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KRONOS INC
Form 10-Q
May 13, 2002

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 March 30, 2002

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 0-20109

Kronos Incorporated

(Exact name of registrant as specified in its charter)

Massachusetts 04-2640942

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

297 Billerica Road, Chelmsford, MA 01824

(Address of principal executive offices) (Zip Code)

(978) 250-9800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

As of April 27, 2002, 19,678,776 shares of the registrant's common stock, \$.01 par value, were outstanding.

KRONOS INCORPORATED

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share amounts)
UNAUDITED

	Three Months Ended		
	March 30, 2002	March 31, 2001	March 31, 2000
Net revenues:			
Product	\$ 33,979	\$ 32,607	\$ 30,100
Service	45,955	35,026	35,026
	79,934	67,633	65,126
Cost of sales:			
Product	8,396	7,939	7,939
Service	22,930	20,342	20,342
	31,326	28,281	28,281

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Gross profit	48,608	39,352	
Operating expenses and other income:			
Sales and marketing	26,058	24,609	
Engineering, research and development	9,251	8,416	
General and administrative	5,075	4,476	
Amortization of intangible assets	724	1,853	
Other income, net	(1,314)	(1,559)	
Special charge	--	2,991	
	39,794	40,786	
Income before income taxes	8,814	(1,434)	
Income tax provision (benefit)	3,041	(502)	
Net income (loss)	\$ 5,773	\$ (932)	\$
Net income (loss) per common share:			
Basic	\$ 0.29	\$ (0.05)	\$
Diluted	\$ 0.28	\$ (0.05)	\$
Average common and common equivalent shares outstanding:			
Basic	19,760,008	18,747,669	19,5
Diluted	20,765,450	18,747,669	20,5

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
UNAUDITED

	March 2002
ASSETS	
Current assets:	
Cash and equivalents	\$ 14,
Marketable securities	25,
Accounts receivable, less allowances of \$9,525 at March 30, 2002 and \$7,151 at September 30, 2001	62,
Deferred income taxes	6,
Other current assets	22,
Total current assets	130,
Property, plant and equipment, net	36,

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Marketable securities	23,
Intangible assets	20,
Goodwill	56,
Deferred software development costs, net	17,
Other assets	16,

Total assets	\$ 301,
	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$	7,
Accrued compensation		24,
Accrued expenses and other current liabilities		14,
Deferred professional service revenues		28,
Deferred maintenance revenues		63,

Total current liabilities		137,
Deferred maintenance revenues		9,
Other liabilities		4,
Shareholders' equity:		
Preferred Stock, par value \$1.00 per share: authorized 1,000,000 shares, no shares issued and outstanding		-
Common Stock, par value \$.01 per share: authorized 50,000,000 shares, 19,911,952 and 19,154,138 shares issued at March 30, 2002 and September 30, 2001, respectively ..		
Additional paid-in capital		35,
Retained earnings		126,
Cost of Treasury Stock (205,685 shares and 95,787 shares at March 30, 2002 and September 30, 2001)		(9,
Accumulated other comprehensive income (loss):		
Foreign currency translation		(1,
Net unrealized (loss) gain on available-for-sale investments		(

Total shareholders' equity		150,

Total liabilities and shareholders' equity	\$	301,
		=====

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
UNAUDITED

	Six Months End	
	March 30,	March
	2002	2001
	-----	-----
Operating activities:		
Net income	\$ 11,970	\$ 1
Adjustments to reconcile net income to net cash and equivalents provided by operating activities:		

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Depreciation	4,405	3
Amortization of intangible assets	1,369	3
Amortization of deferred software development costs	4,629	4
Provision for deferred income taxes	45	(1)
Changes in certain operating assets and liabilities:		
Accounts receivable, net	21,497	13
Deferred maintenance revenue	(3,718)	(1)
Deferred professional service revenue	(3,625)	
Accounts payable, accrued compensation and other liabilities	(6,717)	
Taxes payable	(7,054)	(2)
Non cash portion of special charge	--	1
Other	1,928	
Tax benefit from exercise of stock options	9,654	2
	-----	-----
Net cash and equivalents provided by operating activities	34,383	26
Investing activities:		
Purchase of property, plant and equipment	(4,673)	(3)
Capitalization of software development costs	(5,958)	(5)
Increase in marketable securities	(16,704)	(25)
Acquisitions of businesses and technology, net of cash acquired	(27,311)	(2)
	-----	-----
Net cash and equivalents used in investing activities ...	(54,646)	(36)
Financing activities:		
Net proceeds from exercise of stock option and employee stock purchase plans	15,006	5
Purchase of treasury stock	(14,217)	(6)
Net investment in call option	(2,810)	
	-----	-----
Net cash and equivalents used in financing activities ...	(2,021)	
Effect of exchange rate changes on cash and equivalents	(27)	
	-----	-----
Decrease in cash and equivalents	(22,311)	(11)
Cash and equivalents at the beginning of the period	36,561	23
	-----	-----
Cash and equivalents at the end of the period	\$ 14,250	\$ 11
	=====	=====

See accompanying notes to condensed consolidated financial statements.

