ADVO INC
Form 10-Q
August 11, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(Mark One)

(X) Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended JUNE 28, 2003

or

( ) 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 1-11720

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

Delaware	06-0885252
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Univac Lane, P.O. Box 755, Windsor, CT	06095-0755
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number including area code: (860) 285-6100

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 ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act). Yes X No ___

As of July 26, 2003 there were 19,955,565 shares of common stock outstanding.

ADVO, INC.
INDEX TO QUARTERLY REPORT
ON FORM 10-Q

QUARTER ENDED JUNE 28, 2003

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ADVO, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except share data)

ASSETS	June 28, 2003	September 28, 2002
Current assets:		
Cash and cash equivalents	$ 19,284	$ 12,281
Accounts receivable, net	112,534	120,600
Inventories	2,871	2,415
Prepaid expenses and other current assets	8,754	7,140
Deferred income taxes	11,886	13,189
Total current assets	155,329	155,625
Property, plant and equipment	307,896	276,301
Less accumulated depreciation and amortization	(165,841)	(147,913)
Net property, plant and equipment	142,055	128,388
Investment in deferred compensation plan	11,481	10,311

Goodwill	22,246	22,124
Other assets	13,068	13,661
TOTAL ASSETS	$ 344,179	$ 330,109
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 32,500	$ 22,500
Notes payable - short term	--	1,715
Accounts payable	29,523	32,923
Accrued compensation and benefits	26,599	24,798
Other current liabilities	35,304	37,127
Total current liabilities	123,926	119,063
Long-term debt	113,000	146,750
Deferred income taxes	16,069	12,770
Deferred compensation plan	11,481	10,311
Other liabilities	4,763	4,885
STOCKHOLDERS' EQUITY		
Series A Convertible preferred stock, $.01 par value (Authorized 5,000,000 shares, none issued)	--	--
Common stock, $.01 par value (Authorized 40,000,000 shares, issued 30,725,135 and 30,594,410 shares, respectively)	307	306
Additional paid-in capital	208,940	205,164
Unamortized deferred compensation	(1,971)	(873)
Accumulated earnings	96,788	61,329
	304,064	265,926
Less common stock held in treasury, at cost	(229,310)	(228,473)
Accumulated other comprehensive income (loss)	186	(1,123)
Total stockholders' equity	74,940	36,330
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 344,179	$ 330,109

See Accompanying Notes.

ADVO, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Nine months ended		Three months ended	
	June 28, 2003	June 29, 2002	June 28, 2003	Jun 20

REVENUES	$ 867,929	$ 842,308	$ 289,686	$ 28
Costs and expenses:				
Cost of sales	640,432	616,130	213,810	20
Selling, general and administrative	163,940	161,198	53,739	5
Provision for bad debts	3,222	5,467	512	
OPERATING INCOME	60,335	59,513	21,625	1
Interest expense	6,070	10,035	1,499	
Other (income) expense, net	(864)	823	(317)	
Income before income taxes	55,129	48,655	20,443	1
Provision for income taxes	19,671	18,002	6,837	
NET INCOME	$ 35,458	$ 30,653	$ 13,606	$ 1
BASIC EARNINGS PER SHARE	$ 1.79	$ 1.54	$ .69	$
DILUTED EARNINGS PER SHARE	$ 1.77	$ 1.51	$ .68	$
Weighted average basic shares	19,818	19,963	19,849	2
Weighted average diluted shares	20,027	20,305	20,126	2

See Accompanying Notes.

ADVO, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Nine months ended	
	June 28, 2003	June 29, 2002
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 69,536	$ 58,138
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(38,858)	(21,932)
Proceeds from disposals of property, plant and equipment	549	331
Distributions from equity affiliates	815	71
Acquisitions/joint ventures, net of cash acquired	19	(1,429)
NET CASH USED BY INVESTING ACTIVITIES	(37,475)	(22,959)

Cash flows from financing activities:		
Revolving line of credit - net	(7,500)	(12,500)
Payments on long-term debt	(16,250)	(7,500)
Decrease in note payable - net	(1,715)	(2,391)
Proceeds from exercise of stock options	1,102	2,692
Purchase of common stock for treasury	(820)	(13,469)
NET CASH USED BY FINANCING ACTIVITIES	(25,183)	(33,168)
Effect of exchange rate changes on cash and cash equivalents	125	5
Increase in cash and cash equivalents	7,003	2,016
Cash and cash equivalents at beginning of period	12,281	17,728
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 19,284	$ 19,744
Noncash activities:		
Change in fair value of interest rate swap liabilities	1,090	2,876
Change in noncash portion of deferred compensation plan	1,370	341

See Accompanying Notes.

