ADVANT E CORP
Form 10QSB
November 20, 2007

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington D. C. 20549**

# FORM 10-QSB

**(Mark One)**

**x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended September 30, 2007**

**¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**
**For the transition period from ______ to ______**

**COMMISSION FILE NUMBER: 0-30983**

# ADVANT-E CORPORATION

**(Exact name of small business issuer as specified in its charter)**

| | |
|---|---|
| **DELAWARE** | **88-0339012** |
| **(State or other jurisdiction of incorporation or organization)** | **(IRS Employer Identification No.)** |

**2680 Indian Ripple Rd.**

**Dayton, Ohio 45440**

**(Address of principal executive offices)**

**(937) 429-4288**

**(Issuer s telephone number)**

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ¨

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

As of November 20, 2007 the issuer had 6,815,015 outstanding shares of Common Stock, $.001 Par Value.

Transitional Small Business Disclosure Format: Yes ¨ No x

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**ADVANT-E CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)**

| | Three Months Ended September 30, 2007 | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 |
|---|---|---|---|---|
| Revenue | $ 2,178,155 | 1,368,582 | 5,075,628 | 3,964,509 |
| Cost of revenue | 818,716 | 422,394 | 1,810,060 | 1,199,923 |
| Gross margin | 1,359,439 | 946,188 | 3,265,568 | 2,764,586 |
| Marketing, general and administrative expenses | 876,090 | 589,891 | 2,231,039 | 1,799,812 |
| Operating income | 483,349 | 356,297 | 1,034,529 | 964,774 |
| Other income, net | 18,002 | 14,142 | 73,257 | 46,531 |
| Income before taxes | 501,351 | 370,439 | 1,107,786 | 1,011,305 |
| Income tax expense | 165,467 | 138,064 | 399,184 | 380,369 |
| Net income | $ 335,884 | 232,375 | 708,602 | 630,936 |
| Basic earnings per share | $ 0.05 | 0.04 | 0.11 | 0.10 |
| Diluted earnings per share | $ 0.05 | 0.04 | 0.11 | 0.10 |
| Weighted average shares outstanding | 6,845,015 | 6,403,174 | 6,612,266 | 6,403,174 |
| Weighted average shares outstanding, assuming dilution | 6,845,015 | 6,432,246 | 6,612,266 | 6,429,770 |

The accompanying notes are an integral part of the consolidated condensed financial statements.

**ADVANT-E CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED BALANCE SHEETS**

| | | September 30, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|---|
| Assets | | | |
| Current Assets: | | | |
| Cash and cash equivalents | $ | 1,876,255 | 2,209,782 |
| Short-term investments | | 295,663 | 274,434 |
| Accounts receivable, net | | 894,188 | 477,639 |
| Prepaid software maintenance costs | | 198,742 | |
| Prepaid expenses and deposits | | 70,590 | 28,339 |
| Deferred income taxes | | 50,226 | |
| Total current assets | | 3,385,664 | 2,990,194 |
| Software development costs, net | | 214,684 | 247,621 |
| Property and equipment, net | | 438,257 | 386,697 |
| Goodwill | | 1,376,452 | |
| Other intangible assets, net | | 519,822 | |
| Total assets | $ | 5,934,879 | 3,624,512 |
| Liabilities and Shareholders Equity | | | |
| Current liabilities: | | | |
| Borrowings under bank line of credit | $ | 140,000 | |
| Accounts payable | | 323,317 | 66,936 |
| Accrued salaries and other expenses | | 268,001 | 157,802 |
| Income taxes payable | | 116,049 | 109,642 |
| Deferred revenue | | 621,682 | 112,846 |
| Deferred income taxes | | | 53,119 |
| Total current liabilities | | 1,469,049 | 500,345 |
| Deferred income taxes | | 305,154 | 165,784 |
| Total liabilities | | 1,774,203 | 666,129 |
| Shareholders equity: | | | |
| Common stock, $.001 par value; 20,000,000 shares authorized, 6,875,015 and 6,478,714 issued, and 6,815,015 and 6,478,714 outstanding at September 30, 2007 and December 31, 2006, respectively | | 6,875 | 6,478 |
| Paid-in capital | | 2,210,200 | 1,641,906 |
| Retained earnings | | 2,018,601 | 1,309,999 |
| Treasury stock at cost, 60,000 shares at September 30, 2007 | | (75,000) | |
| Total shareholders equity | | 4,160,676 | 2,958,383 |
| Total liabilities and shareholders equity | $ | 5,934,879 | 3,624,512 |

