EDUCATIONAL DEVELOPMENT CORP
Form 10-Q
July 13, 2006

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended May 31, 2006

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________to__________.

Commission file number: 0-4957

EDUCATIONAL DEVELOPMENT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	73-0750007 (I.R.S. Employer Identification No.)

10302 East 55th Place, Tulsa Oklahoma 74146-6515
(Address of principal executive offices) §

Registrant s telephone number, including area code (918) 622-4522

Indicate by check mark whether the registrant (1) has filed all reports 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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes o No þ

As of July 11, 2006 there were 3,758,264 shares of Educational Development Corporation Common Stock, $0.20 par value outstanding.

TABLE OF CONTENTS

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
PART I. FINANCIAL INFORMATION
ITEM 1
CONDENSED BALANCE SHEETS

	May 31, 2006 (unaudited)	February 28, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 210,741	$ 321,537
Accounts receivable (less allowances for doubtful accounts and returns: 05/31/06 - $191,840; 2/28/06 - $185,209)	2,934,466	2,946,462
Inventories Net	11,042,925	12,159,360
Prepaid expenses and other assets	95,194	119,508
Deferred income taxes	130,400	141,700
Total current assets	14,413,726	15,688,567
INVENTORIES Net	351,762	379,570
PROPERTY AND EQUIPMENT at cost (less accumulated depreciation: 05/31/06 - $1,941,385; 2/28/06 - $1,904,934)	2,457,479	2,493,929
DEFERRED INCOME TAXES	54,200	81,900
	$ 17,277,167	$ 18,643,966
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Note payable to bank	$	$ 676,000
Accounts payable	2,214,478	3,042,937
Accrued salaries and commissions	562,369	566,379
Income taxes	227,156	71,749
Dividends payable		750,785
Other current liabilities	193,736	197,486
Total current liabilities	3,197,739	5,305,336
COMMITMENTS		
SHAREHOLDERS EQUITY:		
Common Stock, $.20 par value (Authorized 8,000,000 shares; Issued 5,772,840 (5/31/06) and 5,771,840 shares (02/28/06); Outstanding 3,762,379 (5/31/06) and 3,753,923 (2/28/06) shares)	1,154,568	1,154,368

Capital in excess of par value	7,582,334	7,577,495
Retained earnings	15,997,245	15,300,999
	24,734,147	24,032,862
Less treasury shares, at cost	(10,654,719)	(10,694,232)
	14,079,428	13,338,630
	$ 17,277,167	$ 18,643,966

See notes to condensed financial statements.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended May 31, 2006	2005
REVENUES:		
Gross sales	$ 10,743,378	$ 10,994,404
Less discounts & allowances	(3,041,585)	(3,111,541)
Transportation revenue	405,184	343,816
Net revenues	8,106,977	8,226,679
COST OF SALES	2,879,370	3,004,776
Gross margin	5,227,607	5,221,903
OPERATING EXPENSES:		
Operating & selling	1,841,743	1,678,171
Sales commissions	1,873,160	1,917,134
General & administrative	425,021	417,309
Interest	2,658	14,692
	4,142,582	4,027,306
OTHER INCOME	5,523	7,903
EARNINGS BEFORE INCOME TAXES	1,090,548	1,202,500
INCOME TAXES	393,900	457,300
NET EARNINGS	$ 696,648	$ 745,200
BASIC AND DILUTED EARNINGS PER SHARE:		
Basic	$ 0.19	$ 0.20
Diluted	$ 0.18	$ 0.19
WEIGHTED AVERAGE NUMBER OF COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING:		
Basic	3,756,461	3,738,133
Diluted	3,886,939	3,901,588
DIVIDENDS DECLARED PER COMMON SHARE	$	$ 0.15

See notes to condensed financial statements.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

	Common Stock (par value $.20 per share) Number of Shares Issued	Amount	Capital in Excess of Par Value	Retained Earnings	Treasury Stock Number of Shares	Amount	Shareholders Equity
BALANCE, MAR. 1, 2006	5,771,840	$ 1,154,368	$ 7,577,495	$ 15,300,999	2,017,917	$ (10,694,232)	$ 13,338,630
Sales of treasury stock			2,539		(7,456)	39,513	42,052
Exercise of options at $2.50/share	1,000	200	2,300				2,500
Cash dividends net of accrual				(402)			(402)
Net earnings				696,648			696,648
BALANCE, MAY 31, 2006	5,772,840	$ 1,154,568	$ 7,582,334	$ 15,997,245	2,010,461	$ (10,654,719)	$ 14,079,428

See notes to condensed financial statements.