KRONOS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A - General

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals that management of Kronos Incorporated (the "Company") considers necessary for a fair presentation of the Company's financial position and results of operations as of and for the interim periods presented pursuant to the rules and regulations of the

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Securities and Exchange Commission. Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures in these financial statements are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the fiscal year ended September 30, 2001. The results of operations for the three and six months ended March 30, 2002 are not necessarily indicative of the results for a full fiscal year. Certain reclassifications have been made in the accompanying consolidated financial statements in order to conform to the fiscal 2002 presentation.

NOTE B - Fiscal Quarters

The Company utilizes a system of fiscal quarters. Under this system, the first three quarters of each fiscal year end on a Saturday. However, the fourth quarter of each fiscal year will always end on September 30. Because of this, the number of days in the first quarter (90 days in fiscal 2002 and 91 days in fiscal 2001) and fourth quarter (93 days in fiscal 2002 and 92 days in fiscal 2001) of each fiscal year varies from year to year. The second and third quarters of each fiscal year will be exactly thirteen weeks long. This policy does not have a material effect on the comparability of results of operations between quarters.

NOTE C - Other Current Assets

Other current assets consists of the following (in thousands):

	March 30, 2002	September 30, 2001
	-----	-----
Inventory	\$5,823	\$5,076
Prepaid income and other taxes	5,483	903
Prepaid commissions	4,163	4,633
Prepaid royalties	2,329	2,251
Prepaid expenses - other	4,449	2,956
	-----	-----
Total	\$22,247	\$15,819
	=====	=====

NOTE D - Goodwill and Other Intangible Assets - Adoption of Statements 141 and 142

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets" (the "Statements"). Under the new rules, goodwill (and intangible assets deemed to have indefinite lives) will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

For acquisitions completed prior to June 30, 2001, the Company has applied the new rules on accounting for business combinations and goodwill and other intangible assets beginning in the first quarter of fiscal 2002. For acquisitions completed after June 30, 2001, the Company has applied the new rules beginning in the fourth quarter of fiscal 2001.

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During the three-month period ended March 30, 2002, the Company completed the initial testing of the impairment of goodwill, as of October 1, 2001. As a result of the test, the Company has concluded that no impairment of goodwill exists as of October 1, 2001.

The following table presents the impact of the new standards related to goodwill amortization (and related tax effects) on net income and earnings per share, as if they had been in effect for the three and six months ended March 31, 2001 (in thousands, except per share data).

	Three Months Ended		Six Months Ended	
	March 30, 2002	March 31, 2001	March 30, 2002	March 31, 2001
Reported net income	\$ 5,773	\$ (932)	\$ 11,970	\$ 1,856
Add back: Goodwill amortization	--	875	--	1,700
Adjusted net income	<u>\$ 5,773</u>	<u>\$ (57)</u>	<u>\$ 11,970</u>	<u>\$ 3,556</u>
Basic earnings-per-share:				
Reported net income	\$ 0.29	\$ (0.05)	\$ 0.61	\$ 0.10
Goodwill amortization	--	0.05	--	0.09
Adjusted net income	<u>\$ 0.29</u>	<u>\$ 0.00</u>	<u>\$ 0.61</u>	<u>\$ 0.19</u>
Diluted earnings-per-share:				
Reported net income	\$ 0.28	\$ (0.05)	\$ 0.58	\$ 0.10
Goodwill amortization	--	0.05	--	0.09
Adjusted net income	<u>\$ 0.28</u>	<u>\$ 0.00</u>	<u>\$ 0.58</u>	<u>\$ 0.18</u>

Acquired intangible assets subject to amortization are presented in the following table.

(in thousands)		
As of March 30, 2002		
	Gross Carrying Amount	Accumulated Amortization
Customer related	\$18,875	\$5,757
Maintenance relationships	6,004	287
Non-compete agreements and other	2,618	1,265
	<u>\$27,497</u>	<u>\$7,309</u>

For the three and six months ended March 30, 2002, amortization expense for intangible assets was \$0.7 million and \$1.4 million, respectively. The estimated

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annual amortization expense for intangible assets for the current and next five fiscal years is as follows (in thousands):

Fiscal Year Ending September 30,	Estimated annual amortization expense
2002	\$2,843
2003	2,853
2004	2,476
2005	2,029
2006	1,989
2007	1,974

NOTE E - Acquisitions

On November 29, 2001, the Company completed the acquisition of certain assets and the ongoing business operations of NW Micro-Technics, Inc. ("NWM"), the former Oregon-based Kronos dealer. The aggregate purchase price was not material to the Company's financial position. The results of NWM's operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since that date. NWM was engaged in the sale and service of employee time and attendance, employee scheduling, data collection and labor management hardware and software systems, including the resale of the Company's products through a dealer relationship. As a result of the acquisition, the Company gains access to existing and prospective customers in the northwestern United States region through its direct sales and service organizations, as well as access to the existing maintenance revenue stream from NWM customers.

On December 28, 2001, the Company completed the acquisition of certain assets and the ongoing business operations of the Integrated Software Business of SimplexGrinnell's Workforce Solutions Division ("SimplexGrinnell"). The aggregate purchase price was \$22.1 million in cash. The results of SimplexGrinnell's operations have been included in the consolidated financial statements since that date. SimplexGrinnell was engaged in the development, sales and support of integrated workforce management software solutions. As a result of the acquisition, the Company expects to increase its presence in the mid-market sector, which includes companies with between 100 and 1,000 employees.

The transaction was accounted for under the purchase method of accounting and accordingly, the assets and liabilities acquired were recorded at their estimated fair values at the effective date of the acquisition. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition (in thousands).

