INSIGNIA SYSTEMS INC/MN
Form 10-Q
November 05, 2014
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

for the quarterly period ended September 30, 2014

or

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: 1-13471

INSIGNIA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**41-1656308**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8799 Brooklyn Blvd.

Minneapolis, MN 55445

(Address of principal executive offices; zip code)

(763) 392-6200

(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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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.

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

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

Number of shares outstanding of Common Stock, $.01 par value, as of October 29, 2014 was 12,295,000.

Table of Contents

Insignia Systems, Inc.

TABLE OF CONTENTS

PART I.	**FINANCIAL INFORMATION**	
Item 1.	**Financial Statements**	3
	Condensed Balance Sheets September 30, 2014 (unaudited) and December 31, 2013	3
	Statements of Operations and Comprehensive Income Three and nine months ended September 30, 2014 and 2013 (unaudited)	4
	Statements of Cash Flows Nine months ended September 30, 2014 and 2013 (unaudited)	5
	Notes to Financial Statements September 30, 2014 (unaudited)	6
Item 2.	**Management s Discussion and Analysis of Financial Condition and Results of Operations**	9
Item 3.	**Quantitative and Qualitative Disclosures about Market Risk**	15
Item 4.	**Controls and Procedures**	15
PART II.	**OTHER INFORMATION**	
Item 1.	**Legal Proceedings**	16
Item 1A.	**Risk Factors**	16
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	16
Item 3.	**Defaults upon Senior Securities**	16
Item 4.	**Mine Safety Disclosures**	16
Item 5.	**Other Information**	16
Item 6.	**Exhibits**	17

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Insignia Systems, Inc.

CONDENSED BALANCE SHEETS

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8,180,000	$ 21,763,000
Accounts receivable, net	7,632,000	4,287,000
Available for sale investments	9,296,000	
Inventories	396,000	307,000
Deferred tax assets	171,000	171,000
Income tax receivable	12,000	11,000
Prepaid expenses and other	817,000	324,000
Total Current Assets	26,504,000	26,863,000
Other Assets:		
Property and equipment, net	1,601,000	1,753,000
Other, net	3,178,000	2,956,000
Total Assets	$ 31,283,000	$ 31,572,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,722,000	$ 2,636,000
Accrued liabilities	1,471,000	1,741,000
Income tax payable	247,000	22,000
Deferred revenue	702,000	261,000
Total Current Liabilities	5,142,000	4,660,000
Long-Term Liabilities:		
Deferred tax liabilities	284,000	284,000
Accrued income taxes	458,000	458,000
Total Long-Term Liabilities	742,000	742,000
Commitments and Contingencies		
Shareholders Equity:		
Common stock, par value $.01:		
Authorized shares - 40,000,000, issued and outstanding shares - 12,346,000 at September 30, 2014 and 12,782,000 at December 31, 2013	123,000	128,000
Additional paid-in capital	19,611,000	20,982,000
Retained earnings	5,669,000	5,060,000
Accumulated other comprehensive loss	(4,000)	
Total Shareholders Equity	25,399,000	26,170,000

Total Liabilities and Shareholders Equity	$	31,283,000	$	31,572,000

See accompanying notes to financial statements.

Table of Contents

Insignia Systems, Inc.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	**2013**	**2014**	**2013**
Services revenues	$ 7,104,000	$ 6,927,000	$ 18,902,000	$ 19,642,000
Products revenues	416,000	393,000	1,365,000	1,207,000
Total Net Sales	7,520,000	7,320,000	20,267,000	20,849,000
Cost of services	3,494,000	3,716,000	10,048,000	10,604,000
Cost of goods sold	317,000	284,000	924,000	848,000
Total Cost of Sales	3,811,000	4,000,000	10,972,000	11,452,000
Gross Profit	3,709,000	3,320,000	9,295,000	9,397,000
Operating expenses:				
Selling	1,433,000	1,586,000	4,160,000	4,138,000
Marketing	416,000	220,000	978,000	649,000
General and administrative	1,022,000	970,000	3,040,000	2,921,000
Total Operating Expenses	2,871,000	2,776,000	8,178,000	7,708,000
Operating Income	838,000	544,000	1,117,000	1,689,000
Other income	13,000	6,000	25,000	20,000
Income Before Taxes	851,000	550,000	1,142,000	1,709,000
Income tax expense	427,000	196,000	533,000	771,000
Net Income	424,000	354,000	609,000	938,000
Other comprehensive income, net of tax:				
Unrealized loss on available for sale securities	(4,000)		(4,000)	
Comprehensive Income	$ 420,000	$ 354,000	$ 605,000	$ 938,000
Net income per share:				
Basic	$ 0.03	$ 0.03	$ 0.05	$ 0.07
Diluted	$ 0.03	$ 0.03	$ 0.05	$ 0.07
Shares used in calculation of net income per share:				
Basic	12,593,000	13,230,000	12,767,000	13,515,000
Diluted	12,824,000	13,370,000	13,003,000	13,581,000

See accompanying notes to financial statements.

