PENNEXX FOODS INC
Form 10QSB
May 15, 2002

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-QSB

(Mark One)

[X] Quarterly report under Section 13 or 15(d) of he Securities Exchange Act of 1934

For the quarterly period ended March 31, 2002

[ ] Transition report under Section 13 or 15(d) of the Exchange Act

For the transition period from ___________ to _________

Commission file number 000-31148

PENNEXX FOODS, INC.

(Exact Name of Small Business Issuer as Specified in Its Charter)

Pennsylvania	23-3008972
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

980 Glasgow Street, Pottstown, PA 19464

(Address of Principal Executive Offices)

610-705-3620

(Issuer's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

Yes ----- No ------

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 25,324,822

Transitional Small Business Disclosure Format (check one):

Yes ----- No X ------

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

PENNEXX FOODS, INC.
Balance Sheets

ASSETS

	March 31, 2002
	(Unaudited)
Current Assets:	
Cash	$ 2,586,371
Trade Receivables, less allowance of $25,595	2,530,305
Inventory	1,574,702
Prepaid Expenses	241,100
Total Current Assets	6,932,478
Fixed Assets:	
Property and Equipment	4,974,548
Less Accumulated Depreciation	1,112,976
Total Fixed Assets	3,861,572
Other Assets:	60,245
Total Assets:	$ 10,854,295

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:	
Current Installments of Capital Lease Obligations	$ 242,807
Accounts Payable	3,111,198
Accrued Expenses	468,665
Total Current Liabilities	3,822,670
Long Term Liabilities:	
Capital Lease Obligations Less Current Installments	619,007
Note Payable	2,500,000
Total Long Term Liabilities	3,119,007
Shareholders' Equity:	
Common Stock	264,249
Additional Paid-In Capital	12,097,881
Deficit	(8,161,690)
Deferred Compensation	(287,822)
Total Shareholders' Equity	3,912,618
Total Liabilities and Shareholders' Equity	$ 10,854,295

See accompanying notes to financial statements.

PENNEXX FOODS, INC.
Statements of Operations
(Unaudited)

	For the Three Month Pe[riod Ended] March 31
	2002
Sales	$10,924,971
Cost of Goods Sold	
Meat	7,031,091
Labor	1,200,807
Supplies	1,218,199
Total Cost of Goods Sold	9,450,097
Gross Profit	1,474,874
Operating Expenses	1,417,171
Income (Loss) from Operations	57,703
Interest (Net of Interest Income)	50,253
Net Income (Loss)	$ 7,450
Income (Loss) Per Share	
Basic	$ 0.00
Diluted	$ 0.00
Weighted Average Shares Outstanding	
Basic	25,825,655
Diluted	27,208,342

See accompanying notes to financial statements.

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PENNEXX FOODS, INC.
Statements of Cash Flows
(Unaudited)

	For the Three Mont March
	2002
Cash Flows From Operating Activities	
Net Income (Loss)	$ 7,450
Adjustments	
Depreciation and Amortization	165,744
Deferred Compensation	26,166
Common Stock Issued for:	
Interest	
Consulting	
Changes in Assets and Liabilities	
Trade Receivables	65,190
Other Receivables	
Inventory	(432,479)
Prepaid Expenses	(39,257)
Accounts Payable	1,010,944
Accrued Expenses	201,881
Net Cash Provided By Operating Activities	1,005,639
Cash Flows From Investing Activities	
Purchase of Property and Equipment	(787,604)
Other Assets	1,527
Net Cash Used for Investing Activities	(786,077)
Cash Flows From Financing Activities	
Line of Credit Advances, Net	
Repayments on Capital Lease Obligations	(48,976)
Net Cash (Used In) Provided by Financing Activities	(48,976)
Net Increase in Cash	170,586
Cash, Beginning of Period	2,415,785
Cash, End of Period	$2,586,371
Supplemental Disclosures of Cash Flow Information	
Interest Paid during the Period	$25,622
Non-cash Items	
Debt Converted into Common Stock	

See accompanying notes to financial statements.

PENNEXX FOODS, INC.
Statement of Shareholders' Equity
Three Month Period Ended March 31, 2002
(Unaudited)

	Common stock $.01 par value 50,000,000 shares authorized			
	Shares issued or issuable	Amount	Additional paid-in capital	Deficit
Balance, January 1, 2002	26,424,822	$ 264,249	$ 12,097,881	$ (8,169,140)
Net Income				7,450
Amortization of compensatory options				
Balance, March 31, 2002	26,424,822	$ 264,249	$ 12,097,881	$(8,161,690)

See accompanying notes to financial statements.