At December 28, 2001	
Accounts receivable	\$6,773
Intangible assets	3,600
Goodwill	17,783
Other assets	743

Total assets acquired	28,899
Deferred professional services revenue	(1,564)
Deferred maintenance revenue	(5,161)
Other liabilities	(124)

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Total liabilities assumed	(6,849)
Net assets acquired	\$22,050

Due to the timing of the SimplexGrinnell acquisition, the Company has not finalized the allocation of the purchase price.

The following table presents the consolidated results of operations on an unaudited pro forma basis as if the acquisition of SimplexGrinnell had taken place at the beginning of the periods presented. The following table has been prepared on the basis of estimates and assumptions available at the time of this filing that the Company and SimplexGrinnell believe are reasonable under the circumstances (in thousands, except per share data).

	Three Months Ended		Six Months Ended	
	March 30, 2002	March 31, 2001	March 30, 2002	March 31, 2001
Total revenues	\$ 79,934	\$ 72,829	\$ 162,632	\$ 144,386
Net income	5,773	(2,056)	10,807	(1,275)
Earnings per share - basic .	\$ 0.29	\$ (0.11)	\$ 0.55	\$ (0.07)
Earnings per share - diluted	\$ 0.28	\$ (0.11)	\$ 0.53	\$ (0.07)

The unaudited pro forma results of operations are for comparative purposes only and do not necessarily reflect the results that would have occurred had the acquisitions occurred at the beginning of the periods presented or the results which may occur in the future.

On February 20, 2002, the Company completed the acquisition of certain assets and the ongoing business operations of Packard Business Systems, Inc. ("Packard"), the former West Virginia-based Kronos dealer. The aggregate purchase price was not material to the Company's financial position. The results of Packard's operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since that date. Packard was engaged in the sale and service of employee time and attendance, employee scheduling, data collection and labor management hardware and software systems, including the resale of the Company's products through a dealer relationship. As a result of the acquisition, the Company gains access to existing and prospective customers in the West Virginia area through its direct sales and service organizations, as well as access to the existing maintenance revenue stream from Packard customers.

On March 18, 2002, the Company completed the acquisition of the outstanding stock of Data Collection Systems Ltd. ("DCS"), a provider of time and attendance applications headquartered in the U.K. The aggregate purchase price was not material to the Company's financial position. The results of DCS's operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since that date. As a result of the acquisition, the Company gains access to existing and prospective customers in the U.K. through its subsidiary in the U.K., Kronos Systems Ltd., as well as access to the existing maintenance revenue stream from DCS customers.

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NOTE F - Source Code License Agreement

On March 15, 2002, the Company entered into an agreement with Best Software Inc. ("Best") to acquire a limited license to the source code and object code for Best's human resources and payroll software (Abra Enterprise (TM)). Under the terms of the agreement, Best will provide the Abra Enterprise source code to the Company and give the Company the right to reproduce, market and sublicense the software. The Company will integrate Abra Enterprise into its Workforce Central(TM) suite and will market and sublicense the integrated product suite. Per the terms of the agreement, the Company shall pay to Best a one-time technology delivery fee, a portion of which is being amortized over a five (5) year period and is included in other assets on the balance sheet. The agreement also requires the Company to pay minimum royalties for the first five (5) years of the agreement with royalty payments based on the number of licensed employees continuing for an aggregate period of ten (10) years.

NOTE G - Comprehensive Income

For the three and six months ended March 30, 2002 and March 31, 2001, comprehensive income (loss) consisted of the following (in thousands):

	Three Months Ended		Six Months Ended	
	March 30, 2002	March 31, 2001	March 30, 2002	March 31, 2001
Comprehensive income (loss):				
Net income (loss)	\$ 5,773	\$ (932)	\$ 11,970	\$ 1,856
Cumulative translation adjustment	125	(666)	328	(540)
Unrealized (loss) gain on available-for-sale securities ...	(274)	200	(425)	405
	-----	-----	-----	-----
Total comprehensive income (loss)	\$ 5,624	\$ (1,398)	\$ 11,873	\$ 1,721

NOTE H - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended		Six Months Ended	
	March 30, 2002	March 31, 2001	March 30, 2002	March 31, 2001
Net income (loss)	\$ 5,773	\$ (932)	\$ 11,970	\$ 1,856
	=====	=====	=====	=====
Weighted-average shares	19,760,008	18,747,669	19,582,466	18,650,372
Effect of dilutive securities:				
Employee stock options ...	1,005,442	--	994,361	604,368
	-----	-----	-----	-----

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Adjusted weighted-average shares and assumed conversions	20,765,450	18,747,669	20,576,827	19,254,740
	=====	=====	=====	=====
Basic earnings per share	\$ 0.29	\$ (0.05)	\$ 0.61	\$ 0.10
	=====	=====	=====	=====
Diluted earnings per share ...	\$ 0.28	\$ (0.05)	\$ 0.58	\$ 0.10
	=====	=====	=====	=====

NOTE I - Stock Split

On October 25, 2001, the Company's Board of Directors approved a three-for-two stock split effected in the form of a 50% stock dividend. This stock dividend was paid on November 15, 2001 to stockholders of record as of November 5, 2001. Accordingly, the presentation of shares outstanding and amounts per share have been restated for all periods presented to reflect the split. The par value of the additional shares was transferred from additional paid-in capital to Common Stock.

