

AVALON DIGITAL MARKETING SYSTEMS INC

Form 8-K

January 14, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): November 3, 2004

AVALON DIGITAL MARKETING SYSTEMS, INC.
(Exact Name of Registrant as Specified in Charter)

Delaware	000-28406	77-0511097
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(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

5255 N. Edgewood Drive, Suite 250
Provo, Utah 84604
(Address of Principal Executive Offices)

(801) 225-7073
(Registrant's telephone number, including area code)

Not applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 425 under the Exchange Act (17 CFR 240.14.a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.01 Entry into a Material Definitive Agreement.

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See the information set forth in "Item 1.03 Bankruptcy or Receivership" below regarding material definitive agreements entered into by the Registrant, which is incorporated herein by reference.

Item 1.03 Bankruptcy or Receivership.

On September 5, 2003, Avalon Digital Marketing Systems, Inc., a Delaware corporation (the "Company"), filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code"). The United States Bankruptcy Court for the District of Utah, Central Division (the "Bankruptcy Court"), entered an order (the "Confirmation Order") on November 3, 2004 confirming the Company's First Amended Plan of Reorganization Pursuant to Chapter 11 of the United States Bankruptcy Code (the "Plan"). The Plan became effective on November 18, 2004. On January 11, 2005, the Company issued a press release announcing the Confirmation Order and the effectiveness of the Plan. Copies of the Plan, the Confirmation Order and the press release are attached hereto as Exhibit 99.1, Exhibit 99.2 and Exhibit 99.3, respectively, and are incorporated herein by reference.

Summary of Material Features of Plan

Below is a summary of the material features of the Plan. Capitalized terms used and not otherwise defined herein shall have the meanings ascribed in the Plan. The following summary of the Plan is qualified in its entirety by reference to the full text of the Plan and the Confirmation Order. Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to such terms in the Plan. Readers are encouraged to read the Plan in its entirety.

Treatment of Claims and Interests under the Plan

The Plan includes a number of distinct Classes of Claims and Interests established in accordance with the Plan and Sections 1122 and 1123(a)(1) of the Bankruptcy Code. Below is a summary of the distributions to be made to holders of Allowed Claims and Interests under the Plan:

Description of Claims or Interests -----	Treatment -----
Administrative Expense Claims.	Unimpaired. Except as provided in Article II Section A of the Plan, and subject to the bar date provisions contained therein, each holder of an Allowed Administrative Expense Claim or a fee payable under 28 U.S.C. ss. 1930 will receive, in full satisfaction of its Administrative Expense Claim, cash equal to the amount of such Administrative Expense Claim on the later to occur of the Effective Date and the date on which such Claim shall become an Allowed Claim.
Priority Tax Claims.	Unimpaired. The holder of an Allowed Priority Tax Claim shall, unless the holder of such Claim agrees to a different treatment, receive, in the Company's sole discretion, either: (a) a cash payment, on the later to occur of the Effective Date and the date such

Claim becomes and Allowed Priority Tax Claim; or (b) on account of such Allowed Priority Tax Claim deferred cash payments over a period not exceeding six years after the date of assessment, the total of which payments shall be equal to the amount of such Allowed Priority Tax Claim plus interest at the applicable non-default statutory interest rate with respect to such Allowed Priority Tax Claim.

Class 1A - The Mulligan Group Secured Claim.

Impaired. On the Effective Date or as reasonably practicable thereafter, the Mulligan Group Secured Claim shall be reduced to the total amount of \$116,690. That amount shall bear interest from the date the Company filed its petition under the Bankruptcy Code at the rate of six percent (6%) per annum. On the Effective Date or as reasonably practicable thereafter, the Company shall distribute to The Mulligan Group the amount of \$95,630, which shall reduce the Mulligan Group Secured Claim. The remaining portion of the Mulligan Group Secured Claim shall be evidenced by a secured promissory

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note (the "Mulligan Group Note"), in form and substance reasonably acceptable to the Mulligan Group, with provisions which (a) preserve the Mulligan Group's existing security interest and lien in property of the Company, (b) provide for interest at the rate of six percent (6%) per annum on the unpaid balance, and (c) provide for the payment of the remaining balance of the Mulligan Group Secured Claim in three (3) equal monthly installments over the course of three (3) consecutive months, with the first installment due thirty (30) days after the Effective Date, the second installment due sixty (60) days after the Effective Date and the final installment due ninety (90) days after the Effective Date. As of the date of this Current Report, the Company has paid the first installments under the Mulligan Group Note. In addition, in consideration for reducing its claim, the Bankruptcy Court approved the issuance to The Mulligan Group of a warrant to purchase 293,933 shares of Common Stock of the Company at an exercise price equal to 110% of the

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fair market value of the Company's Common Stock on the Effective Date.

Class 1B - The Zions Bank Secured Claim.