The accompanying notes are an integral part of the consolidated condensed financial statements.

**ADVANT-E CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

| | Nine Months Ended September 30, 2007 | 2006 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 708,602 | 630,936 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation | 162,233 | 105,624 |
| Amortization of software development costs | 48,300 | 93,793 |
| Amortization of intangible assets | 21,178 | |
| Loss on disposal of assets | | 41,921 |
| Deferred income taxes | (41,784) | 116,963 |
| Purchases of trading securities | (154,868) | |
| Proceeds from sales of trading securities | 159,184 | |
| Net unrealized gain on trading securities | (12,573) | |
| Net realized gain on sale of securities | (12,972) | (8,768) |
| Increase (decrease) in cash arising from changes in assets and liabilities: | | |
| Accounts receivable | (101,139) | (95,099) |
| Prepaid software maintenance costs | (26,430) | |
| Prepaid expenses and deposits | (3,841) | (21,015) |
| Accounts payable | 70,493 | 11,538 |
| Accrued salaries and other expenses | 68,320 | 11,315 |
| Income taxes payable | 6,407 | (349,347) |
| Deferred revenue | 38,310 | 5,077 |
| Net cash flows from operating activities | 929,420 | 542,938 |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale securities | | (107,966) |
| Proceeds from sale of available-for-sale securities | | 90,085 |
| Purchases of property and equipment | (181,246) | (238,480) |
| Software development costs | (15,363) | (199,056) |
| Cash paid for purchase of Merkur Group, Inc. | (971,338) | |
| Net cash flows from investing activities | (1,167,947) | (455,417) |
| Cash flows from financing activities: | | |
| Net payments on bank line of credit | (20,000) | |
| Purchase of treasury stock | (75,000) | |
| Net cash flows from financing activities | (95,000) | |
| Net decrease in cash and cash equivalents | (333,527) | 87,521 |
| Cash and cash equivalents, beginning of period | 2,209,782 | 1,763,435 |
| Cash and cash equivalents, end of period | $ 1,876,255 | 1,850,956 |
| Supplemental disclosures of cash flow items: | | |
| Income taxes paid | $ 434,561 | 641,000 |
| Noncash transactions: | | |
| Common stock issued in connection with purchase of Merkur Group, Inc. | 568,692 | |

The accompanying notes are an integral part of the consolidated condensed financial statements.

**ADVANT-E CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)**

**September 30, 2007**

**Note 1: Basis of Presentation, Organization and Other Matters**

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-QSB. Accordingly, they do not include all of the information and notes to financial statements required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the unaudited consolidated condensed financial statements include all adjustments considered necessary for a fair presentation of financial position, results of operations, and cash flows for the interim periods.

Results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the full year ending December 31, 2007. These unaudited consolidated condensed financial statements should be read in conjunction with the consolidated financial statements, accounting policies, and financial notes thereto included in Advant-e Corporation s 2006 Form 10-KSB filed with the Securities and Exchange Commission.