Table of Contents

Insignia Systems, Inc.

STATEMENTS OF CASH FLOWS

(Unaudited)

Nine Months Ended September 30	**2014**	**2013**
Operating Activities:		
Net income	$ 609,000	$ 938,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	824,000	806,000
Change in allownace for doubtful accounts	34,000	105,000
Deferred income tax expense		3,000
Stock-based compensation	300,000	324,000
Gain on sale of property and equipment	(14,000)	(12,000)
Changes in operating assets and liabilities:		
Accounts receivable	(3,379,000)	(1,309,000)
Inventories	(89,000)	(33,000)
Income tax receivable	(1,000)	775,000
Prepaid expenses and other	(526,000)	144,000
Accounts payable	86,000	729,000
Accrued liabilities	(270,000)	(220,000)
Excess tax benefit from stock options	(11,000)	
Income tax payable	236,000	252,000
Deferred revenue	441,000	421,000
Net cash provided by (used in) operating activities	(1,760,000)	2,923,000
Investing Activities:		
Purchases of property and equipment	(319,000)	(231,000)
Acquisition of selling rights and other	(542,000)	
Purchases of investments	(10,255,000)	
Proceeds from sale of investments	955,000	
Proceeds received from sale of property and equipment	14,000	15,000
Net cash used in investing activities	(10,147,000)	(216,000)
Financing Activities:		
Proceeds from issuance of common stock, net	199,000	85,000
Excess tax benefit from stock options	11,000	
Repurchase of common stock, net	(1,886,000)	(2,328,000)
Net cash used in financing activities	(1,676,000)	(2,243,000)
Increase (decrease) in cash and cash equivalents	(13,583,000)	464,000
Cash and cash equivalents at beginning of period	21,763,000	20,271,000
Cash and cash equivalents at end of period	$ 8,180,000	$ 20,735,000
Supplemental disclosures for cash flow information:		
Cash paid during the year for income taxes	$ 377,000	$ 557,000
Non-cash financing activities:		
Cashless exercise of options	$	$ 4,000

See accompanying notes to financial statements.

Table of Contents

Insignia Systems, Inc.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

1. **Summary of Significant Accounting Policies.**

Description of Business. Insignia Systems, Inc. (the Company) markets in-store advertising products, programs and services to consumer packaged goods manufacturers and retailers. The Company s products include the Insignia Point-of-Purchase Services (POPS) in-store advertising program, thermal sign card supplies for the Company s Impulse Retail systems, laser printable cardstock and label supplies. Additionally, in October 2014, the Company announced the introduction of a new product, The Like MachineTM, which is an in-store consumer approval device. The Company obtained a licensing agreement to sell this product and it is expected to be fully rolled out during 2015.

Basis of Presentation. Financial statements for the interim periods included herein are unaudited; however, they contain all adjustments, including normal recurring accruals, which in the opinion of management, are necessary to present fairly the financial position of the Company at September 30, 2014, its results of operations for the three and nine months ended September 30, 2014 and 2013, and its cash flows for the nine months ended September 30, 2014 and 2013. Results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year.

The financial statements do not include certain footnote disclosures and financial information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and, therefore, should be read in conjunction with the financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

The Summary of Significant Accounting Policies in the Company s 2013 Annual Report on Form 10-K describes the Company s accounting policies.