NOTE J - New Accounting Pronouncements

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. This statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 is effective for the Company October 1, 2002, and early adoption is allowed. The Company does not expect SFAS No. 144 to have a material effect on its earnings or financial position.

In January 2002, the Emerging Issues Task Force (EITF) issued EITF No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred" (formerly EITF Abstracts, Topic No. D-103). This EITF requires that reimbursements received for out-of-pocket expenses incurred should be characterized as revenue in the income statement as opposed to a reduction of expenses incurred. Out-of-pocket expenses include travel expenses such as airfare, hotel, mileage and meals that the customer will reimburse the service vendor. The EITF is effective for financial reporting periods beginning after December 15, 2001. As a result of the adoption of the EITF, service revenues and the corresponding cost of sales increased by \$0.3 million for the three month periods ended March 30, 2002 and March 31, 2001, and by \$0.6 million and \$0.5 million for the six month periods ended March 30, 2002 and March 31, 2001, respectively.

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

Forward Looking Statements

This discussion includes certain forward-looking statements about Kronos' business and its expectations, including statements relating to revenues derived from prior acquisitions, revenue growth rates and gross profit, operating expenses, future acquisitions and available cash, investments and operating cash flow. Any such statements are subject to risk that could cause the actual

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results to vary materially from expectations. For a further discussion of the various risks that may affect Kronos' business and expectations, see "Certain Factors That May Affect Future Operating Results" at the end of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Critical Accounting Policies

Management's discussion and analysis of financial condition and results of operations are based upon Kronos' consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires Kronos to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. Kronos bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions.

Kronos has identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of consolidated financial statements. This listing is not a comprehensive list of all of Kronos' accounting policies. Please refer to Note A in the Notes to Consolidated Financial Statements in Item 14 of Kronos' Annual Report on Form 10-K for the year ended September 30, 2001 for further information.

Revenue Recognition - Kronos recognizes revenues in accordance with the provisions of the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, "Software Revenue Recognition," as amended by SOP 98-9, "Modification of SOP 97-2, With Respect to Certain Transactions." Product revenue from sales and sales-type leases is recognized upon shipment when a noncancelable agreement has been signed, there are no uncertainties surrounding product acceptance, the fees are fixed and determinable and collection is probable. Revenue earned on software arrangements involving multiple elements which qualify for separate element treatment is allocated to each element based on the relative fair values of those elements based on vendor specific objective evidence. In instances where vendor specific objective evidence does not exist for delivered elements, typically software products, the residual method is used to recognize revenue. Typically software fees are due within one year from date of contract signing. If the fee due from the customer is not fixed or determinable, including payment terms greater than one year from contract signing, revenue is recognized as payments become due and all other conditions for revenue recognition have been satisfied. Revenues from maintenance agreements are recognized ratably over the contractual period and all other service revenues are recognized as the services are performed.

Allowance for Doubtful Accounts and Sales Returns Allowance - Kronos maintains an allowance for doubtful accounts to reflect estimated losses resulting from the inability of customers to make required payments. This allowance is based on estimates made by Kronos after consideration of factors such as the composition of the accounts receivable aging, bad debt history, and customer creditworthiness. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances and bad debt expense may be required. In addition, Kronos maintains a sales returns allowance to reflect estimated losses for sales returns and adjustments. This allowance is established by Kronos using estimates based on historical experience. If Kronos experiences an increase in sales returns and adjustments, additional allowances and charges against revenue may be required.

Valuation of Intangible Assets and Goodwill - In assessing the recoverability of goodwill and other intangible assets, Kronos must make

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assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, Kronos may be required to record impairment charges against these assets in the reporting period in which the impairment is determined. For intangible assets, this evaluation includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over their estimated useful lives, Kronos will record an impairment charge in the amount by which the carrying value of the assets exceeds their fair value. For goodwill, the impairment evaluation includes a comparison of the carrying value of the reporting unit which houses goodwill to that reporting unit's fair value. The fair value of the reporting unit is based upon the net present value of future cash flows, including a terminal value calculation. If the reporting unit's estimated fair value exceeds the reporting unit's carrying value, no impairment of goodwill exists. If the fair value of the reporting unit does not exceed its carrying value, then further analysis would be required to determine the amount of the impairment, if any. For the first six months of fiscal 2002, no impairment was recorded.

Capitalization of Software Development Costs - Costs incurred in the research, design and development of software for sale to others are charged to expense until technological feasibility is established. Thereafter, software development costs are capitalized and amortized to product cost of sales on a straight-line basis over the lesser of three years or the estimated economic lives of the respective products, beginning when the products are offered for sale. Costs incurred in the development of software for internal use are charged to expense until it becomes probable that future economic benefits will be realized. Thereafter, certain costs are capitalized and amortized to operating expense on a straight-line basis over the lesser of three years or the estimated economic life of the software.

Results of Operations

Revenues. Revenues for the three and six month periods ended March 30, 2002 were \$79.9 million and \$156.1 million, respectively, as compared to \$67.6 million and \$132.8 million for the comparable periods in the prior year. Revenue growth was 18% for both the three and six month periods ended March 30, 2002, as compared to 9% and 5% in the comparable periods in the prior year. The revenue growth rates experienced in the three and six month periods ended March 30, 2002 were primarily attributable to the continued increase in demand for Kronos' services. In addition, revenues were favorably impacted by acquisition of businesses over the preceding four quarters. The revenue growth rate experienced in the second quarter of fiscal 2001 was principally due to the unusually low growth rate experienced in the second quarter of fiscal 2000.