***Nature of Operations***

Advant-e Corporation through its wholly-owned subsidiaries, Edict Systems, Inc. and Merkur Group, Inc. (collectively, the Company ), develops, markets, resells, and hosts software and provides services that allow its customers to send and receive business documents electronically in standard and proprietary formats. Edict Systems specializes in providing hosted Electronic Data Interchange solutions that utilize the Internet as the primary communications method. Edict customers use its solutions to connect with business partners, integrate data with internal systems, expand and manage electronic trading communities, and validate data via a hosted business rule service. Merkur Group develops, private labels, and resells software and provides professional services, technical maintenance, and support to provide solutions that integrate with large Supply Chain Management (SCM), Customer Relationship Management (CRM), and financial and Enterprise Resource Planning (ERP) systems for automating inbound and outbound business documents.

***Principles of Consolidation***

The consolidated condensed financial statements include the accounts of Advant-e Corporation and its wholly-owned subsidiary, Edict Systems, Inc. throughout the periods covered by this Form 10-QSB and its wholly-owned subsidiary Merkur Group, Inc. since the date of its acquisition by Advant-e Corporation on July 2, 2007. Inter-company accounts and transactions are eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates used in preparing these financial statements include those considered in the assessment of recoverability of capitalized software development costs, and those used in recording prepaid software maintenance costs, deferred revenue and net deferred tax liabilities. It is at least reasonably possible that the significant estimates used will change within the next year.

***Cash and Cash Equivalents***

The Company classifies as cash equivalents all highly liquid investments with original maturities of three months or less.

***Short-term Investments***

Short-term investments are reported at fair value using available quoted market prices and consist of marketable equity and U. S. Treasury debt securities. These investments are classified as trading securities. Through September 30, 2006 these investments were classified as available-for-sale securities and unrealized gains and losses, net of deferred taxes, were recorded in shareholders equity as other comprehensive income. In the fourth quarter of 2006 management determined that it was appropriate to reclassify the short-term investments from available-for-sale securities to trading securities due to the active and frequent buying and selling of the securities. In connection with this reclassification, all unrealized gains and losses, net of deferred taxes, at October 1, 2006 and for subsequent periods are included in earnings.

The Company uses the specific identification method to determine the cost of securities sold.

***Revenue Recognition***

The Company recognizes revenues in accordance with the Securities Exchange Commission Staff Accounting Bulletin 101 (SAB 101), which requires the Company to recognize revenue when, in addition to other criteria, delivery has occurred or services have been rendered.

Revenues from Internet-based products and services (Web EDI and EnterpriseEC, etc) are comprised of four components account activation and trading partner set-up fees, monthly subscription fees, usage based transactional fees and customer payments for the Company s development of applications designed to meet specific customer specifications.

Revenues earned from account activation and trading partner set-up fees are recognized after the Company performs consultative work required in order to establish an electronic trading partnership between the customer and their desired trading partners. Trading partnerships, once established, require no ongoing effort on the part of the Company and customers are able to utilize the electronic trading partnerships either directly with their customers or via a service provider other than the Company.

Revenue from monthly subscription fees is recognized over the period to which the subscription applies.

Revenue from usage based transaction fees is recognized in the period in which the transactions are processed.

Revenue from the sale of software and related products is recognized upon activation of the software and delivery to the customer when title and risk of loss are transferred. The Company follows the guidance provided in Emerging Issues Task Force Abstract ( EITF ) No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. Based upon this guidance the Company records the revenue from the sale of software and related products at gross, and the related software purchases are included in cost of sales. Customers have a 30-day period in which they can choose to accept or return the software. Historically, customer returns have not been significant.

Revenue from maintenance contracts is recognized over the life of the maintenance and support contract period, generally twelve months. Revenue from professional services is recognized upon the performance of those services.

Revenue from customer payments for the Company s development of applications designed to meet specific customer specifications is recognized over the contract period, generally twelve months.

***Software Maintenance Costs***

Prepaid software maintenance costs represent amounts paid to the primary software supplier of Merkur Group, Inc. for providing program upgrades and software modifications to remediate programming errors during the lives of the related customer maintenance and support contracts. These costs are charged to expense over the lives of the maintenance and support contract periods, generally twelve months.