Inventories. Inventories are primarily comprised of parts and supplies for Impulse Retail systems, sign cards, and rollstock. Inventory is valued at the lower of cost or market using the first-in, first-out (FIFO) method, and consists of the following:

	September 30, 2014	December 31, 2013
Raw materials	$ 94,000	$ 71,000
Work-in-process	15,000	12,000
Finished goods	287,000	224,000
	$ 396,000	$ 307,000

6

Table of Contents

Property and Equipment. Property and equipment consists of the following:

		September 30, 2014		December 31, 2013
Property and Equipment:				
Production tooling, machinery and equipment	$	3,848,000	$	3,826,000
Office furniture and fixtures		260,000		260,000
Computer equipment and software		1,075,000		896,000
Web site		65,000		65,000
Leasehold improvements		616,000		616,000
Construction in-progress		60,000		34,000
		5,924,000		5,697,000
Accumulated depreciation and amortization		(4,323,000)		(3,944,000)
Net Property and Equipment	$	1,601,000	$	1,753,000

Depreciation expense was approximately $159,000 and $471,000 in the three and nine months ended September 30, 2014, respectively, and $158,000 and $506,000 in the three and nine months ended September 30, 2013, respectively.

Stock-Based Compensation. The Company measures and recognizes compensation expense for all stock-based awards at fair value using the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The Company recognizes stock-based compensation expense on a straight-line method over the requisite service period of the award.

There were 406,000 stock option awards, with a weighted average exercise price of $3.02, granted during the nine months ended September 30, 2014, and the Company estimated the fair value of these awards using the following weighted average assumptions: expected life of 3.7 years, expected volatility of 50%, dividend yield of 0% and risk-free interest rate of 1.1%.

The Company estimated the fair value of stock-based rights granted during the nine months ended September 30, 2014, under the Company s employee stock purchase plan using the following weighted average assumptions: expected life of 1.0 years, expected volatility of 50%, dividend yield of 0% and risk-free interest rate of 0.13%.

There were 25,000 restricted stock units granted during the nine months ended September 30, 2014. The shares were granted at $3.03 per share, based on the stock price on the date of the grant and vest over three years. Stock-based compensation expense for the restricted stock units during the three and nine months ended September 30, 2014 was $11,000 and $15,000, respectively, which is included in stock-based compensation expense.

In May 2014, equity grants were made by the Company to the Board of Directors, pursuant to the 2013 Omnibus Stock and Incentive Plan, as amended, in the form of fully vested shares of common stock. The total number of shares granted to the Board of Directors was 29,701. The shares were issued at $3.03 per share, based on the stock price on the date of grant, for a total value of $90,000, which is included in stock-based compensation expense.

Total stock-based compensation expense recorded for the three and nine months ended September 30, 2014 was $83,000 and $300,000, respectively, and for the three and nine months ended September 30, 2013 was $108,000 and $324,000, respectively.

Total options exercised in the three and nine months ended September 30, 2014 were for approximately 26,000 shares and 95,000 shares, for which the Company received proceeds of $24,000 and $125,000, respectively. During the three and nine months ended September 30, 2013, there were approximately 24,000 and 37,000 stock options exercised, for which the Company received proceeds of $10,000 and $23,000, respectively. A portion of the stock option exercises in the three and nine months ended September 30, 2014 and 2013 were done on a cashless basis.

Table of Contents

Net Income per Share. Basic net income per share is computed by dividing net income by the weighted average shares outstanding and excludes any potential dilutive effects of stock options. Diluted net income per share gives effect to all diluted potential common shares outstanding during the period.

Options to purchase approximately 695,000 and 578,000 shares of common stock with a weighted average exercise price of $4.20 and $4.27, respectively, were outstanding at September 30, 2014 and were not included in the computation of common stock equivalents for the three and nine months ended September 30, 2014 because their exercise prices were higher than the average fair market value of the common shares during the reporting period. Options to purchase approximately 538,000 and 1,005,000 shares of common stock with a weighted average exercise price of $4.20 and $3.48, respectively, were outstanding at September 30, 2013 and were not included in the computation of common stock equivalents for the three and nine months ended September 30, 2013 because their exercise prices were higher than the average fair market value of the common shares during the reporting period.

Weighted average common shares outstanding for the three and nine months ended September 30, 2014 and 2013 were as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	**2013**	**2014**	**2013**
Denominator for basic net income per share - weighted average shares	12,593,000	13,230,000	12,767,000	13,515,000
Effect of dilutive securities:				
Stock options and restricted stock units	231,000	140,000	236,000	66,000
Denominator for diluted net income per share - weighted average shares	12,824,000	13,370,000	13,003,000	13,581,000

2. **Investments.** During the three months ended September 30, 2014, the Company began an investment strategy intended to increase the yield on our available cash balances. The Company has classified all investments as a current asset, as they are available for current operations. These investments are in debt securities, with an average maturity of approximately one year, and are classified as available for sale.