ADVO, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

Operating results for the nine-month period ended June 28, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending September 27, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in ADVO's annual report on Form 10-K for the fiscal year ended September 28, 2002.

Certain reclassifications have been made in the fiscal 2002 financial statements to conform to the fiscal 2003 presentation.

2. SUMMARY OF ACCOUNTING POLICIES

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("Statement") No. 143, "Accounting for Asset Retirement Obligations". Statement No. 143 establishes accounting standards for the recognition and measurement of legal obligations associated with the retirement of tangible long-lived assets and requires the recognition of a liability for an asset retirement obligation in the period in which it is incurred. The Company adopted Statement No. 143 at the beginning of fiscal 2003 and such adoption had no effect on the Company's financial position and results of operations.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and for the disposal of a segment of a business. The Company adopted Statement No. 144 at the beginning of fiscal 2003 and such adoption had no effect on the Company's financial position and results of operations.

In July 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which supercedes Emerging Issues Task Force Issue ("EITF") No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Associated with a Restructuring)". Statement No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred as opposed to when management is committed to an exit plan. Such liabilities should be recorded based on their fair value, as defined. This statement is effective for exit or disposal activities initiated after December 31, 2002. The Company recorded a severance charge in the first quarter of fiscal 2003 and recognized the liability in accordance with Statement No. 146.

In November 2002, the FASB issued Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Guarantees of Indebtedness of Others" which requires companies to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN No. 45 provides specific guidance for identifying the characteristics of contracts that are subject to its guidance in its entirety from those only subject to the initial recognition and measurement provisions. The recognition and measurement provisions of FIN No. 45 are effective on a prospective basis for guarantees issued or modified after December 31, 2002.

The disclosure requirements of FIN No. 45 are effective for interim and annual period financial statements ending after December 15, 2002. The Company's contingent consideration related to the acquisition of ADVO Canada in June 2002 is subject to the disclosure requirements of FIN No. 45. If certain earning targets are met by ADVO Canada, the Company will be required to pay an additional payment of up to a maximum of $0.7 million over the next three years. Upon completion of the first year, ADVO Canada met its earning targets and the previous shareholders received $0.2 million during the third quarter of fiscal 2003.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Statement No. 148 also amends the disclosure requirements of Statement No. 123, "Accounting for Stock-Based Compensation", to require more prominent and additional disclosure in both annual and interim financial statements on the method of accounting for stock-based compensation. The interim disclosure provisions are effective for financial reports for interim periods beginning after December 15, 2002. The Company adopted the disclosure provisions of Statement No. 148 in the second quarter of fiscal 2003. See Note 5 of the "Notes to Consolidated Financial Statements".

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" which addresses when a company should include in its financial statements the assets and liabilities of unconsolidated variable interest entities ("VIEs"). It defines VIEs as those entities in which equity investors do not have the characteristics of a controlling financial interest or in which equity investors do not bear the residual economic risks. FIN No. 46 is effective for fiscal years or interim periods beginning after June 15, 2003. The Company is currently evaluating the effect, if any, that FIN No. 46 may have on its financial statements in the fourth quarter of fiscal 2003.

3. COMPREHENSIVE INCOME

Comprehensive income for a period encompasses net income and all other changes in a company's equity other than from transactions with the company's owners. The Company's comprehensive income was as follows:

	Nine months ended		Three months e	
	June 28, 2003	June 29, 2002	June 28, 2003	J
(In thousands)				
Net income	$35,458	$30,653	$13,606	$
Other comprehensive income:				
Reclassification of unrealized gain on derivative instruments	1,090	2,876	--	
Foreign currency translation adjustments	219	9	128	
Total comprehensive income	$36,767	$33,538	$13,734	$

4. EARNINGS PER SHARE

Basic earnings per share excludes the effect of common stock equivalents, such as stock options, and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if common stock equivalents, such as stock options, were exercised.