On December 28, 2001, Kronos acquired certain assets and the ongoing business operations of the Integrated Software Business of SimplexGrinnell's Workforce Solutions Division ("SimplexGrinnell"). The revenues and results of operations related to the acquisition are included in the three and six month periods ended March 30, 2002. Kronos presently anticipates that revenue growth, including revenues from customers obtained in the acquisition of businesses, will range between 12% - 17% in the third quarter of fiscal 2002 and range between 14% - 17% for all of fiscal 2002.

Product revenues for the quarter increased 4% to \$34.0 million as compared to \$32.6 million and a product revenue increase of 2% in the second quarter of fiscal 2001. Product revenue for the first six months of fiscal 2002 increased 4% to \$69.2 million as compared to \$66.6 million and a product revenue decline of 2% in the first six months of fiscal 2001. The product revenue growth experienced in the three and six month periods ended March 30, 2002 was

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attributable to revenues related to the conversion to Kronos products and add-on sales to customers acquired from other providers of labor management solutions. Product revenue derived from acquired customers was \$2.7 million and \$3.4 million in the three and six month periods ended March 30, 2002, respectively. Management believes that, as a result of various factors including the broad economic slowdown, many transactions, particularly those of larger transaction value, have been deferred. The deferral of various transactions has negatively impacted the organic revenue growth rates in the three and six month periods ended March 30, 2002.

Service revenues for the second quarter of fiscal 2002 increased to \$46.0 million as compared to \$35.0 million in the second quarter of fiscal 2001. Service revenues for the first six months of fiscal 2002 were \$86.9 million as compared to \$66.2 million for the first six months of the prior year. Service revenues increased 31% in both the three and six months ended March 30, 2002. Excluding the effect of incremental service revenues from acquisition of businesses in the preceding four quarters, service revenues increased 14% and 18% in the three and six month periods ended March 30, 2002, respectively. In addition to the acquisition of businesses, the growth in service revenues in the three and six month periods ended March 30, 2002 reflects an increase in the level of professional services accompanying new and upgrade sales and, to a lesser extent, an increase in maintenance revenue from the expansion of the installed base and the level of services sold to the installed base. Service revenues grew at a rate of 18% and 14% during the three and six month periods ended March 31, 2001, respectively. The growth in service revenues in these prior periods reflect an increase in maintenance revenue from expansion of the installed base, increased level of services sold to the installed base and, to a lesser extent, incremental maintenance revenues resulting from Kronos' acquisitions of various dealer territories.

Gross Profit. Gross profit as a percentage of revenues was 61% for the three and six month periods ended March 30, 2002, as compared to 58% and 59% for the same periods of the prior year. The improvement in gross profit in the three and six month periods ended March 30, 2002 was attributable to an increase in service gross profit, which was partially offset by a decrease in product gross profit in these periods. Management anticipates gross profit to be between 61% and 63% over the remainder of the fiscal year. Product gross profit as a percentage of product revenues was 75% and 76% in the three and six month periods ended March 30, 2002, respectively, compared to 76% in the same periods of the prior year. The decrease in product gross profit in this quarter is primarily related to higher royalty costs, higher production costs attributable to a newly released terminal, and higher costs associated with the SimplexGrinnell product line. This decrease is partially offset by a higher proportion of software sales that typically carry a higher gross profit than hardware sales.

Service gross profit as a percentage of service revenues was 50% for the three and six month periods ended March 30, 2002, compared to 42% in the same periods of the prior year. The improvement in service gross profit is attributable to increased productivity in the service organization. The improvement in productivity is the result of leveraging investments in service systems to more effectively manage the resources required to deliver professional services and customer support.

Net Operating Expenses. Net operating expenses as a percentage of revenues were 50% and 49% for the three and six month periods ended March 30, 2002, respectively, as compared to 60% and 57% for the same periods in the prior year. The decrease in operating expenses as a percentage of revenues was primarily due to the special charge recorded in the second quarter of fiscal 2001 and the elimination of goodwill amortization due to Kronos' adoption of Statements of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations" and

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No. 142 ("SFAS 142") "Goodwill and Other Intangible Assets" effective October 1, 2001 (see Note D in the Notes to Condensed Consolidated Financial Statements). On a pro forma basis, excluding the special charge and amortization expense, net operating expenses as a percentage of revenues for the three and six month periods ended March 31, 2001 were 54% and 53%, respectively.

