PROVENA FOODS INC
Form 10-Q
May 03, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2002

Commission File Number 1-10741

PROVENA FOODS INC.

(Exact name of registrant as specified in its charter)

California	95-2782215
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

5010 Eucalyptus Avenue, Chino, California	91710
(Address of principal executive offices)	(ZIP Code)

(909) 627-1082

(Registrant's telephone number, including area code)

Indicate by checkmark 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___

The number of shares of Provena Foods Inc. Common Stock outstanding as April 27, 2002 was:

Common Stock 3,109,302 shares

PROVENA FOODS INC.

Form 10-Q Report for the First Quarter Ended March 31, 2002

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

PROVENA FOODS INC.

Condensed Statements of Operations

(Unaudited)

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
Net sales	$ 9,772,060	7,738,681
Cost of sales	8,810,846	6,824,153
Gross profit	961,214	914,528
Operating expenses:		
Distribution	305,016	324,003
General and administrative	497,035	437,637
Operating income	159,163	152,888
Interest expense, net	(123,766)	(194,364)
Other income, net	57,309	58,942
Earnings before income taxes	92,706	17,466
Income tax expense	37,000	7,600
Net earnings	$ 55,706	9,866
Earnings per share:		
Basic	$ .02	.00
Diluted	$ .02	.00
Shares used in computing earnings per share:		
Basic	3,099,362	3,043,882

Diluted	3,099,362	3,043,882

See accompanying Notes to Condensed Financial Statements.

PROVENA FOODS INC.

Condensed Balance Sheets

Assets	March 31, 2002 (Unaudited)	December 31, 2001
Current assets:		
Cash and cash equivalents	$ 54,543	206,777
Accounts receivable, less allowance for doubtful accounts of $40,225 at 2002 and $0 at 2001	3,423,103	3,238,935
Inventories	3,343,413	3,190,660
Prepaid expenses	165,994	12,443
Deferred tax assets	106,203	106,203
Total current assets	7,093,256	6,755,018
Property and equipment, net	15,980,611	16,128,662
Other assets	175,650	181,268
Deferred tax assets, net of current	328,884	328,884
	$23,578,401	23,393,832
Liabilities and Shareholders' Equity		
Current liabilities:		
Line of credit	$ 3,592,225	4,000,000
Current portion of long-term debt	495,285	495,285
Current portion of capital lease obligation	113,200	113,200
Accounts payable	1,582,097	1,362,058
Accrued liabilities	1,619,420	1,229,273
Deferred tax liability	46,394	46,394
Income taxes payable	37,000	-
Total current liabilities	7,485,621	7,246,210
Long-term debt, net of current portion	6,292,634	6,395,906
Capital lease obligation, net of current portion	424,684	453,628
Deferred tax liability, net of current	416,802	416,802
Shareholders' equity:		
Capital stock, no par value; authorized 10,000,000		

shares; issued and outstanding 3,104,794 at 2002 and 3,089,516 at 2001	5,005,007	4,983,339
Retained earnings	3,953,653	3,897,947
Total shareholders' equity	8,958,660	8,881,286
	$23,578,401	23,393,832

See accompanying Notes to Condensed Financial Statements.

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PROVENA FOODS INC.

Condensed Statements of Cash Flows

(Unaudited)

	Three Months March 31
	2002
Cash flows from operating activities:	
Net earnings	$ 55,706
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:	
Depreciation and amortization	204,483
Increase (decrease) in provision for bad debts	40,225
Increase in accounts receivable	(224,393)
Increase in inventories	(152,753)
Increase in prepaid expenses	(153,551)
Increase in income taxes receivable	-
Decrease (increase) in other assets	5,618
Increase in accounts payable	220,039
Increase (decrease) in accrued liabilities	390,147
Increase in income taxes payable	37,000
Net cash provided by (used in) operating activities	422,521
Cash flows from investing activities:	
Additions to property and equipment	56,432
Net cash used in investing activities	56,432
Cash flows from financing activities:	
Payments on long term debt	(103,272)
Payments on capital lease obligation	(28,944)
Proceeds from (repayments of) line of credit	(407,775)

Proceeds from sale of capital stock	21,668
Cash dividends paid	-
Net cash provided by (used in) financing activities	(518,323)
Net decrease in cash and cash equivalents	(152,234)
Cash and cash equivalents at beginning of period	206,777
Cash and cash equivalents at end of period	$ 54,543
Supplemental disclosures of cash flow information:	
Cash paid during the period for:	
Interest	$ 124,004
Income taxes	$ -

See accompanying Notes to Condensed Financial Statements.