	Nine months ended		Three months ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
(In thousands, except per share data)				
Net income	$35,458	$30,653	$13,606	$10,144
Weighted average basic shares	19,818	19,963	19,849	20,010
Effect of dilutive securities:				

Stock options	186	315	250	324
Restricted stock	23	27	27	19
Dilutive potential basic shares	209	342	277	343
Weighted average diluted shares	20,027	20,305	20,126	20,353
Basic earnings per share	$ 1.79	$ 1.54	$ .69	$ .51
Diluted earnings per share	$ 1.77	$ 1.51	$ .68	$ .50

5. STOCK - BASED COMPENSATION

The Company maintains several stock-based compensation plans relating to stock options. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25 ("APB Opinion No. 25") "Accounting for Stock Issued to Employees", and related Interpretations. Aside from the amortization of restricted stock awards, no stock-based employee compensation cost is reflected in net income, as all options granted under those plans have an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the Black-Scholes fair value method which is described in Statement No. 123, to stock-based employee compensation plans.

	Nine months ended		Three m
	June 28, 2003	June 29, 2002	June 28, 2003
(In thousands, except per share data)			
Net income, as reported	$ 35,458	$ 30,653	$ 13,606
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(3,026)	(3,500)	(1,176)
Pro forma net income	$ 32,432	$ 27,153	$ 12,430
Earnings per share:			
Basic - as reported	$ 1.79	$ 1.54	$ .69
Basic - pro forma	$ 1.64	$ 1.36	$ 63
Diluted - as reported	$ 1.77	$ 1.51	$ .68
Diluted - pro forma	$ 1.62	$ 1.35	$ 62

For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the stock options' vesting period, ranging from one to four years. The pro forma effect on net income and related earnings per share may not be representative of the future years' impact since the terms and conditions of new grants may vary from the current terms.

6. NON-RECURRING CHARGES

In the third quarter of fiscal 2002, the Company recorded a pre-tax charge of approximately $4.2 million, or $0.13 per share, in selling, general and administrative costs for structural changes to the sales and marketing organization.

ADVO, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section should be read in conjunction with the consolidated financial statements of the Company and the notes thereto.

RESULTS OF OPERATIONS

REVENUES The Company reported third quarter revenues of $289.7 million, increasing $8.7 million, or 3.1%, over prior year's third quarter. For the first nine months of fiscal 2003, revenues were $867.9 million, increasing $25.6 million, or 3.0%, over the comparable prior year period. The revenue gains for both the three and nine-month periods were primarily attributable to the volume growth in the Company's core shared mail products as demonstrated by the Company's key statistics and to a lesser degree pricing gains. Total shared mail pieces distributed increased 4.1% for the third quarter and 2.9% for the year-to-date period of fiscal 2003 over the comparable prior year periods of fiscal 2002. Total shared mail packages increased 0.1% and 1.5% for the three and nine months ended June 28, 2003 versus the same periods in the prior year. In addition, average pieces per package were 7.85 for both the third quarter and nine months ended June 28, 2003 growing 4.0% and 1.4%, respectively, over the prior quarter and year-to-date periods.

The third quarter and nine-month periods of fiscal 2003 included revenues of $1.1 million and $5.0 million, respectively, associated with the acquisition of ADVO Canada in June 2002. The revenue growth detailed above was offset in part by shifts in product mix and weights which contributed to the 1.4% and 0.5% decrease in revenue per thousand pieces for the third quarter and nine-months ended June 28, 2003, respectively.

OPERATING EXPENSES Cost of sales, as a percentage of revenue, was 73.8% for both the three and nine-month periods ended June 28, 2003, reflecting an increase over the prior year of 0.2 percentage points for the quarter and 0.7 percentage points for the nine-month year-to-date period. Cost of sales, in absolute terms, increased $7.0 million for the third quarter and $24.3 million for the first nine months of fiscal 2003 over the comparable periods of the prior year. Distribution costs, primarily consisting of postage costs, increased 5.1% for the third quarter and 5.2% for the current year-to-date period due to the shared mail package and piece growth in fiscal 2003 and the postal rate increase in the prior year. Also contributing to the cost of sales increase for the quarter and year-to-date periods of fiscal 2003 were higher facilities and overhead costs, which included such items as utilities, insurance and increased rent associated with the modernization of certain facilities. Offsetting these increased costs were efficiencies at the Company's branches. The Company's cost per thousand pieces manufactured decreased 6.6% and 5.6% for the current quarter and year-to-date period, respectively, as compared to the prior year periods even as the Company processed an increased number of pieces and packages.

