derived from the Company s audited consolidated financial statements for the fiscal year ended March 30, 2001.

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Thirteen weeks ended	
	June 29, 2001	June 30, 2000
Revenue:		
Product	$10,356	$7,980
Service	2,022	1,219
Total revenue	12,378	9,199
Cost of revenue:		
Product	4,387	3,334
Service	376	394
Total cost of revenue	4,763	3,728

Gross profit	7,615	5,471
Operating expenses:		
Sales and marketing	3,574	2,250
Research and development	614	896
General and administrative	1,838	1,373
Website and related costs	413	
Goodwill amortization		150
Total operating expenses	6,439	4,669
Income from operations	1,176	802
Interest and other income, net	121	188
Income before taxes	1,297	990
Provision for income taxes	52	41
Net income		

	$1,245	$949
Net income per share:		
Basic	$0.10	$0.08
Diluted	$0.10	$0.08
Shares used to compute net income per share:		
Basic	12,105	11,976
Diluted	12,508	12,486

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Thirteen weeks ended	
	June 29, 2001	June 30, 2000
Cash flows from operating activities:		
Net income	$1,245	$949
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	618	561
Change in allowance for doubtful accounts	106	14
Changes in assets and liabilities:		
Accounts receivable	(1,746)	(770)
Inventories	(788)	(148)
Prepaid expenses and other assets	(47)	(109)
Accounts payable and accrued expenses	1,348	(302)
Payment of legal settlement	(855)	
Accrued payroll and benefits	(28)	(297)
Other liabilities	25	
Net cash used in operating activities	(122)	(102)
Cash flows from investing activities:		

Maturities of marketable securities	3,463	1,704
Purchases of marketable securities	(3,349)	(708)
Purchases of property and equipment	(1,262)	(1,670)
Net cash used in investing activities	(1,148)	(674)
Cash flows from financing activities:		
Issuance of common stock	84	46
Net cash provided by financing activities	84	46
Net decrease in cash and cash equivalents	(1,186)	(730)
Cash and cash equivalents at beginning of period	4,052	6,959
Cash and cash equivalents at end of period	$2,866	$6,229

Non-cash financing activities:

Issuance of common stock in exchange for cancellation of liability	$	$300
Additional goodwill accrual relating to purchase of Health Net assets		506

See Notes to Condensed Consolidated Financial Statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Interim Results

The interim unaudited financial information of Cholestech Corporation (the Company) is prepared in conformity with generally accepted accounting principles in the United States of America. The financial information included herein has been prepared by management, without audit by independent accountants who do not express an opinion thereon, and should be read in conjunction with the audited consolidated financial statements contained in the Annual Report on Form 10-K for the fiscal year ended March 30, 2001. The condensed consolidated balance sheet as of March 30, 2001 has been derived from, but does not include all the disclosures contained in, the audited consolidated financial statements for the fiscal year ended March 30, 2001. The information furnished includes all adjustments and accruals consisting only of normal recurring accrual adjustments that are, in the opinion of management, necessary for a fair presentation of results for the interim periods. Certain information or footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles has been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The interim results are not necessarily indicative of the results of operations for the full fiscal year ending March 29, 2002.

2. Balance Sheet Data

The components of inventories are as follows (in thousands):

	June 29, 2001	March 30, 2001
Raw materials	$ 1,527	$ 1,263
Work-in-process	1,567	1,219
Finished goods	1,352	1,176

$4,446 $3,658

3. Change In Accounting Principle

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS No. 142), which establishes financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets*. It addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. SFAS No. 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

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Pursuant to SFAS No. 142, goodwill is not required to be amortized as an expense into the results of operations. It is, however, subject to periodic reviews for impairment. A two-step impairment test shall be used to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized, if any.

The Company has elected to early adopt SFAS No. 142 beginning with the first quarter of fiscal 2002. The Company has reviewed its goodwill for impairment and determined that no impairment loss needs to be recognized. The Company currently has $3.1 million of unamortized goodwill, all of which is in the WellCheck business unit. The Company has no other intangible assets in any of its business units.

The following table reconciles the Company s fiscal 2001 first quarter net income adjusted to exclude goodwill amortization pursuant to SFAS No. 142 to amounts previously reported.