PROVENA FOODS INC.

Notes to Condensed Financial Statements

March 31, 2002 and 2001 (Unaudited)

(1) Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with the requirements of Form 10-Q and, therefore, do not include all information and footnotes which would be presented were such financial statements prepared in accordance with accounting principles generally accepted in the United States for annual financial statement purposes. These statements should be read in conjunction with the audited financial statements presented in the Company's Form 10-K for the year ended December 31, 2001. In the opinion of management, the accompanying financial statements reflect all adjustments which are necessary for a fair presentation of the results for the interim periods presented. Such adjustments consisted only of normal recurring items. The results of operations for the three months ended March 31, 2002 are not necessarily indicative of results to be expected for the full year.

(2) Inventories

Inventories at March 31, 2002 and December 31, 2001 consist of:

	2002	2001
Raw materials	$1,317,644	1,393,975
Work-in-process	873,840	842,577
Finished goods	1,151,929	954,108

	$3,343,413	3,190,660
	==========	==========

(3) Segment Data

Business segment sales and operating income (loss) for the three months ended March 31, 2002 and 2001 and assets at March 31, 2002 and December 31, 2001 are as follows:

	2002	2001
Net sales to unaffiliated customers:		
Swiss American Sausage Division	$ 8,177,597	6,413,644
Royal-Angelus Macaroni Division	1,594,463	1,325,037
Total net sales	$ 9,772,060	7,738,681
Operating income (loss):		
Swiss American Sausage Division	$ 208,098	324,933
Royal-Angelus Macaroni Division	(91,826)	(173,653)
Corporate	42,891	1,608
Operating income	$ 159,163	152,888
Identifiable assets:		
Swiss American Sausage Division	$18,934,751	18,428,801
Royal-Angelus Macaroni Division	4,061,943	4,328,435
Corporate	581,707	636,596
Total assets	$23,578,401	23,393,832

(4) Earnings per Share

Basic earnings per share are net earnings divided by the weighted average number of common shares outstanding during the period, and diluted earnings per share are net earnings divided by the sum of the weighted average plus an incremental number of shares attributable to outstanding options. Options for 107,111 shares were not used in the diluted loss calculations for the following periods because their effect was antidilutive.

	Three Months Ended March 31,	
	2002	2001
Net earnings	$ 55,706	9,866
Weighted average number of shares	3,099,362	3,043,882
Incremental shares for options	-	-
Weighted average plus incremental shares	3,099,362	3,043,882

Basic earnings (loss) per share	$ .02	.00
Diluted earnings (loss) per share	$ .02	.00

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

Results of Operations

(Unaudited)	Three Months Ended March 31, 2002	2001
	(amounts in thousands)	
Net sales by division:		
Swiss American	$8,178	$6,414
Royal-Angelus	1,594	1,325
Total	$9,772	$7,739
Sales in thousands of pounds by division:		
Swiss American	5,427	4,532
Royal-Angelus	2,814	2,659

Forward-Looking Statements

The following discussion may contain "forward-looking statements" that express or imply expectations of future performance, developments or occurrences. Actual events may differ materially from these expectations due to uncertainties relating to the economy, competition, demand, commodities, credit markets, energy supplies and other factors.

Swiss American Sausage Co. Meat Division

Sales by the processed meat division increased about 28% in dollars and 20% in pounds in the 1st three months of 2002 over the same period in 2001. Sales in dollars increased proportionately more than in pounds because of higher selling prices to reflect meat price increases. Swiss operated at a $208,098 profit in the 1st quarter of 2002 compared to a $324,933 profit for the 1st quarter of 2001. Reduced profits were caused by lower margins resulting primarily from higher insurance and maintenance costs.

Royal-Angelus Macaroni Company Pasta Division

The pasta division's sales increased about 20% in dollars and 6% in pounds in the 1st quarter of 2002 compared to the 1st quarter of 2001. The percentage increases were higher in dollars than in pounds because of a reduced proportion of lower price-per-pound bulk sales and higher selling prices to reflect higher flour costs. Royal operated at a $91,826 loss for the 1st quarter of 2002 compared to a $173,653 loss for the 1st quarter of 2001. Sales and operating results were both adversely affected by competition resulting from increased industry capacity, but increased sales resulted in a reduced loss because of the increase in plant utilization. Royal is continuing to seek personnel experienced in pasta sales and production and to aggressively pursue sales opportunities.