As a percentage of revenues, selling, general and administrative ("SG&A") costs, including the provision for bad debts, decreased 0.8 percentage points to 18.7% for the third quarter of fiscal 2003 and 0.5 percentage points to 19.3% for the nine-month period ended June 28, 2003 reflecting the Company's commitment of strictly monitoring fixed costs. In absolute terms SG&A costs, including the provision for bad debts, decreased $0.6 million for the third quarter and increased $0.5 million for the nine-month year-to-date period when compared to the same periods in the prior year. SG&A costs included higher incentive compensation for the three and nine months ended June 28, 2003 but were offset to a degree by lower bad debt expense. SG&A costs for the current nine-month period included an $0.8 million severance charge pursuant to the departure of the Company's former Chief Financial Officer. The third quarter and nine-month year-to-date SG&A expenses of fiscal 2003 included $3.3 million and $6.7 million, respectively, of costs for a project focused on developing programs to accelerate the achievement of the Company's revenue growth potential. These costs included incremental consulting expenses, additional compensation and other re-deployed costs associated with the formation of this project group. In the prior year's quarter and year-to-date periods, SG&A costs included a $4.2 million charge relating to structural changes to strengthen the Company's sales and marketing organization.

OPERATING INCOME Operating income for the third quarter of fiscal 2003 was $21.6 million, increasing $2.3 million, or 12.0%, over the same period of the prior year. For the first nine months of fiscal 2003, operating income was $60.3 million, versus $59.5 million for the same period of fiscal 2002, increasing $0.8 million.

INTEREST EXPENSE For the third quarter and nine months of fiscal 2003, interest expense decreased $1.7 million and $4.0 million, respectively, compared to the same periods of the prior year. Contributing to this decrease were lower market rates of interest, a decrease in the average outstanding debt balance and the elimination of the Company's interest swap agreements at the beginning of December 2002.

OTHER INCOME/EXPENSE For the three and nine months ended June 28, 2003, other income of $0.3 million and $0.9 million, respectively, resulted primarily from the equity earnings of a newspaper partnership with the Company which was accounted for under the equity method. In the prior year's third quarter and year-to-date periods, other expense of $0.1 million and $0.8 million, respectively, included equity earnings of $0.1 million and equity losses of $0.3 million associated with the start up of the newspaper partnership.

INCOME TAXES The effective income tax rate for the three and nine months ended June 28, 2003 was approximately 33.4% and 35.7%, respectively versus 37% for the comparable periods in the prior year. The decrease in the tax rate was due to federal and state tax credits expected to be received by the end of the current fiscal year.

EARNINGS PER SHARE As a result of the Company's improved earnings, lower interest expense and higher other income, diluted earnings per share increased 36.0% to $0.68 for the third quarter of fiscal 2003 from $0.50 for the same period of the prior year. On a year-to-date basis, diluted earnings per share were $1.77 for the first nine months of fiscal 2003 versus $1.51 in the comparable prior year period, representing a 17.2% increase.

FINANCIAL CONDITION

Working capital decreased $5.2 million from $36.6 million at September 28, 2002 to $31.4 million at June 28, 2003. The decrease in working capital from the end of the prior year is attributable to a $0.3 million decrease in current assets and a $4.9 million increase in current liabilities. The components of current assets included: a $8.1 million decrease in accounts receivable attesting to the Company's focused collection efforts, offset by increases of $7.0 million in cash and cash equivalents and $1.6 million in prepaid and current assets due in part to higher insurance premiums.

The increase in current liabilities included: a $10.0 million increase in the current portion of long-term debt due to scheduled debt repayments and a $1.8 million increase in accrued compensation and benefits for higher incentive wages. These increases were offset by decreases of $3.4 million in accounts payable due the timing of vendor payments and $1.8 million in other current liabilities due to the timing of customer advances and the expiration of the Company's interest rate swap agreements.

Stockholders' equity increased $38.6 million to $74.9 million at June 28, 2003. The increase in stockholders' equity was primarily the result of the Company's $35.5 million year-to-date net income. Other increases were $2.8 million of stock and option related transactions by associates, a positive change of $1.1 million in the fair value of derivative instruments and cumulative foreign currency translation adjustments of $0.2 million. Offsetting these increases were treasury stock purchases of $0.9 million, which consisted of $0.7 million pursuant to elections by employees to satisfy tax withholding requirements under the Company's restricted stock and stock option plans and $0.2 million made on the open market during the first fiscal quarter associated with the Company's buyback program.