Impaired. On the later of the Effective Date or entry of a Final Order allowing the Zions Bank Secured Claim, or as soon as reasonably practicable thereafter, the Company shall abandon the collateral securing the Zions Bank Secured Claim, namely the Bridgeview Financial Residual Payment Account, to Zions Bank in full and final payment and satisfaction of the Zions Bank Secured Claim, provided, however, that if there are remaining proceeds in the Account after Zions has used the proceeds of the Account to satisfy its claim in full, Zions shall remit any remaining balance to the Company, depending on when Zions receives full payment. The Zions Bank Secured Claim was fully satisfied by the Company prior to the Effective Date.

Class 1C - Other Secured Claims.

Unimpaired. On the later of the Effective Date or entry of a Final Order allowing a Secured Claim, or as reasonably practicable thereafter, each Holder of an Allowed Secured Claim shall receive, in the Company's sole discretion, one of the following distributions: (a) the payment of such Holder's Allowed Secured Claim in full in Cash; (b) the sale or disposition proceeds of the property securing such Allowed Secured Claim to the extent of the value of the Company's interest in such property; (c) the surrender to the Holder of any Allowed Secured Claim of the property securing such Claim; or (d) such other distributions as shall be necessary to satisfy the requirements of the Bankruptcy Code and/or as such Holder of an Allowed Secured Claim shall agree in satisfaction of their Claim.

Class 2 - Other Priority Claims (other than Priority Tax Claims).

Unimpaired. On the later of the Effective Date or entry of a Final Order allowing an Other Priority Claim, or as soon as reasonably practicable thereafter, each Holder of an Allowed Priority Claim shall receive the full amount of its Claim in cash.

Class 3 - General Unsecured Claims.

Impaired. On or after the Effective Date or as soon as practicable thereafter as determined by the Plan Administrator, the Plan Administrator shall pay the Holders of General Unsecured Claims on a pro rata basis:

(a) a specified amount of the proceeds of the issuance and sale of the Notes and Warrants, which amount shall not be less than \$200,000; (b) 100% of Bankruptcy Cause of Action Recoveries, until such time as the Holders of General Unsecured Claims receive payment of 50% of their General Unsecured Claims, at which time any additional Bankruptcy Cause of Action Recoveries shall be divided equally between Holders of General Unsecured Claims and the Company; and (c) a specified number of shares of Common Stock of the Company. Assuming that Holders of Equity Interests receive a

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distribution under the Plan, the shares of Common Stock issued to holders of General Unsecured Claims will represent fifteen percent (15%) of the Common Stock of the Company on a fully-diluted basis immediately following the issuance and sale of the Notes and the Warrants, assuming the full conversion of the Notes, full exercise of the Warrants and full exercise of the options underlying the Management Option Plan.

Class 4 - Equity Interests.

Impaired. As approved by the Bankruptcy Court, upon the affirmative vote of the holders of General Unsecured Claims, voting as a separate class, on the Effective Date, all Equity Interests in the Company, including preferred shares, common shares, and/or other forms of equity security or other interests shall be deemed extinguished, and the certificates and other documents representing such Equity Interests shall be deemed extinguished and canceled and the Common Stock of the Company shall be issued on the Effective Date or as soon as practicable thereafter, such that on the Effective Date or as soon as practicable thereafter, holders of Equity Interests shall hold an aggregate of 73,483 shares of the Common Stock of the Company (which will represent one percent (1%) of the Common Stock of the Company on a fully-diluted basis immediately following the issuance and sale of the Notes and the Warrants, assuming the full conversion of the Notes, full exercise of the Warrants and full exercise of the options underlying the

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Management Option Plan).

Issuance and Sale of Notes and Warrants under the Plan

Pursuant to the terms of the Plan, the Company entered into a Note and Warrant Purchase and Security Agreement (the "Purchase Agreement"), dated as of May 28, 2004, by and among the Company and the Purchasers listed on Exhibits D-1 and D-2 thereto (the "Purchase Agreement"). In accordance with the Purchase Agreement, on December 13, 2004, the Company completed the issuance and sale to the Purchasers of Notes with an aggregate principal amount of \$1,337,713 and Warrants to purchase an aggregate of 734,828 shares of Common Stock. The payment and performance by the Company of the Notes are secured by a first-priority lien and continuing security interest in all of the personal property of the Company, subject only to the security interests currently in favor of the Mulligan Group and Zions Bank. The Notes are convertible, at the option of the holders thereof, into shares of Common Stock at the rate of \$0.26 in principal amount per share of Common Stock. The conversion rate under the Notes is subject to adjustments if specified events occur. The Warrants may be exercised for shares of Common Stock at any time prior to December 13, 2011 at an exercise price of \$0.0001 per share of Common Stock. The exercise price of the Warrants is subject to adjustments if specified events occur. As a result of the issuance and sale of the Notes and the Warrants, a total of 5,143,795 shares of Common Stock have been reserved for issuance by the Company upon conversion of the Notes and 734,828 shares of Common Stock have been reserved for issuance by the Company upon exercise of the Warrants. This summary of the terms of the Notes and Warrants is qualified in its entirety by reference to the forms of Notes and Warrants attached as exhibits to the Purchase Agreement, a copy of which is attached hereto as Exhibit 99.4. The terms and provisions of the Purchase Agreement and the Notes, Warrants and other transaction documents were approved and made effective by the Bankruptcy Court pursuant to the Confirmation Order.