Sales and marketing expenses as a percentage of revenues were 33% for the three and six month periods ended March 30, 2002, as compared to 36% and 35% for the comparable periods in the prior year. The decrease in sales and marketing expense as a percent of revenue was attributable to leveraging our investment in infrastructure to generate higher sales volumes. Engineering, research and development expenses as a percentage of revenues were 12% and 11% for the three and six month periods ended March 30, 2002 as compared to 12% for the comparable periods in the prior year. The decrease as a percentage of revenues for the six month period ended March 30, 2002 as compared to the same period in the prior fiscal year was due to higher sales volume. Engineering expenses of \$9.3 million and \$8.4 million in the second quarter of fiscal 2002 and 2001, respectively, are net of capitalized software development costs of \$3.0 million and \$2.8 million, respectively. Engineering expenses of \$17.2 million and \$16.3 million in the first six months of fiscal 2002 and 2001, respectively, are net of capitalized software development costs of \$5.6 million and \$5.5 million, respectively. General and administrative expenses as a percentage of revenues were 6% in the three and six month periods ended March 30, 2002 as compared to 7% in three month period ended March 31, 2001 and 6% in the six month period ended March 31, 2001. Amortization of intangible assets as a percentage of revenues was 1% in the three and six month periods ended March 30, 2002 as compared to 3% in the comparable periods of the prior year. The decrease in amortization is the result of the elimination of goodwill amortization described above. Other income, net is principally attributable to interest income earned from Kronos' cash as well as investments in its marketable securities and lease portfolio. Management anticipates that operating expenses, as a percent of revenues in the final six months of fiscal 2002 will be less than that experienced in the first six months of fiscal 2002.

Prior Year Special Charge. A special charge in the amount of \$3.0 million related to the termination of Kronos' Crosswinds Technology operations was recorded in the second quarter of fiscal 2001. The Crosswinds Technology Group, which was purchased in May 1999, was responsible for the product development, marketing and sales support of time and attendance applications that operated as a Microsoft Outlook plug-in product. Lower than anticipated sales of these applications, redundant infrastructure and ongoing operating losses has resulted in the termination of the stand-alone operating unit. Revenues in the first six months of fiscal 2001 generated by the Crosswinds Technology Group approximated \$0.5 million. The \$3.0 million charge consists of \$1.6 million in termination costs, \$1.3 million for the write off of intangible assets and \$0.1 million in other costs.

Income Taxes. For the three and six month periods ended March 30, 2002, the income tax provisions as a percentage of pretax income were 34.5% and 34.8%, respectively. As a percentage of pretax income, the three month period ended March 31, 2001 had a tax benefit of 35.0% and the six month period ended March 31, 2001 had a tax provision of 35.0%. Kronos' effective income tax rate may fluctuate between periods as a result of various factors, none of which is material, either individually or in the aggregate, to the consolidated results of operations.

Newly Issued Accounting Standards. In June 2001, the Financial Accounting Standards Board (the "FASB") issued SFAS 141 and SFAS 142. Under the new rules, goodwill (and intangible assets deemed to have indefinite lives) will no longer be amortized but will be subject to annual impairment tests in accordance with

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the Statements. Other intangible assets will continue to be amortized over their useful lives.

For acquisitions completed prior to June 30, 2001, the Company applied the new rules on accounting for business combinations and goodwill and other intangible assets beginning in the first quarter of fiscal year 2002. For acquisitions completed after June 30, 2001, Kronos applied the new rules beginning in the fourth quarter of fiscal 2001. On a pro forma basis, Kronos would have realized an increase in net income of \$0.9 million, or \$0.05 per diluted share for the three months ended March 31, 2001 and \$1.7 million, or \$0.09 per diluted share for the six months ended March 31, 2001, if these new standards had been applied to the first six months of fiscal 2001. During the second quarter of fiscal 2002, Kronos completed the initial testing of the impairment of goodwill, as of October 1, 2001. As a result of the test, Kronos has concluded that no impairment of goodwill exists as of October 1, 2001.

In October 2001, the FASB issued Statements of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. This statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS 144 is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years, with early application encouraged. Kronos does not expect SFAS No. 144 to have a material effect on its earnings or financial position.

In January 2002, the Emerging Issues Task Force (EITF) issued EITF No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred" (formerly EITF Abstracts, Topic No. D-103). This EITF requires that reimbursements received for out-of-pocket expenses incurred should be characterized as revenue in the income statement as opposed to a reduction of expenses incurred. Out-of-pocket expenses include travel expenses such as airfare, hotel, mileage and meals that the customer will reimburse the service vendor. The EITF is effective for financial reporting periods beginning after December 15, 2001. As a result of the adoption of the EITF, service revenues and the corresponding cost of sales increased by \$0.3 million for the three month periods ended March 30, 2002 and March 31, 2001, and by \$0.6 million and \$0.5 million for the six month periods ended March 30, 2002 and March 31, 2001, respectively.

Liquidity and Capital Resources

As of March 30, 2002, Kronos had negative working capital of \$6.8 million as compared to working capital of \$11.1 million at September 30, 2001. Kronos believes that this decrease in working capital is principally due to cash spent on the acquisition of businesses and technology and the purchase of treasury stock during the first six months of fiscal 2002. During the first six months of fiscal 2002, working capital was reduced as Kronos used available cash of \$27.3 million to complete acquisitions of businesses with a net working capital of \$0.5 million and an acquisition of technology. In addition, Kronos completed purchases of common shares of approximately \$14.2 million during the first six months of fiscal 2002 for share repurchases pursuant to Kronos' stock repurchase program as well as the purchase of mature stock from employees related to the exercise of stock options. Cash, cash equivalents and marketable securities amounted to \$63.2 million as of March 30, 2002, and \$68.8 million as of September 30, 2001. The decline in cash, cash equivalents and marketable securities in the first six months of fiscal 2002 is primarily attributable to

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cash used in the Company's acquisitions and stock repurchases.