***Accounts Receivable and Credit Policies***

Accounts receivable are uncollateralized customer obligations due under normal trade terms generally requiring payment upon receipt of invoice or within thirty days.

Accounts receivable include amounts billed to customers and amounts that are unbilled at the end of the period for services that were performed before the end of the period. Customer account balances with invoices dated over 30 days old are considered delinquent.

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management s best estimate of the amounts that will not be collected. Management considers account balances that are over 90 days old as having a high probability of uncollectibility and generally includes those amounts in the valuation allowance. In addition, management individually reviews accounts receivable balances and, based on an assessment of current creditworthiness, estimates the account balances that will not be collected and includes those amounts, if any, in the valuation allowance.

The allowance for uncollectible accounts was $17,000 at September 30, 2007 and $23,000 at December 31, 2006.

***Software Development Costs***

The Company accounts for the costs of computer software that it develops for internal use and costs associated with operation of its web sites in accordance with the American Institute of Certified Public Accountants Statement of Position ( SOP ) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Emerging Issues Task Force ( EITF ) No. 00-2 Accounting for Web Site Development Costs . Such capitalized costs represent solely the salaries and benefits of employees working on the graphics and content development stages, or adding functionality or features. In accordance with SOP 98-1 and EITF No. 00-2, overhead, general and administrative and training costs are not capitalized. The Company accounts for the costs of computer software that it sells, leases and markets as a separate product in accordance with Financial Accounting Standards Board Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed . Capitalized costs are amortized by the straight-line method over the remaining estimated economic lives of the software application, generally three years, and are reported at the lower of unamortized cost or net realizable value.

***Property and Equipment***

Property and equipment consist of computers and office equipment, computer software, and leasehold improvements carried at cost. Depreciation is provided using straight line and accelerated methods over the estimated useful lives of the assets of three to seven years. Costs of normal maintenance and repairs are charged to expense as incurred.

***Goodwill and Other Intangible Assets, net***

Goodwill represents the excess of the Company s purchase price over the fair value of the net identifiable assets of a business acquired. Goodwill is tested for impairment annually. Other intangible assets consist of contractual vendor relationships, customer relationships and proprietary computer software. Intangible assets acquired in business acquisitions are recorded at their fair values using the income approach or cost approach. The other intangible assets are amortized on a straight-line basis over their expected useful lives of five to seven years.

***Income Taxes***

Deferred income taxes are determined using the liability method of accounting. Under this method, the net deferred tax asset or liability is determined based on the enacted laws and rates applied to the temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets and liabilities result principally from temporary differences in the financial statement and tax bases of accounts receivable, prepaid software maintenance costs, other intangible assets, deferred revenue and accrued salaries and other expenses.

***Earnings Per Share***

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the year. Diluted earnings per share includes the dilutive effect of any outstanding warrants.

***Advertising***

All advertising costs are expensed as incurred. Advertising was $12,127 and $9,086 in the quarter ended September 30, 2007 and 2006, respectively, and $30,079 and $16,357 in the nine months ended September 30, 2007 and 2006, respectively.

***Comprehensive income***

Comprehensive income consists of net income and other gains and losses affecting shareholders equity that under U.S. generally accepted accounting principles are excluded from net income. Other comprehensive income and accumulated other comprehensive income consist solely of net unrealized gains on short-term investments that were classified as available-for-sale securities through September 30, 2006.

**Note 2: Acquisition**

On July 2, 2007, Advant-e Corporation acquired 100% of the outstanding shares of Merkur Group, Inc., a Delaware corporation owned principally by the brother of the Company s CEO. The results of Merkur Group, Inc. s operations have been included in the consolidated financial statements since that date. Merkur Group, Inc. develops, private labels, and resells software and provides professional services, technical maintenance, and support to provide solutions that integrate with large Supply Chain Management (SCM), Customer Relationship Management (CRM), and financial and Enterprise Resource Planning (ERP) systems for automating inbound and outbound business documents.