	Thirteen Weeks Ended	
	June 29, 2001	June 30, 2000
Reported net income	$1,245	$949
Add back: Goodwill amortization		150
Adjusted net income	$1,245	$1,099

Basic EPS:	
Reported net income	$0.10 $0.08
Goodwill amortization	0.01
Adjusted net income	$0.10 $0.09
Diluted EPS:	
Reported net income	$0.10 $0.08
Goodwill amortization	0.01
Adjusted net income	$0.10 $0.09

4. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted earnings per share gives effect to all potential common stock outstanding during a period, if dilutive.

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A reconciliation of the basic and diluted earnings per share calculations follows:

(In thousands, except per share data)

	Thirteen Weeks Ended June 29, 2001			Thirteen Weeks Ended June 30, 2000 (1)		
	Net Income	Shares	Per Share	Net Income	Shares	Per Share
Basic EPS	$1,245	12,105	$0.10	$949	11,976	$0.08
Effect of dilutive securities		403			510	
Diluted EPS	$1,245	12,508	$0.10	$949	12,486	$0.08

As of June 29, 2001, options to purchase 1,425,488 shares of common stock were considered anti-dilutive because the respective exercise prices were greater than the average fair market value of the common stock. As of June 30, 2000, options to purchase 328,533 shares of common stock were considered anti-dilutive because the respective exercise prices were greater than the average fair market value of the common.

(1) See Note 3 for adjusted earnings per share data which reflect the adoption of SFAS No. 142.

5. Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, (SFAS No. 133), which establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The Company adopted SFAS No. 133, as required by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of the FASB Statement No. 133,* beginning with the first quarter of fiscal 2002. The adoption of SFAS No. 133 had no material impact on financial reporting and related disclosures of the Company.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, *Business Combinations*, (SFAS No. 141), which establishes financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations* and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises.* It requires that all business combinations in the scope of SFAS No. 141 are to be accounted for using one method, the purchase method. The provisions of SFAS No. 141 apply to all business combinations initiated after June 30, 2001, and also apply to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001 or later. The Company adopted SFAS No. 141 beginning with the quarter ended June 29, 2001; such adoption had no impact on the financial reporting and related disclosures of the Company.

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In July 2001, the Financial Accounting Standards Board issued SFAS No. 142 *Goodwill and Other Intangible Assets*, (SFAS No. 142), which establishes financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets.* It addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition, and after they have been initially recognized in the financial statements. The provisions of SFAS No. 142 are effective starting with fiscal years beginning after December 15, 2001. Early adoption is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not previously been issued. Accordingly, the Company has elected to early adopt SFAS No. 142 beginning with the quarter ended June 29, 2001 and has disclosed the impact of such adoption in Note 3 to the condensed consolidated financial statements.

6. Contingencies

On February 5, 1999, a complaint entitled Ree v. Pinckert, et al., No. C99-0562 (PJH) was filed in the United States District Court for the Northern District of California. The action was a putative class action and the complaint alleged that the Company and certain of its current and former officers violated the federal securities laws by making false and misleading statements concerning the Company and its business during the period of June 28, 1996 through June 25, 1998. On June 14, 2001, the Company executed an agreement in principle with plaintiffs to resolve this matter for a payment $3.0 million by its insurance carrier. The Company recorded a $1.3 million charge during the fiscal year ended March 30, 2001 for legal fees and insurance costs related to resolving this matter. The Company paid $855,000 to its insurance company and $121,000 for legal fees in the quarter ended June 29, 2001. The settlement is still contingent on court approval.

The Company is subject to various legal claims and assessments in the ordinary course of business, none of which are expected by management to result in a material adverse effect on the consolidated financial statements.

7. Segment Information

During fiscal 2000, the Company launched two new business units, WellCheck and WellCheck.com. As a result, the Company operated in three reportable segments: Diagnostic Products, WellCheck and WellCheck.com. The Company has determined that starting in fiscal 2002, WellCheck and WellCheck.com will operate and be managed as one segment. All operating results will present the combined results for WellCheck and WellCheck.com as a single segment, and as a result, all prior year activity has been combined to reflect the change. The Company s wholly-owned subsidiary, WellCheck.com, was legally merged into its wholly-owned subsidiary, WellCheck, effective June 22, 2001. For fiscal 2002, the two resulting segments are strategic business units that offer different products, and as a result, are managed separately. The accounting policies of the segments are the same. Segment data excludes all corporate-headquarters costs as they are not allocated to the operating segments, and inter-segment

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revenue is eliminated. Asset information by segment has not been presented as the Company does not produce such information.

Results for the thirteen weeks ended June 29, 2001 and June 30, 2000 by segment are as follows (in thousands):

	Diagnostic Products		WellCheck	Inter-Company	Total
	2001	2000			