Cash generated from operations amounted to \$34.4 million in the first six months of fiscal 2002 as compared to \$26.5 million in the first six months of fiscal 2001. The increase in cash generated from operations is primarily attributable to collections of accounts receivable and an increase in net income, partially offset by a decrease in deferred revenues and payments of bonuses and commissions. Also contributing to the increase in cash generated from operations is an increase in the tax benefit from exercise of stock options, however, this is substantially offset by the corresponding reduction in income taxes payable. Cash used for property, plant and equipment was \$4.7 million in the first six months of fiscal 2002 compared to \$3.0 million in the same period of fiscal 2001. Kronos' use of cash for the acquisition of businesses and technology in the first six months of fiscal 2002 was principally related to the acquisitions of specified assets and/or businesses of Kronos' dealers and/or other providers of labor management solutions as well as the acquisition of the source code license for the Abra Enterprise human resources and payroll software. Kronos is assessing several acquisition opportunities that may be completed over the next twelve months, although there can be no assurance that these acquisitions will be completed. Excess cash reserves not required for operations, investments in property, plant and equipment or acquisitions are invested in marketable securities. Marketable securities increased by \$16.7 million in the first six months of fiscal 2002 compared to an increase of \$25.8 million in the first six months of fiscal 2001.

Under Kronos' stock repurchase program, Kronos repurchased 230,500 common shares in the first six months of fiscal 2002 at a cost of \$10.4 million compared to 202,500 common shares at a cost of \$4.9 million for the same period in the prior year. The common shares repurchased under the program are used for Kronos' employee stock option plans and employee stock purchase plan. Cash provided by operations was sufficient to fund investments in capitalized software development costs, property, plant and equipment and stock repurchases. Kronos believes that with cash generated from ongoing operations it has adequate cash and investments and operating cash flow to fund its investments in property, plant and equipment, software development costs, cash payments related to acquisitions, if any, and any additional stock repurchases for the foreseeable future. If the need arose, Kronos believes that based on its current debt-free balance sheet and its financial position, it would be successful in securing financing from the capital markets.

During the quarter ended March 30, 2002, Kronos did not engage in:

- o material off-balance sheet activities, including the use of structured finance or special purpose entities,
- o trading activities in non-exchange traded contracts, or
- o transactions with persons or entities that benefit from their non-independent relationship with Kronos.

Certain Factors That May Affect Future Operating Results

Except for historical matters, the matters discussed in this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). Kronos desires to take advantage of the safe harbor provisions of the Act and is including this statement for the express purpose of availing itself of the protection of the safe harbor with respect to all forward looking statements that involve risks and uncertainties.

Kronos' actual operating results may differ from those indicated by forward

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looking statements made in this Quarterly Report on Form 10-Q and presented elsewhere by management from time to time because of a number of factors including the potential fluctuations in quarterly results, timing and acceptance of new product introductions by Kronos and its competitors, the dependence on Kronos' time and attendance product line, the ability to attract and retain sufficient technical personnel, competitive pricing pressure, and the dependence on alternate distribution channels and on key vendors, as further described below and in Kronos' Annual Report on Form 10-K for the fiscal year ended September 30, 2001, which are specifically incorporated by reference herein.

Potential Fluctuations in Quarterly Results. Kronos' quarterly operating results may fluctuate as a result of a variety of factors, including the purchasing patterns of its customers, mix of products and services sold, the ability of Kronos to effectively integrate acquired businesses into Kronos' operations, the timing of the introduction of new products and product enhancements by Kronos and its competitors, the strategy employed by Kronos to enter the Human Resource (HR)/Payroll market, market acceptance of new products, competitive pricing pressure and general economic conditions. Kronos historically has realized a relatively larger percentage of its annual revenues and profits in the fourth quarter and a relatively smaller percentage in the first quarter of each fiscal year, although there can be no assurance that this pattern will continue. In addition, while Kronos has contracts to supply systems to certain customers over an extended period of time, substantially all of Kronos' product revenue and profits in each quarter result from orders received in that quarter. If near-term demand for Kronos' products weakens or if significant anticipated sales in any quarter do not close when expected, Kronos' revenues for that quarter will be adversely affected. Kronos believes that its operating results for any one period are not necessarily indicative of results for any future period.

Product Development and Technological Change. Continual change and improvement in computer software and hardware technology characterize the markets for frontline labor management systems. Kronos' future success will depend largely on its ability to enhance the capabilities and increase the performance of its existing products and to develop new products and interfaces to third party products on a timely basis to meet the increasingly sophisticated needs of its customers. Although Kronos is continually seeking to further enhance its product offerings and to develop new products and interfaces, including products for the HR/Payroll market, there can be no assurance that these efforts will succeed, or that, if successful, such product enhancements or new products will achieve widespread market acceptance, or that Kronos' competitors will not develop and market products which are superior to Kronos' products or achieve greater market acceptance.

Dependence on Time and Attendance Product Line. To date, more than 90% of Kronos' revenues have been attributable to sales of time and attendance systems and related services. Although Kronos has announced its intention to enter the licensed HR/Payroll market this fiscal year, Kronos expects that its dependence on the time and attendance product line for revenues will continue for the foreseeable future. Competitive pressures or other factors could cause Kronos' time and attendance products to lose market acceptance or experience significant price erosion, adversely affecting the results of Kronos' operations.