The Company

Company net sales were up about 26% and the Company realized net earnings of $55,706 in the 1st quarter of 2002 compared to $9,866 for the 1st quarter of 2001. Both divisions contributed to the increased sales and the decreased loss at Royal produced the improvement in net earnings. The Company's gross profit margin for the 1st quarter of 2002 was 9.8% compared to 11.8% a year ago. The Company's margin decreased because Swiss's margin decreased primarily as the result of increased insurance and maintenance costs, with Royal's margin up as a result of sales increasing proportionately more than production costs.

General and administrative expenses were up about $60,000 for the 1st quarter of 2002 compared to the same period in 2001 because of recovery of a doubtful account in the 1st quarter of 2001 versus an increased reserve for doubtful accounts in 2002, reduced by lower health benefit costs. Distribution expenses were down about $20,000 in spite of increased sales because of reduced advertising and salesman expenses partially offset by higher freight and insurance. Net interest expense decreased about $70,000 primarily because of lower interest rates, augmented by slightly lower total debt, despite slightly higher borrowings under the bank line of credit in the 1st quarter of 2002 versus the 1st quarter of 2001.

Meat plant employees are represented by United Food and Commercial Workers Union, Local 588, AFL-CIO, CLC under a collective bargaining agreement which expired March 31, 2002. Negotiations to renew the agreement are progressing normally. Pasta plant employees are represented by United Food and Commercial Workers Union, Local 1428, AFL-CIO, CLC under a collective bargaining agreement which expires September 29, 2002. There has been no significant labor unrest at the Company's plants and the Company believes it has a satisfactory relationship with its employees.

Liquidity and Capital Resources

The Company has generally satisfied its normal working capital requirements with funds derived from operations and borrowings under its bank line of credit, which is part of a credit facility with Comerica Bank-California. The line of credit is payable on demand, is subject to annual review, and bears interest at a variable annual rate of 0.75% over the bank's "Base Rate." The maximum amount of the line of credit is the lesser of $4,000,000, or 30% of inventories plus 80% of receivables, with a limit of $1,500,000 for inventories, determined monthly. At March 31, 2002 the "Base Rate" was 4.75% per annum, 30% of inventories plus 80% of receivables was $3,592,225 and the Company had $3,592,225 of borrowings under the bank line of credit.

As part of the credit facility, Comerica Bank-California issued a $4,060,000 letter of credit to support $4,000,000 of industrial development bonds issued in 1998 for costs relating to the construction of the Company's meat plant. The bonds bear a variable rate of interest payable monthly and set weekly at a market rate - 1.5% per annum at March 31, 2002. The Company pays a 1.5% per annum fee on the amount of the letter of credit and fees of the bond trustee estimated at 0.5% of the bond principal per year. Monthly payments of bond principal into a sinking fund began May 1, 2000, total $76,700 the first year and increase about 5.6% each year until May 1, 2022, when $813,500 of remaining principal is payable in 18 equal monthly payments.

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Also as part of the credit facility, the bank made four loans to the Company for the new meat plant, a $1,280,000 real estate loan and three equipment loans totalling $2,614,788. The real estate loan was made in December 1999, bears a fixed rate of interest of 9.1% per annum and is payable in equal monthly payments of principal and interest over its 25 year term. Each equipment loan bears a variable rate of interest and is payable in equal monthly payments of principal plus interest over its term, with issue date, initial amount, term and rate as follows: July 1999, $1,000,000, 7 year, bank's "Base Rate"; September 1999, $1,200,000, 7 year, bank's "Base Rate" plus 0.25%; and December 1999, $414,788, 5 year, bank's "Base Rate" plus 0.75%.

All parts of the credit facility are secured by substantially all of the Company's assets, including accounts receivable, inventory, equipment and fixtures, the Company's two Chino buildings and the new meat plant, none of which is otherwise encumbered. The credit facility prohibits mergers, acquisitions, disposal of assets, borrowing, granting security interests, and changes of management and, as modified for 2002, requires a tangible net worth greater than $8,500,000, increasing to $8,900,000 at June 30, 2002 and by $200,000 each quarter thereafter; working capital not less than negative $625,000 increasing to negative $400,000 at June 30, 2002, negative $200,000 at September 30, 2002 and $0 at December 31, 2002; debt service coverage not less than 1.3; and quarterly dividends not exceeding the net income of the prior quarter. The Company was not in default under any of the covenants at March 31, 2002 and expects to be in compliance with all covenants at June 30, September 30, and December 31, 2002.