Registration Rights Agreement

In connection with the closing of the issuance and sale of the Notes and Warrants under the Purchase Agreement, the Company also entered into a Registration Rights Agreement (the "Registration Rights Agreement"). Under the Registration Rights Agreement, the Company is obligated to prepare and file with the Securities and Exchange Commission a registration statement registering under the Securities Act of 1933, as amended (the "Securities Act"), the registrable securities of the Company held by stockholders of the Company who are parties to the Registration Rights Agreement. In addition, from time to time, such holders of registrable securities of the Company may require the

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Company to effect the registration under the Securities Act of such holders' registrable securities of the Company. Subject to the conditions set forth in the Registration Rights Agreement, such holders may also participate in registrations of equity securities proposed and initiated by the Company. This summary of the terms of the registration rights granted by the Company is qualified in its entirety by reference to the Registration Rights Agreement attached hereto as Exhibit 99.5.

Capitalization

Pursuant to the Plan and the Confirmation Order, and prior to the closing of the issuance and sale of the Notes and Warrants under the Purchase Agreement, the Company also adopted and filed with the Secretary of State of the State of Delaware an Amended and Restated Certificate of Incorporation on December 9, 2004 (the "Amended Certificate"), a copy of which is attached hereto as Exhibit 99.6, and adopted Amended and Restated Bylaws on December 8, 2004, a

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copy of which is attached hereto as Exhibit 99.7. The authorized capital stock of the Company provided by the Amended Certificate consists of 10,000,000 of shares of Common Stock. As of the date of this Current Report, the Company has issued no shares of its authorized Common Stock, but has reserved for issuance the following shares: (i) 1,102,242 shares for issuance under the Plan to the holders of General Unsecured Claims, (ii) 73,483 shares for issuance under the Plan to the Equity Interests, (iii) 5,143,795 shares for issuance upon conversion of the Notes, (iv) 734,828 shares for issuance upon exercise of the Warrants and (v) 293,933 shares for issuance to the Mulligan Group pursuant to warrants issued under the Plan.

Assets and Liabilities of the Company as of Confirmation Date

Information as to the assets and liabilities of the Company as of November 30, 2004 is filed as Exhibit 99.8 hereto and incorporated herein by reference. Such information has been extracted from the Company's operating report filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 11, 2005.

Safe Harbor

Certain statements contained in this report are "forward-looking" in that they reflect management's expectations and beliefs regarding the future performance of the Company. Such forward-looking statements are subject to uncertainties and factors relating to the Company's operations and business environment, all of which are difficult to predict and many of which are beyond the control of the Company. The Company believes that the continuing risks associated with the consummation of the Company's emergence from protection under Chapter 11 of the U.S. Bankruptcy Code, including the satisfaction of conditions to that emergence, among others, could cause actual results to differ materially from those expressed or implied by forward-looking statements made by or on behalf of the Company.

Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal

Year.

See the information set forth in "Item 1.03 Bankruptcy or Receivership" above regarding amendments to the Company's Certificate of Incorporation and Bylaws, which is incorporated herein by reference.

Item 9.01. Financial Statements and Exhibits.

- (a) Not applicable.
- (b) Not applicable.
- (c) Exhibits

99.1 First Amended Plan of Reorganization Pursuant to Chapter 11 of the United States Bankruptcy Code of Avalon Digital Marketing Systems, Inc.

99.2 Order Confirming Debtor's First Amended Plan of Reorganization Pursuant to Chapter 11 of the United States Bankruptcy Code of Avalon Digital Marketing Systems, Inc.

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- 99.3 Press Release of Avalon Digital Marketing Systems, Inc. dated January 11, 2005.
- 99.4 Note and Warrant Purchase and Security Agreement dated as of May 28, 2004 by and among Avalon Digital Marketing Systems, Inc. and the Purchasers listed on Exhibits D-1 and D-2 thereto.
- 99.5 Registration Rights Agreement dated as of December 9, 2004 by and among Avalon Digital Marketing Systems, Inc. and Avalon Acquisition Company, LLC, Networks Direct, Inc. and The Mulligan Group, LLC.
- 99.6 Amended and Restated Certificate of Incorporation of Avalon Digital Marketing Systems, Inc.
- 99.7 Amended and Restated Bylaws of Avalon Digital Marketing Systems, Inc.
- 99.8 Balance Sheet Information for the Month Ended November 30, 2004.

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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 hereunto duly authorized.

Date: January 13, 2005

Avalon Digital Marketing Systems, Inc.

By: /s/ TYLER THOMPSON

Name: Tyler Thompson
Its: Chief Executive Officer

Exhibit Index

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Exhibit 99.8 Balance Sheet Information for the Month Ended November 30, 2004.