PROPERTY, PLANT AND EQUIPMENT

Capital expenditures for property, plant and equipment were $38.9 million for the nine-month period ending June 28, 2003. The Company is concentrating its capital investments on the development of software for its order fulfillment and service delivery redesign project. There were also capital outlays for Alphaliner computerized mail sorters, assorted computer hardware and renovations to certain of the Company's facilities. Capital expenditures for the entire year are expected to be in the high $40 million range.

LIQUIDITY

The Company's main source of liquidity continues to be funds generated from operating activities. The Company also has available unused credit commitments of $127.0 million, of which $117.4 million may be used to fund working capital requirements.

Cash and cash equivalents increased $7.0 million for the nine-month period ended June 28, 2003. The increase was derived from net cash provided by operating activities of $69.5 million offset by net investing activities of $37.5 million and net financing activities of $25.2 million.

Net cash provided by operating activities was $69.5 million for the period ended June 28, 2003. Principal contributing factors were the Company's net earnings and a decrease in accounts receivable due to stringent collection efforts counterbalanced by the timing of both vendor payments and customer advances. Net cash provided by operating activities increased $11.4 million over the prior year.

Investing activities for the nine-month period ended June 28, 2003 mainly related to capital expenditures for property, plant and equipment as previously discussed. For the prior period ended June 29, 2002 investing activities consisted of $21.9 million for capital expenditures and $1.4 million for the acquisition of ADVO Canada and a MailCoups franchisee.

Net cash used for financing activities for the periods ended June 28, 2003 and June 29, 2002 was $25.2 million and $33.2 million, respectively. In the current year debt payments of $23.8 million included net payments on the revolver and scheduled principal payments on the term loan. In addition, cash used for financing activities included the final payment of a $1.7 million note resulting from the acquisition of Mail Marketing Systems, Inc. ("MMSI"). These uses of cash were offset by proceeds of $1.1 million pursuant to stock option exercises. Financing activities in the prior year included debt payments of $20.0 million, payment of a $2.4 million note associated with the acquisition of MMSI and $13.5 million of treasury stock purchases offset by cash of $2.7 million generated from the exercise of options.

Contractual and commercial commitments

The Company's contractual obligations are as follows:

(In millions)	Long-term debt	Operating leases
Less than one year	$ 32.5	$ 15.4
One to three years	113.0	28.0
Four to five years	--	12.1
After five years	--	16.8
Total	$ 145.5	$ 72.3

ADVO, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's long-term debt obligations are discussed below in the "Financing Arrangements" section. The Company leases property in its normal business operations under noncancellable operating leases. Certain of these leases contain renewal options and certain leases also provide for cost escalation payments.

The Company has various agreements with International Business Machines Corporation ("IBM") Global Services to provide systems development, technical support, a customer support center and server farm management services to the Company. The noncancellable portions of these contracts have lapsed, allowing the Company the option to cancel these contracts subject to termination charges ranging from $12.7 million in fiscal 2003 to $0.2 million in fiscal 2008 depending on the year in which the cancellation becomes effective.

The Company has agreements with various paper suppliers to assure the continuity of supply as well as supply of proper paper grades. Approximately 70% of the Company's expected paper requirements are covered by these agreements. The Company has negotiated prices that are tied to a published paper price index. These arrangements expire at various dates through October 31, 2005.

The Company has outstanding letters of credit of approximately $9.6 million under separate agreements expiring in April 2004, primarily relating to its worker's compensation program.

The Company anticipates it will be able to meet its commitments detailed above through funds generated from operations or from unused credit under its revolving line of credit.

FINANCING ARRANGEMENTS

The Company maintains a credit agreement which provides for total credit facilities of $300 million, consisting of a $135 million term loan and a $165 million revolving line of credit. The $300 million credit facility has been reduced by scheduled term loan principal payments to date. At June 28, 2003, there was $145.5 million of debt outstanding, with $32.5 million classified as current due to scheduled principal payments. The Company anticipates it will be able to meet its debt obligations through funds generated from operations. During July 2003, the Company borrowed an additional $5.0 million under the revolving line of credit.

Under the terms of the credit agreement, the Company is required to maintain certain financial ratios. In addition, the credit agreement also places restrictions on disposals of assets, mergers and acquisitions, dividend payments, investments and additional debt.

NEW ACCOUNTING PRONOUNCEMENTS

The FASB has issued several Statements of Financial Accounting Standards that the Company adopted at the beginning of the fiscal year. For further discussion of these Statements see Note 2 of the "Notes to Consolidated Financial Statements".