4

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended May 31, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES	$ 1,271,839	$ 851,857
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	( )	(30,944)
Net cash used in investing activities	( )	(30,944)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under revolving credit agreement	1,200,000	3,159,000
Payments under revolving credit agreement	(1,876,000)	(4,077,000)
Dividends paid	(751,187)	
Cash received from exercise of stock options	2,500	45,000
Tax benefit of stock options exercised		12,240
Cash received from sale of treasury stock	42,052	21,117
Cash paid to acquire treasury stock	( )	(77,250)
Net cash used in financing activities	(1,382,635)	(916,893)
Net Decrease in Cash and Cash Equivalents	(110,796)	(95,980)
Cash and Cash Equivalents, Beginning of Period	321,537	364,024
Cash and Cash Equivalents, End of Period	$ 210,741	$ 268,044
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 6,064	$ 17,699
Cash paid for income taxes	$ 201,400	$ 61,200
Supplemental Disclosure of Non-Cash Financing Activities		
Dividends declared	$	$ 560,720

See notes to condensed financial statements.

EDUCATIONAL DEVELOPMENT CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS

Note 1 The information shown with respect to the three months ended May 31, 2006 and 2005, which is unaudited, includes all adjustments which in the opinion of Management are considered to be necessary for a fair presentation of earnings for such periods. The adjustments reflected in the financial statements represent normal recurring adjustments. The results of operations for the three months ended May 31, 2006 and 2005, respectively, are not necessarily indicative of the results to be expected at year end due to seasonality of the product sales.

These financial statements and notes are prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting and should be read in conjunction with the Financial Statements and accompanying notes contained in the Company s Annual Report to Shareholders for the Fiscal Year ended February 28, 2006.

Note 2 Effective June 30, 2005 the Company signed a Sixth Amendment to the Credit and Security Agreement with Arvest Bank which provided a $3,500,000 line of credit through June 30, 2006. Effective September 2, 2005, the Company signed a Seventh Amendment to the Credit and Security Agreement with Arvest Bank which increased the line of credit from $3,500,000 to $5,000,000 through June 30, 2006. Interest is payable monthly at the Wall Street Journal prime-floating rate minus 0.75% (7.25% at May 31, 2006) and borrowings are collateralized by substantially all the assets of the Company. At May 31, 2006 the Company had no debt outstanding under this agreement. Available credit under the revolving credit agreement was $5,000,000 at May 31, 2006. Borrowings outstanding under the agreement ranged from $0 to $676,000 during the first quarter ended May 31, 2006. This agreement was renewed under similar terms through June 30, 2007.

Note 3 Inventories consist of the following:

	May 31, 2006	February 28, 2006
Current:		
Book inventory	$ 11,071,885	$ 12,186,820
Inventory valuation allowance	(28,960)	(27,460)
Inventories net current	$ 11,042,925	$ 12,159,360
Non-current:		
Book inventory	$ 588,000	$ 657,000
Inventory valuation allowance	(236,238)	(277,430)
Inventories non-current	$ 351,762	$ 379,570

The Company occasionally purchases book inventory in quantities in excess of what will be sold within the normal operating cycle due to minimum order requirements of the Company s primary supplier. These amounts are included in non-current inventory.

Significant portions of inventory purchases by the Company are concentrated with an England based publishing company. Purchases from this England based publishing company were approximately $1.8 million and $3.0 million for the three months ended May 31, 2006 and 2005, respectively. Total inventory purchases from all suppliers were approximately $2.0 million and $3.6 million for the three months ended May 31, 2006 and 2005, respectively.

Note 4 Basic earnings per share (EPS) is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS is based on the combined weighted average number of common shares outstanding and dilutive potential common shares issuable which include, where appropriate, the assumed exercise of options. In computing diluted EPS the Company has utilized the treasury stock method.

6

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION

The computation of weighted average common and common equivalent shares used in the calculation of basic and diluted earnings per share (EPS) is shown below.

	Three Months Ended May 31, 2006	2005
Net Earnings	$ 696,648	$ 745,200
Basic EPS:		
Weighted Average Shares Outstanding	3,756,461	3,738,133
Basic EPS	$ 0.19	$ 0.20
Diluted EPS:		
Weighted Average Shares Outstanding	3,756,461	3,738,133
Assumed Exercise of Options	130,478	163,455
Shares Applicable to Diluted Earnings	3,886,939	3,901,588
Diluted EPS	$ 0.18	$ 0.19

Since March 1, 1998, when the Company began its stock repurchase program, 2,328,436 shares of the Company s common stock at a total cost of $11,805,937 have been acquired. The Board of Directors has authorized purchasing up to 2,500,000 shares as market conditions warrant.