3. **Line of Credit.** During the three months ended September 30, 2014, the Company opened a line of credit, which is collateralized by our investment balances. The total availability under the line of credit is $7,500,000 and bears interest at LIBOR plus 2% (effective rate of 2.16% as of September 30, 2014). There were no amounts outstanding on this line of credit at any point the three months ended September 30, 2014.

4. **Selling Arrangement.** In February 2011, the Company paid News America Marketing In-Store, LLC (News America) $4,000,000 in exchange for a 10-year arrangement to sell signs with price into News America s network of retailers as News America s exclusive agent. The $4,000,000 is being amortized on a straight-line basis over the 10-year term of the arrangement. Amortization expense, which was $100,000 and $300,000 in both the three and nine months ended September 30, 2014 and 2013, respectively, and is expected to be $400,000 per year over the next five years, is recorded within cost of services in the Company s statements of operations and comprehensive income. The net carrying amount of the selling arrangement is recorded within other assets on the Company s condensed balance sheets.

5. **Retail Access and Distribution Agreement.** On February 21, 2014, the Company and Valassis Sales and Marketing Services, Inc. (Valassis) signed the Retail Access and Distribution Agreement (the New Valassis Agreement) that replaced all prior agreements. As a result of this new agreement, Valassis is no longer a reseller of the Company s POPSign and the Company regained access to all consumer packaged goods manufacturers for the sale of POPSigns. On March 24, 2014, the Company received notice of termination from Valassis of the New Valassis Agreement. The termination of all material portions of this agreement was effective on August 11, 2014. Additionally, as a result of the termination of this agreement, the amount owed to Valassis by the Company was reduced from $500,000 to $250,000, which is being amortized over the original term of the New Valassis Agreement, which is approximately four years.

6. **Income Taxes.** For the three and nine months ended September 30, 2014, the Company recorded income tax expense of $427,000 and $533,000, or 50.2% and 46.7% of income before taxes, respectively. For the three and nine months ended September 30, 2013, the Company recorded income tax expense of $196,000 and $771,000, or 35.6% and 45.1% of income before taxes, respectively. The income tax provision for the three and nine months ended September 30, 2014 and 2013 is comprised of federal and state taxes. The

Table of Contents

primary differences between the Company s September 30, 2014 and 2013 effective tax rates and the statutory federal rate are expenses related to stock-based compensation and nondeductible meals and entertainment. The Company reassesses its effective rate each reporting period and adjusts the annual effective rate if deemed necessary, based on projected annual taxable income. The result of that reassessment as of September 30, 2014 caused the Company s effective tax rate for the three months ended September 30, 2014 to be higher than the effective tax rate for the nine months ended September 30, 2013.

As of September 30, 2014 and December 31, 2013, the Company has unrecognized tax benefits totaling $458,000, including interest, which relates to state nexus issues. The amount of the unrecognized tax benefits, if recognized, that would affect the effective income tax rates of future periods is $458,000. Due to the current statute of limitations regarding the unrecognized tax benefits, the unrecognized tax benefits and associated interest is not expected to change significantly in 2014.

7. **Concentrations.** During the nine months ended September 30, 2014, two customers accounted for 30% and 12% of the Company s total net sales. During the nine months ended September 30, 2013, two customers accounted for 27% and 11% of the Company s total net sales. At September 30, 2014, two customers accounted for 37% and 12% of the Company s total accounts receivable. At December 31, 2013, two customers accounted for 47% and 14% of the Company s total accounts receivable.

Although there are a number of customers that the Company sells to, the loss of a major customer could adversely affect operating results. Additionally, the loss of a major retailer from the Company s retail network could adversely affect operating results.

8. **Shareholders Equity.** On December 3, 2013, the Board of Directors authorized the repurchase of up to $5,000,000 of the Company s common stock on or before December 3, 2015. The plan allows the repurchases to be made in open market or privately negotiated transactions. For the three and nine months ended September 30, 2014, the Company repurchased approximately 455,000 and 602,000 share at a total cost of $1,431,000 and $1,886,000, respectively.