PENNEXX FOODS, INC.
Notes to Condensed Financial Statements
March 31, 2002

1. Basis of Presentation.

The unaudited condensed financial statements have been prepared by Pennexx Foods, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such SEC rules and regulations; nevertheless, the Company believes that the disclosures are adequate to make the information presented not misleading. These financial statements and the notes hereto should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001. In the opinion of the Company, all adjustments, including normal recurring adjustments, necessary to present fairly the financial position of the Company as of March 31, 2002 and the results of its operations and cash flows for the three month period then ended have been included. The results of operations for the interim period are not necessarily indicative of the results for the year.

2. Accounting Policies.

There have been no changes in accounting policies used by the Company during the quarter ended March 31, 2002.

3. Summary of Business.

The Company, incorporated on July 20, 1999 in the Commonwealth of Pennsylvania, prepares case-ready meats for distribution to retailers in the Northeastern United States. It grants credit to its customers without requiring collateral.

4. Inventory.

The Company's inventories are valued at the lower of first-in, first-out or market. Inventories at March 31, 2002 consist of the following:

Unfinished Beef, pork, veal, lamb	$ 516,284
Packaging supplies	718,422
Finished goods	339,996
	$ 1,574,702

5. Note Payable.

The Company has established a $30,000,000 revolving line of credit with its 50% shareholder, Smithfield Foods, Inc. ("Smithfield"). The Company's outstanding balance under the line of credit bears interest at 1% above prime and is secured by all of the Company's assets. The loan will mature in 2006. At March 31, 2002, the Company's outstanding principal balance under the line of credit was $2.5 million and the accrued and unpaid interest was $91,867.

6. Net Income (Loss) Per Share.

Basic income /(loss) per share ("EPS") is computed using the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of common stock issuable upon exercise of stock options. The potential dilutive common shares for the period ending March 31, 2002 are 1,382,687. For the period ending March 31, 2001, there were no dilutive potential common shares because the assumed exercise of the options would be anti-dilutive.

Item 2. Management's Discussion and Analysis or Plan of Operation

Certain information contained in this Quarterly Report on Form 10-QSB represents "forward-looking" statements (as defined in Section 27A of the Securities Act of 1933, as amended) that involve risks and uncertainties which may cause actual results to differ materially from those predicted in the forward-looking statements. If any of the Company's assumptions on which such statements are based prove incorrect, or should unanticipated circumstances arise, the Company's actual results could materially differ from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors, including, but not limited to, those listed under Item 6, "Note Regarding Forward-Looking Statements" filed with the Securities and Exchange Commission on Form 10-KSB for the year ended December 31, 2001.

Results of Operations

Sales for the three-month period ended March 31, 2002 were $10.9 million, representing an increase of approximately $2.9 million or 36% over sales of $8.0 million from the corresponding period of 2001. This increase was primarily the result of the increase in the volume of products handled (due in part to increasing sales to existing customers as well as sales to new customers) but was also partially due to a change in the mix of products sold in favor of higher priced items. As the diversity of services that the Company offers continues to grow, customers are increasing both the range of products as well as the quantity ordered.

Cost of goods sold for the three-month period ended March 31, 2002 was $9.4 million which resulted in a gross profit of approximately $1.5 million or 14% of sales. By comparison, cost of goods sold for the three-month period ended March 31, 2001 was $7.2 million, which resulted in a gross profit of $0.8 million or 9% of sales. The Company's cost of goods sold is comprised of three main components: meat, direct payroll, and supplies. These items accounted for approximately 64%, 11% and 11% of sales, respectively, in the three months ended March 31, 2002 as compared to 65%, 16% and 10% of sales for the corresponding period of the prior year. Direct payroll declined as a percentage of sales in 2002 compared to 2001 due to increasing labor efficiencies.

Operating expenses for the three months ended March 31, 2002 were $1.4 million (13% of sales) as compared to $1.1 million (14% of sales) for the corresponding period of 2001. This increase of $0.3 million resulted from increased non-productive payroll expenses, increased depreciation expenses, increased maintenance expenses, increased insurance expenses, and increased freight and commissions expenses due to sales volume and continued growth.

Interest expense (net of interest income) for the three-month period ended March 31, 2002 was approximately $0.05 million compared to approximately $0.07 million for the comparable period of 2001. This decrease in interest expense (net of interest income) is principally due to the increase in interest earned on investments. The net income for the three-month period of 2002 was approximately $0.008 million as compared to a net loss of $0.4 million for the first three months of 2001.

On April 2, 2002, the Company purchased and will be renovating a new facility located on Tabor Avenue in Philadelphia, PA (the "Tabor Avenue Facility"). The Company intends to consolidate all operations in the new plant when it is refurnished and equipped. The purchase price for the property was $2.0 million. The Company's estimate to renovate and equip the new facility is as follows:

Renovation Cost	$2.5 million	to	$4.0 million
Equipment Costs	$9.0 million	to	$12.0 million
Total	$11.5 million	to	$16.0 million

In addition to these expenses, the Company will also incur moving expenses and other costs associated with the proposed move to the new plant. Although employment will be offered to the existing work force, the Company believes that it will have to replace at least a portion of the work force which chooses not to relocate from Pottstown. As a result, the Company will probably experience, at least temporarily, certain lost efficiencies among workers, and will incur additional costs to train new employees.