Dependence on Alternate Distribution Channels. Kronos markets and sells its products through its direct sales organization, independent dealers and its OEM partner, ADP, Inc ("ADP"). In the first six months of fiscal 2002, approximately 13% of Kronos' revenue was generated through sales to dealers and ADP. Management does not anticipate that its intention to enter the HR/Payroll market will have a negative impact on its relationship with ADP. However, a reduction in the sales efforts of Kronos' major dealers and/or ADP, or termination or changes in their relationships with Kronos, could have a material adverse affect

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on the results of Kronos' operations.

Competition. The frontline labor management industry and the HR/Payroll market are highly competitive. The number of competitors is also increasing as applications and systems providers such as human resources management, payroll processing and enterprise resource planning (ERP), enter these markets. Technological changes such as those allowing for increased use of the Internet have also resulted in new entrants into the markets. Although Kronos believes it has core competencies that are not easily obtainable by competitors, maintaining Kronos' technological and other advantages over competitors will require continued investment by Kronos in research and development and marketing and sales programs. There can be no assurance that Kronos will have sufficient resources to make such investments or be able to achieve the technological advances necessary to maintain its competitive advantages. Increased competition could adversely affect Kronos' operating results through price reductions and/or loss of market share.

Attracting and Retaining Sufficient Technical Personnel for Product Development, Support and Sales. Kronos has encountered intense competition for experienced technical personnel for product development, technical support and sales and expects such competition to continue in the future. Any inability to attract and retain a sufficient number of qualified technical personnel could adversely affect Kronos' ability to produce, support and sell products in a timely manner.

Protection of Intellectual Property. Kronos has developed, and through its acquisitions of businesses, acquired, proprietary technology and intellectual property rights. Kronos' success is dependent upon its ability to further develop and protect its proprietary technology and intellectual property rights. Kronos seeks to protect products, software, documentation and other written materials primarily through a combination of trade secret, patent, trademark and copyright laws, confidentiality procedures and contractual provisions. While Kronos has attempted to safeguard and maintain its proprietary rights, it is unknown whether Kronos has been or will be successful in doing so.

Despite Kronos' efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of its products or obtain and use information that is regarded as proprietary. Policing unauthorized use of Kronos' products is difficult. While Kronos is unable to determine the extent to which piracy of its software products exists, software piracy can be expected to be a persistent problem, particularly in foreign countries where the laws may not protect proprietary rights as fully as in the United States. Kronos can offer no assurance that it can adequately protect its proprietary rights or that its competitors will not reverse engineer or independently develop similar technology.

Infringement of Intellectual Property Rights. Kronos cannot provide assurance that others will not claim that Kronos developed or acquired intellectual property rights are infringing on their intellectual property rights or that Kronos does not in fact infringe on those intellectual property rights.

Any litigation regarding intellectual property rights could be costly and time-consuming and divert the attention of Kronos' management and key personnel from business operations. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement might also require Kronos to enter into costly royalty or license agreements, and in this event, Kronos may not be able to obtain royalty or license agreements on acceptable terms, if at all. Kronos may also be subject to significant damages or an injunction against the use of its products. A successful claim of patent or other intellectual property

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infringement against Kronos could cause immediate and substantial damage to its business and financial condition.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

(a) The 2002 Annual Meeting of Stockholders of Kronos Incorporated was held on February 7, 2002.

(b) At the Annual Meeting, Messrs. D. Bradley McWilliams and Lawrence Portner were elected as Class I Directors for three-year terms expiring in 2005. In addition, the Directors whose terms of office continue after the meeting are two Class II Directors: Messrs. Mark S. Ain and W. Patrick Decker and two Class III Directors: Messrs. Richard J. Dumler and Samuel Rubinovitz. The tabulation was as follows:

	FOR	WITHHELD
	---	-----
D. Bradley McWilliams	17,273,846	247,480
Lawrence Portner	17,273,003	248,323

(c) Adoption of the Company's 2002 Stock Incentive Plan was approved as follows:

FOR	AGAINST	ABSTAIN	BROKER NON VOTES
---	-----	-----	-----
12,856,775	2,392,134	154,793	2,117,624

(d) Amendments to the Company's 1992 Employee Stock Purchase Plan and an increase in the number of shares available under the Plan from 1,378,125 to 1,678,125, were approved as follows:

FOR	AGAINST	ABSTAIN	BROKER NON VOTES
---	-----	-----	-----
14,984,008	260,232	159,462	2,117,624

(e) The other item voted upon at the meeting was the ratification of the selection of Ernst & Young LLP as the Company's independent auditors for the 2002 fiscal year.

FOR	AGAINST	ABSTAIN
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17,437,064	77,195	7,067

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1(1) Best Software Inc./Kronos Incorporated Agreement, dated as of March 15, 2002 by and between Kronos Incorporated and Best Software, Inc.

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the fiscal quarter ended March 30, 2002.

(1) Confidential treatment requested as to certain portions thereof.

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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.

KRONOS INCORPORATED

By /s/ Paul A. Lacy

Paul A. Lacy
Executive Vice President,
Chief Financial and
Administrative Officer
(Duly Authorized Officer and
Principal Financial Officer)

May 13, 2002

KRONOS INCORPORATED

EXHIBIT INDEX

Exhibit Number	Description
10.1(1)	Best Software Inc./Kronos Incorporated Agreement, dated as of March 15, 2002 by and between Kronos Incorporated and Best Software, Inc.

(1) Confidential treatment requested as to certain portions thereof.