9. **Recently Issued Accounting Pronouncements**. In May 2014, the Financial Accounting Standards Board (FASB) issued guidance creating Accounting Standards Codification (ASC) Section 606, Revenue from Contracts with Customers . The new section will replace Section 605, Revenue Recognition and creates modifications to various other revenue accounting standards for specialized transactions and industries. The section is intended to conform revenue accounting principles with a concurrently issued International Financial Reporting Standards with previously differing treatment between United States practice and those of much of the rest of the world, as well as, to enhance disclosures related to disaggregated revenue information. The updated guidance is effective for annual reporting periods beginning on or after December 15, 2016, and interim periods within those annual periods. The Company will adopt the new provisions of this accounting standard at the beginning of fiscal year 2017, given that early adoption is not an option. The Company will further study the implications of this statement in order to evaluate the expected impact on the financial statements.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Company s financial statements and related notes. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated due to various factors discussed under Cautionary Statement Regarding Forward-Looking Statements and elsewhere in this Quarterly Report on Form 10-Q and the Risk Factors described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, our Current Reports on Form 8-K and our other SEC filings.

Table of Contents

Company Overview

Insignia Systems, Inc. (referred to in this Quarterly Report on Form 10-Q as Insignia, we, us, our and the Company) markets in-store adverti products, programs and services to consumer packaged goods manufacturers (customers) and retailers. The Company was incorporated in 1990. Since 1998, the Company has been focusing on providing in-store advertising services through the Insignia Point-Of-Purchase Services (POPS) in-store advertising program. Insignia POPS® includes the Insignia POPSign® program.

Insignia s POPSign is a national, account-specific, in-store, shelf-edge advertising program that we believe delivers significant sales increases. Funded by consumer packaged goods manufacturers, the program allows manufacturers to deliver vital product information to consumers at the point-of-purchase. The brand information is combined with each retailer s store-specific prices and is displayed on the retailer s unique sign format. We believe that combining manufacturer and retailer information provides consumers the information they want and need to make purchasing decisions, while building store and brand equity.

For retailers, Insignia s POPSign program is a source of incremental revenue and is an in-store advertising program that delivers a complete call to action on a product-specific and store-specific basis. For consumer packaged goods manufacturers, Insignia s POPSign program provides access to what we believe is the optimum retail advertising site for their products the retail shelf-edge. In addition, we believe manufacturers benefit from significant sales increases, short lead times, micro-marketing capabilities, such as store-specific and multiple language options, and a wide variety of program features and enhancements that provide unique advertising advantages.

Additionally, in October 2014, the Company announced the introduction of a new product, The Like MachineTM, which is an in-store consumer approval device. The Company expects to roll out this product fully during 2015. The Company licenses this product from TLM Holdings, LLC, a company in which Insignia s Chief Sales and Marketing Officer, Tim Halfmann, serves as a non-operating principal.

The Company s internet address is www.insigniasystems.com. The Company has made all of the reports it files with the SEC available free of charge on its web site. The Company s web site is not incorporated by reference into this Report on Form 10-Q. Copies of reports can also be obtained free of charge by requesting them from Insignia Systems, Inc., Attention: CFO, 8799 Brooklyn Boulevard, Minneapolis, Minnesota 55445; telephone 763-392-6200.

Business Overview

Summary of Financial Results

For the quarter ended September 30, 2014, the Company generated total net sales of $7,520,000, as compared with total net sales of $7,320,000 for the quarter ended September 30, 2013. For the nine months ended September 30, 2014, we generated total net sales of $20,267,000, as compared with total net sales of $20,849,000 in the nine months ended September 30, 2013. Net income for the quarter ended September 30, 2014 was $424,000, as compared to $354,000 for the quarter ended September 30, 2013. The net income for the nine months ended September 30, 2014 was $609,000, compared to $938,000 for the nine months ended September 30, 2013.

At September 30, 2014, our cash, cash equivalents and available for sale investments balance was $17,476,000, as compared to $21,763,000 at December 31, 2013. This decrease in cash and cash equivalents was due primarily to the repurchase of approximately $1.9 million of common stock, as well as an increase in accounts receivable of approximately $3.4 million. We have no debt and believe we have adequate liquidity to fund operations for at least the next twelve months.

Table of Contents

Results of Operations

The following table sets forth, for the periods indicated, certain items in the Company s Statements of Operations and Comprehensive Income as a percentage of total net sales.

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	**2013**	**2014**	**2013**
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	50.7	54.7	54.1	55.0
Gross profit	49.3	45.3	45.9	45.0
Operating expenses:				
Selling	19.1	21.7	20.6	19.8
Marketing	5.5	3.0	4.8	3.1
General and administrative	13.6	13.3	15.0	14.0
Total oper				