Note 5 The Company accounts for stock-based compensation whereby share-based payment transactions with employees, such as stock options and restricted stock, are measured at estimated fair value at date of grant and recognized as compensation expense over the vesting period.

In the fourth quarter of fiscal year 2005, the Company early adopted Statement of Financial Accounting Standards No. 123 (revised 2004) Share Based Payment (SFAS No. 123R) which eliminates the alternative of applying the intrinsic value measurement provision of Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees to stock compensation awards and requires that share-based payment transactions with employees, such as stock options and restricted stock, be measured at fair value and recognized as compensation expense over the vesting period. The Company adopted SFAS No. 123R on the modified retrospective application method to all prior years for which SFAS No. 123R was effective. For the Company, this began with its fiscal year ended February 28, 1997.

There were no stock options granted during the quarter ended May 31, 2006.

Note 6 Freight costs and handling costs incurred are included in operating & selling expenses and were $559,028 and $533,311 for the three months ended May 31, 2006 and 2005, respectively.

Note 7 The Company has two reportable segments: Publishing and Usborne Books at Home (UBAH). These reportable segments are business units that offer different methods of distribution to different types of customers. They are managed separately based on the fundamental differences in their operations. The Publishing Division markets its products to retail accounts, which include book, school supply, toy and gift stores and museums, through commissioned sales representatives, trade and specialty wholesalers and an internal telesales group. The UBAH Division markets its product line through a network of independent sales consultants through a combination of direct sales, home shows, book fairs and the Internet.

The accounting policies of the segments are the same as those of the Company. The Company evaluates segment performance based on earnings (loss) before income taxes of the segments, which is defined as segment net sales reduced by direct cost of sales and direct expenses. Corporate expenses, depreciation, interest expense and income taxes are not allocated to the segments, but are listed in the other column. Corporate expenses include the executive department, accounting department, information services department, general office management and building facilities management. The Company s assets and liabilities are not allocated on a segment basis.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION

Information by industry segment for the three months ended May 31, 2006 and 2005 is set forth below:

	Publishing	UBAH	Other	Total
Three Months Ended May 31, 2006				
Net revenues from external customers	$ 2,071,212	$ 6,035,765	$	$ 8,106,977
Earnings before income taxes	$ 658,422	$ 1,325,100	$ (892,974)	$ 1,090,548
Three Months Ended May 31, 2005				
Net revenues from external customers	$ 2,160,108	$ 6,066,571	$	$ 8,226,679
Earnings before income taxes	$ 769,503	$ 1,342,985	$ (909,988)	$ 1,202,500

ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Factors Affecting Forward Looking Statements

This Quarterly Report on Form 10-Q, including the documents incorporated herein by reference, contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are not historical facts but are expectations or projections based on certain assumptions and analyses made by our senior management in light of their experience and perception of historical trends, current conditions, expected future developments and other factors. Actual events and results may be materially different from anticipated results described in such statements. The Company s ability to achieve such results is subject to certain risks and uncertainties. Such risks and uncertainties include but are not limited to, product prices, continued availability of capital and financing, and other factors affecting the Company s business that may be beyond its control.

The words estimate, project, intend, expect, anticipate, believe and similar expressions are intended to identif forward-looking statements. These forward-looking statements are found at various places throughout this report and the documents incorporated in this report by reference as well as in other written materials, press releases and oral statements issued by us or on our behalf. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date that they are made. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report.

Table of Contents

EDUCATIONAL DEVELOPMENT CORPORATION

Overview

The Company operates two separate divisions, Publishing and Usborne Books at Home (UBAH), to sell the Usborne line of children s books. These two divisions each have their own customer base. The Publishing Division markets its products on a wholesale basis to various retail accounts. The UBAH Division markets its products to individual consumers as well as school and public libraries.

The following table sets forth consolidated statement of income data as a percentage of total revenues.

	Three Months Ended May 31,	
	2006	2005
Net revenues	100.0%	100.0%
Cost of sales	35.5%	36.5%
Gross margin	64.5%	63.5%
Operating expenses:		
Operating & selling	22.7%	20.4%
Sales commissions	23.1%	23.3%
General & administrative	5.3%	5.1%
Interest	0.0%	0.2%
Total operating expenses	51.1%	49.0%
Other income	0.0%	0.1%
Earnings before income taxes	13.4%	14.6%
Income taxes	4.8%	5.5%
Net earnings	8.6%	9.1%

Operating Results for the Three Months Ended May 31, 2006

The Company earned income before income taxes of $1,090,548 for the three months ended May 31, 2006 compared with $1,202,500 for the three months ended May 31, 2005