Cash decreased $152,234 in the 1st quarter of 2002 compared to a $46,686 decrease in the 1st quarter of 2001. Operating activities provided $422,521 of cash primarily from net earnings, depreciation and amortization and increases in accounts payable and accrued liabilities, partially offset by increases in accounts receivable, inventories and prepaid expenses. Accounts receivable and inventories increased because of increased sales. Investing activities used $56,432 of cash for modest additions to property and equipment, and financing activities used $518,323 of cash for payments on long term debt and the capital lease obligation and repayments of the bank line of credit.

Commitments and Contingencies

The following table shows the long-term debt principal and capital lease obligation payments due in the specified periods as of December 31, 2001. The lease payments are estimates because they are proportional to pounds of a product sold.

		Year Ended December 31,					
(amounts in thousands)	Totals	2002	2003	2004	2005	2006	Th
Long-Term Debt	$6,891	495	504	504	435	341	
Capital Lease Obligation	567	113	113	113	113	115	

Totals	$7,458	608	617	617	548	456

The Company expects that its operations and bank line of credit will provide adequate working capital to satisfy the normal needs of its operations for the foreseeable future, including cash

flow to service its debt. The 1st quarter usually requires higher cash expenditures than any other quarter because of annual retirement benefit contributions and initial insurance premiums.

The Company believes that it has a good relationship with Comerica Bank-California, as evidenced by the bank's previous over-advances under the line of credit, waiver of defaults under the financial covenants and modifications of the financial covenants. That relationship is crucial to the Company, because the line of credit is payable on demand, the Company could not make an immediate repayment of the line of credit, and a failure to repay the line after demand would render the entire credit facility in default. As a result, neither a default under a financial covenant nor the bank's waiver of such a default affects the bank's power to cause the credit facility to be in default and require that it be restructured or refinanced.

Critical Accounting Policies

In December 2001, the Securities and Exchange Commission requested that all registrants list their most "critical accounting policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations, and indicated that a "critical accounting policy" is one which is both important to the portrayal of the registrant's financial condition and results of operations and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Critical for the Company is determining the allowance for doubtful accounts because of the risk of failing to foresee a major credit loss, and inventory valuation when inventory cost may exceed fair value less cost to sell because of the difficulty of determining the latter.

New Accounting Standards

The Financial Accounting Standards Board in June 2001 issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" applicable to business combinations initiated after June 30, 2001, SFAS No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002 and SFAS No. 143, "Accounting for Asset Retirement Obligations" effective January 1, 2003 and in August 2001 issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" effective January 1, 2002. These standards are adopted by the Company as they become effective and, in the opinion of management, have not had and will not have a material effect on the Company's financial position, results of operations or liquidity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The industrial development bonds, the bank line of credit, and the equipment loans bear variable rates of interest (see Liquidity and Capital Resources under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations) which tend to follow market interest rates and change the Company's interest expense in the same direction as changes in interest rates. A

1% per annum change in the rate borne by the industrial development bonds would change annual interest expense by almost $40,000. Assuming an average bank line of credit balance of $4,000,000 plus $1,500,000 average principal balance of equipment loans, a 1% per annum change in the rate borne by those borrowings would change annual interest expense by $55,000.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS No significant litigation.

ITEM 2. CHANGES IN SECURITIES None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS None.

ITEM 5. OTHER INFORMATION

Common Stock Repurchase and Sale

During the 1st three months of 2002, the Company did not purchase any shares of its common stock under its stock repurchase program.

During the 1st three months of 2002, the Company sold 15,278 newly issued shares of its common stock under its 1988 Employee Stock Purchase Plan, at an average selling price of $1.42 per share. From inception of the Plan through March 31, 2002, employees have purchased a total of 626,340 shares.

American Stock Exchange Listing

The Company's common stock trades on the American Stock Exchange under the ticker symbol "PZA".

Cash Dividends Paid

No cash dividend was paid in the 1st quarter of 2002.

Management Stock Transactions

No purchases or sales of the Company's common stock by officers or directors were reported during the 1st quarter of 2002.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) No exhibits are filed with this report.

(b) No reports on Form 8-K were filed during the three months ended March 31, 2002.

SIGNATURE

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.

Date: April 27, 2002

PROVENA FOODS INC.

By /s/ Thomas J. Mulroney

Thomas J. Mulroney
Vice President and
Chief Financial Officer