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are defined as those that are most important to the portrayal of a company's financial condition and results and which require complex or subjective judgments or estimates. The preparation of financial statements in conformity with general accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates under different assumptions and conditions. The Company had determined its critical accounting policies to include the allowance for doubtful accounts and the valuation of goodwill and intangible assets.

Allowance for doubtful accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. On a monthly basis, the Company conducts meetings to identify and review potential problems, such as a bankruptcy filing or deterioration in the customer's financial condition, to ensure the Company is adequately accrued for potential loss. The Company also calculates a trended write-off of bad debts over a rolling twelve-month period and takes into account aging category and historical trends. If a customer's situation changes, such as bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts.

Valuation of goodwill and intangible assets

Goodwill represents the excess purchase price over the fair value of net assets acquired in connection with purchase business combinations. The Company is required to test goodwill annually for impairment. Impairment exists when the carrying amount of goodwill exceeds its fair market value. The Company's goodwill impairment test was performed by comparing the net present value of projected cash flows to the carrying value of goodwill. The Company utilized discount rates determined by management to be similar with the level of risk in the current business model. The Company performed the annual impairment testing during the third quarter of fiscal 2003 and determined that no impairment of goodwill exists. If the assumptions the Company made regarding estimated cash flows, such as future operating performance and other factors used to determine the fair value, are less favorable than expected, the Company may be required to record an impairment charge.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's interest expense is sensitive to changes in interest rates. In this regard, changes in interest rates affect the interest paid on its debt. To mitigate the impact of interest rate fluctuations, the Company had historically maintained interest rate swap agreements on notional amounts totaling $100 million. However, the interest rate swap agreements expired on December 9, 2002.

If interest rates should change by 2 percentage points for the remainder of the 2003 fiscal year from those rates in effect at June 28, 2003, assuming no change in the outstanding debt balance and considering the effects of the Company's interest rate swap agreements, interest expense would increase/decrease by approximately $0.7 million.

FORWARD LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Such forward looking statements are based on current information and expectations and are subject to risks and uncertainties that could cause the Company's actual results to differ materially from those in the forward looking statements. The Company's business is promotional in nature, and ADVO serves its clients on a "just in time" basis. As a result, fluctuations in the amount, timing, pages and weight, and kinds of advertising pieces can vary significantly from week to week, depending on its customers' promotional needs, inventories, and other factors. In any particular quarter these transactional fluctuations are difficult to predict, and can materially affect the Company's revenue and profit results. The Company's business contains additional risks and uncertainties which include but are not limited to: general changes in customer demand and pricing, the possibility of consolidation throughout the retail sector, the impact of economic and political conditions on retail advertising spending and our distribution system, postal and paper prices, possible governmental regulation or legislation affecting aspects of the Company's business, the efficiencies achieved with technology upgrades, the number of shares the Company will purchase in the future under its buyback program, fluctuations in interest rates related to the outstanding debt and other general economic factors.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company evaluated, under the supervision and with the participation of management, the principal executive officer and principal financial officer, the design and operation of its disclosure controls and procedures to determine whether they are effective in ensuring that the disclosure of required information is made timely in accordance with the Securities Exchange Act and the rules and forms of the Securities and Exchange Commission.

The principal executive officer and principal financial officer have concluded, based on their review, that the Company's disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-14(c) and 15d-14(c), were, as of the end of the period covered by this Quarterly Report on Form 10-Q, effective to ensure that information required to be disclosed by the Company in reports it files under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. No change to the Company's internal control over financial reporting occurred during the period covered by this Quarterly Report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibit Index

Exhibit No.	Exhibits
10	Executive Severance Agreement between James M. Dahmus and ADVO, Inc. dated April 17, 2003.
31.1	Certification Pursuant to Section 302 of the

	Sarbanes-Oxley Act of 2002 - Gary M. Mulloy.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - James M. Dahmus.
32.1	Certification of Periodic Report Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Gary M. Mulloy.
32.2	Certification of Periodic Report Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - James M. Dahmus.

(b) Reports on Form 8-K

The Company furnished a current report on Form 8-K dated July 17, 2003 which reported the Company's earnings press release for the third quarter ended June 28, 2003.

Omitted from this Part II are items which are inapplicable or to which the answer is negative for the period covered.

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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.

ADVO, Inc.

Date: August 11, 2003

By: /s/ JOHN D. SPERIDAKOS

John D. Speridakos
Vice President and Controller
(Principal Accounting Officer)

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