The aggregate purchase price of $1,540,030 was comprised of cash payments of $927,938 and issuance of 396,301 unregistered common shares valued at $568,692 to the former shareholders of Merkur Group, Inc. and $43,400 in related acquisition costs. The value of the unregistered common shares issued was determined based on a weighted-average market price of Advant-e Corporation s common shares over the 5-trading day period from June 28, 2007 through July 5, 2007.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

| | |
|---|---|
| Current assets and deposit | $ 645,918 |
| Property and equipment | 32,547 |
| Goodwill | 1,376,452 |
| Other intangible assets | 541,000 |
| Total assets acquired | 2,595,917 |
| Liabilities, principally current, assumed | 861,127 |
| Deferred income taxes | 194,760 |
| Total liabilities assumed | 1,055,887 |
| Net assets acquired | $ 1,540,030 |

Of the $541,000 of acquired other intangible assets, $226,000 was assigned to proprietary internally developed and commercially available for sale computer software, with a useful life of seven years; $130,000 was assigned to the Company s contractual relationship resulting from its Certified Partner Agreement with a software supplier, with a useful life of five years; and $185,000 was assigned to customer relationships resulting in a recurring revenue stream, with a useful life of seven years. The amortization of the proprietary computer software and the contractual relationship are charged to cost of revenue and the amortization of the customer relationships is charged to marketing, general and administrative expenses.

The following pro-forma information shows results of operations as if the acquisition had occurred at the beginning of those periods:

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Revenue | $ 2,178,155 | 1,883,764 | 5,961,348 | 5,573,181 |
| Income before taxes | 501,351 | 360,863 | 1,138,892 | 1,072,885 |
| Net income | 335,884 | 215,654 | 776,826 | 716,467 |
| Basic earnings per share | 0.05 | 0.03 | 0.11 | 0.11 |
| Diluted earnings per share | 0.05 | 0.03 | 0.11 | 0.10 |

**Note 3: Software Development Costs**

Software development costs at September 30, 2007 and the changes during the nine months then ended are summarized as follows:

| | **Cost** | **Accumulated Amortization** | **Net** |
|---|---|---|---|
| Balance, January 1, 2007 | $ 1,497,372 | 1,249,751 | 247,621 |
| Additions | 15,363 | | 15,363 |
| Amortization | | 48,300 | (48,300) |
| Balance, September 30, 2007 | $ 1,512,735 | 1,298,051 | 214,684 |

The unamortized costs relate exclusively to internal use software and costs associated with web site development and related enhancements. The additions in the first nine months of 2007 relate to costs capitalized in connection with the development of a new hosted value-added application.

The ongoing assessment of recoverability of capitalized software development costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future revenues, estimated economic lives and changes in software and hardware technologies. Impairment of asset value is considered whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

**Note 4: Bank Line of Credit**

The Company has a bank line of credit to borrow up to $350,000 at the bank s prime commercial interest rate plus 1.00% (8.75% at September 30, 2007). The line of credit is automatically renewable at the bank s option. Any borrowings under this line of credit are unsecured and are payable upon demand. Borrowings outstanding at September 30, 2007 were $140,000. The Company has a second bank line of credit to borrow up to $400,000 with no outstanding borrowings at any time during 2006 or 2007.

**Note 5: Income taxes**

Income tax expense consists of the following:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Current expense | $ 188,983 | 84,779 | 440,968 | 263,406 |
| Deferred expense (benefit) | (23,516) | 53,285 | (41,784) | 116,963 |
| Total income tax expense | $ 165,467 | 138,064 | 399,184 | 380,369 |

**Note 6: Earnings per share**

The reconciliation of the numerators and denominators of the basic and diluted earnings per share calculations for the three months and the nine months ended September 30, 2007 and 2006 follows:

**Income**