Revenues

	Three Months Ended May 31,		$ Increase/	% Increase/
	2006	2005	(decrease)	(decrease)
Gross sales	$ 10,743,378	$ 10,994,404	$ (251,026)	(2.3%)
Less discounts & allowances	(3,041,585)	(3,111,541)	69,956	(2.2%)
Transportation revenue	405,184	343,816	61,368	17.8%
Net revenues	$ 8,106,977	$ 8,226,679	$ (119,702)	(1.5%)

The UBAH Division s gross sales decreased 1.2% or $78,230 during the three month period ending May 31, 2006 when compared with the same quarterly period a year ago. The Company attributes this decrease primarily to an 8.1% decrease in home party sales, a 22.0% decrease in direct sales and a 7.1% decrease in school and library sales, offset by a 45.3% increase in Internet sales and a 3.3% increase in book fair sales. The decline in home shows is attributed in part to the consultants doing more book fairs and to the fact that when consultants host a home show and combine it with an e-show, the sale is categorized both as an Internet sale and a home show. The decline in direct sales occurred as more consultants replace these orders with Internet orders. The decline in school and library sales is due to the decline in funding received by the schools. The Publishing Division s gross sales decreased 3.9% or $172,796 during the three month period ending May 31, 2006 when compared with the same quarterly period a year ago. The Company attributes this to an 11% decrease in sales to the smaller books stores, offset by a 5% increase in sales to the national chains.

EDUCATIONAL DEVELOPMENT CORPORATION

The UBAH Division s discounts and allowances were $795,518 and $784,600 for the quarterly periods ended May 31, 2006 and 2005, respectively. The UBAH Division is a multi-level selling organization that markets its products through independent sales representatives (consultants). Sales are made to individual purchasers and school and public libraries. Most sales in the UBAH Division are at retail. As a part of the UBAH Division s marketing programs, discounts between 40% and 50% of retail are offered on selected items at various times throughout the year. The discounts and allowances in the UBAH Division will vary from year to year depending upon the marketing programs in place during any given year. The UBAH Division s discounts and allowances were 12.4% of UBAH s gross sales for the quarterly period ended May 31, 2006 and 12.0% for the quarterly period ended May 31, 2005.

The Publishing Division s discounts and allowances are a much larger percentage of gross sales than discounts and allowances in the UBAH Division due to the different customer markets that each division targets. The Publishing Division s discounts and allowances were $2,246,067 and $2,326,941 for the quarterly periods ended May 31, 2006 and 2005, respectively. The Publishing Division sells to retail book chains, regional and local bookstores, toy and gift stores, school supply stores and museums. To be competitive with other wholesale book distributors, the Publishing Division sells at discounts between 48% and 55% of the retail price, based upon the quantity of books ordered and the dollar amount of the order. The Publishing Division s discounts and allowances were 52.1% of Publishing s gross sales for the quarterly period ended May 31, 2006 and 51.9% for the quarterly period ended May 31, 2005.

The increase in transportation revenues for the three months ended May 31, 2006 is the result of the January 2006 increase in the shipping rates charged in the UBAH Division.

Expenses

	Three Months Ended May 31,			%
			$ Increase/	Increase/
	2006	2005	(decrease)	(decrease)
Cost of sales	$ 2,879,370	$ 3,004,776	$ (125,406)	(4.2%)
Operating & selling	1,841,743	1,678,171	163,572	9.7%
Sales commissions	1,873,160	1,917,134	(43,974)	(2.3%)
General & administrative	425,021	417,309	7,712	1.8%
Interest	2,658	14,692	(12,034)	(81.9%)
Total	$ 7,021,952	$ 7,032,082	$ (10,130)	0.1%

Cost of sales decreased 4.2% for the three months ended May 31, 2006 when compared with the three months ended May 31, 2005. In comparing the 4.2% decrease in cost of sales with the 2.3% decrease in gross sales, consideration must be given to the mix of products sold. The Company s cost of products it sells from inventory ranges from 25% to 34% of the gross sales price, depending upon the product sold. Cost of sales as a percentage of gross sales was 26.8% for the three months ended May 31, 2006 and for the three months ended May 31, 2005 was 27.3%. Cost of sales is the inventory cost of the product sold, which includes the cost of the product itself and inbound freight charges. Purchasing and receiving costs, inspection costs, warehousing costs, and other costs of our distribution network are included in operating and selling expenses. These costs totaled $290,683 in the quarter ended May 31, 2006 and $267,440 in the quarter ended May 31, 2005. Readers are advised to be cautious when comparing our gross margins with the gross margins of other companies, since some companies include the costs of their distribution networks in cost of sales.

In addition to costs associated with our distribution network (noted above), operating and selling costs include expenses of the