The Company expects to capitalize the acquisition and renovation costs of the Tabor Avenue Facility as well as the transactional expenses incurred in connection with the purchase. These amounts will be amortized over the estimated 39 year life of the building. The costs of moving and installing equipment in the new plant will be capitalized and depreciated over three years.

When the Company vacates the Pottstown plant, it will write-off all remaining unamortized leasehold improvements located there. At March 31, 2002 the amount of such unamortized leasehold improvements was $185,000.

Liquidity and Capital Resources

At March 31, 2002, the Company had $2.6 million of cash (and cash equivalents). The Company's current ratio at March 31, 2002 was 1.8 to 1.0.

Generally, the Company maintains an unfinished inventory of meat supplies equal to approximately 60-75% of estimated weekly sales volume. Purchases are made using the trade credit programs of suppliers, which allow the Company to purchase meat supplies with payment due within seven days. Inventory is purchased generally on a daily basis and in advance (i.e., in anticipation) of customer orders.

The Company's working capital decreased from $3.8 million at December 31, 2001 to $3.1 million at March 31, 2002, principally as a result of the purchase of property and equipment (including $0.2 million as a down payment on the Tabor Avenue plant). Inventory at March 31, 2002 was unusually high due to heavy purchases of supplies in anticipation of second quarter volume. Accounts payable increased from $2.1 million at December 31, 2001 to $3.1 million at March 31, 2002 as a result of the Company's efforts to take advantage of credit

terms provided by suppliers. Finally, accrued expenses were unusually high at March 31, 2002 as a result of the timing of payroll dates in relation to the quarter ending March 31, 2002.

Smithfield has agreed to allow the Company to use up to $18.3 million of the $30 million credit line (see note 5 to financial statements) to allow the Company to purchase, renovate and equip the Tabor Avenue Facility. If the actual costs exceed this amount, the Company will have to get incremental funding approval from Smithfield, use internally generated funds, or secure additional commercial financing. The amount outstanding on the Smithfield line of credit was as follows on the dates indicated:

Description	March 31, 2002	December 31, 2001
Principal Advances	$ 2,500,000	$2,500,000
Accrued Interest	$ 91,867	$58,000
Total	$ 2,591,867	$2,558,000

The Company has also applied for certain economic development related financing for the new facility in an aggregate amount of $10 million. To the extent received, these amounts would be used to repay advances made by Smithfield on the line of credit. The economic development loans, if obtained, would bear below market interest rates.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in a lawsuit with the landlord at the Pottstown facility. Proceedings began on November 11, 2000 in the Montgomery County Court of Common Pleas. The landlord has alleged that the Company failed to make timely rental payments and is seeking damages and ejectment. The Company's defense is that the rent was withheld because of the landlord's prior failure to honor its obligations to make certain improvements at the property. All rents due to date have either been paid to the landlord or deposited into escrow. Since the commencement of the litigation, the landlord has filed a voluntary petition for protection from its creditors under Chapter 11 of the Bankruptcy Code. As a result, the case has been transferred to the Federal bankruptcy court. If the Company were to lose this suit, whether before the Montgomery County Court or the Federal bankruptcy court, the landlord could eject the Company from the property, and the Company could lose some or all of the benefit of certain improvements made to the property in the aggregate approximate amount of $185,000.

The current lease at the Pottstown plant terminated in accordance with its terms on April 30, 2002. However, the Company is nonetheless continuing to use the plant for production because the Tabor Avenue Facility is not yet operational. On April 25, 2002 the landlord filed a motion for partial summary judgment with the United States Bankruptcy Court for the Eastern District of Pennsylvania to evict, eject and dispossess the Company from the Pottstown plant. Because management does not believe the Tabor Avenue Facility will be operational until the end of the third quarter of 2002, if the Court forced the Company to vacate the Pottstown facility before the Tabor Avenue Facility is available, the Company would not have a plant in which to operate, which would, in turn, have a material, adverse effect on the Company's operations.

Item 6. Exhibits and Reports on Form 8-K

The Company filed no Current Reports on Form 8-K during the three month period ended March 31, 2002. However, the Company filed a Current Report on Form 8-K dated April 2, 2002 in connection with its purchase of the Tabor Avenue Facility.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PENNEXX FOODS, INC.

Date: May 15, 2002

By: /s/ Michael D. Queen

Michael D. Queen
President

By: /s/ George B. Pearcy

George B. Pearcy
Chief Financial Officer

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