

Edgar Filing: SRI SURGICAL EXPRESS INC - Form 10-Q

SRI SURGICAL EXPRESS INC  
Form 10-Q  
May 15, 2002

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended MARCH 31, 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: 000-20997

SRI/SURGICAL EXPRESS, INC.  
(Exact name of Registrant as specified in its Charter)

Florida  
(State of Incorporation)

59-3252632  
(I.R.S. Employer  
Identification No.)

12425 Race Track Road  
Tampa, Florida 33626  
(Address of Principal Executive Offices)

(813) 891-9550  
(Registrant's Telephone Number)

Indicate by check 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  \_\_\_\_\_

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Number of outstanding shares of each class of Registrant's Common Stock as of  
May 1, 2002:

Common Stock, par value \$.001 - 6,421,277

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PART I - FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

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SRI/SURGICAL EXPRESS, INC.  
CONDENSED STATEMENTS OF INCOME  
(In thousands, except per share data)  
(unaudited)

Three  
March 31,  
2002  
----

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Revenues	\$ 21,755
Cost of revenues	15,497
	-----
Gross profit	6,258
Distribution expenses	1,432
Selling and administrative expenses	3,456
	-----
Income from operations	1,370
Unrealized gain (loss) on derivative instruments	65
Interest expense, net	238
	-----
Income before income taxes	1,197
Income tax expense	449
	-----
Income before cumulative effect of change in accounting policy	748
Cumulative effect of change in accounting policy, net of tax	--
	-----
Net income	\$ 748
	=====
Dividends on preferred stock	--
	-----
Net income available for common shareholders	\$ 748
	=====
Income per common share, basic:	
Income available for common shareholders before cumulative effect of change in accounting principle	\$ 0.12
Cumulative effect of change in accounting principle	\$ --
	-----
Net income available for common shareholders	\$ 0.12
	=====
Income per common share, diluted:	
Income before cumulative effect of change in accounting principle	\$ 0.11
Cumulative effect of change in accounting principle	\$ --
	-----
Net income	\$ 0.11
	=====
Weighted average common shares outstanding, basic	6,417
	=====
Weighted average common shares outstanding, diluted	6,618
	=====

The accompanying notes are an integral part of these financial statements.

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(In thousands)

	March 31, 2002 ---- (unaudited)	December 31, 2001 ----
ASSETS		
Cash and cash equivalents	\$ 575	\$ 538
Accounts receivable, net	10,903	11,896
Inventories, net	6,835	6,737
Prepaid expenses and other assets	2,320	2,631
Reusable surgical products, net	24,348	25,554
Property, plant and equipment, net	31,145	30,085
Goodwill, net	5,244	5,244
	-----	-----
Total assets	\$ 81,370 =====	\$ 82,685 =====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Notes payable to bank	\$ 16,876	\$ 17,612
Accounts payable	3,980	6,479
Employee related accrued expenses	1,063	943
Other accrued expenses	1,302	1,532
Obligation under capital lease	4,536	4,562
Deferred tax liability, net	1,064	1,064
Unrealized loss on derivative instruments	524	589
	-----	-----
Total liabilities	29,345	32,781
Shareholders' equity		
Common stock	6	6
Additional paid-in capital	30,314	28,941
Retained earnings	21,705	20,957
	-----	-----
Total shareholders' equity	52,025	49,904
	-----	-----
Total liabilities and shareholders' equity	\$ 81,370 =====	\$ 82,685 =====

The accompanying notes are an integral part of these financial statements.

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	Three Months Ended 2002 ----
Cash flows from operating activities	
Net income	\$ 748
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	750
Amortization of reusable surgical products	892
Provision for reusable surgical products shrinkage	506
Deferred income taxes	--
Cumulative effect of change in accounting principle	--
Unrealized loss on derivative instruments	(65)
Change in assets and liabilities (net of business combinations):	
Accounts receivable, net	993
Inventories	(98)
Prepaid expenses and other assets	311
Accounts payable	(2,499)
Employee related and other accrued expenses	82
	-----
Net cash provided by operating activities	1,620
	-----
Cash flows from investing activities	
Purchases of property, plant and equipment	(1,810)
Purchases of reusable surgical products	(192)
	-----
Net cash used in investing activities	(2,002)
	-----
Cash flows from financing activities	
Net borrowings on notes payable to bank	(736)
Payments on obligation under capital lease	(26)
Net proceeds from issuance (repurchase) of common stock	1,181
Dividends paid	--
	-----
Net cash provided by (used in) financing activities	419
	-----
Increase (decrease) in cash and cash equivalents	37
Cash and cash equivalents at beginning of period	538
	-----
Cash and cash equivalents at end of period	\$ 575
	=====
Supplemental cash flow information	
Cash paid for interest	\$ 186
	=====
Cash paid for income taxes	\$ (9)
	=====
Supplemental schedule of non-cash activities:	
Income tax benefit of stock options exercised	\$ 192
	=====

The accompanying notes are an integral part of these financial statements.

SRI/SURGICAL EXPRESS, INC.  
NOTES TO CONDENSED FINANCIAL STATEMENTS  
(unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements of SRI/Surgical Express, Inc. (the "Company"), formerly Sterile Recoveries, Inc., have been prepared in accordance with the Securities and Exchange Commission's instructions to Form 10-Q and, therefore, omit or condense footnotes and certain other information normally included in financial statements prepared in accordance with generally accepted accounting principles. The accounting policies followed for quarterly financial reporting conform with generally accepted accounting principles for interim financial statements and include those accounting policies disclosed in the Company's Form 10-K for the year ended December 31, 2001 filed with the Securities and Exchange Commission. In the opinion of management, all adjustments of a normal recurring nature that are necessary for a fair presentation of the financial information for the interim periods reported have been made. The results of operations for the three months ended March 31, 2002 are not necessarily indicative of the results that can be expected for the entire year ending December 31, 2002. The unaudited financial statements should be read in conjunction with the financial statements and the notes thereto included in the Form 10-K.

The Company operates on a 52-53 week fiscal year ending the Sunday nearest December 31. There are 13 weeks included for the three month periods ended March 31, 2002 and March 31, 2001, respectively.

The condensed statements of income and cash flows for the three months ended March 31, 2001 have been restated for the effect of derivative financial instruments recognized during the fourth quarter of 2001 as previously disclosed.

2. LINE OF CREDIT

The Company's outstanding balance under its \$45.0 million revolving credit facility was approximately \$16.9 million and \$17.6 million on March 31, 2002 and December 31, 2001, respectively.

The revolving facility is secured by substantially all of the Company's assets and has a maturity date of June 30, 2003. The facility's interest rate varies between 225 and 275 basis points over LIBOR (1.880% as of March 31, 2002), depending on the Company's leverage. The credit facility requires the Company to maintain (a) minimum net worth of not less than \$37.0 million plus 75% of cumulative net income for each fiscal quarter beginning with the fiscal quarter ending March 31, 2000; (b) a leverage ratio of not more than 2.5 to 1.0; and (c) a fixed charge coverage ratio of 2.25 to 1.0 through December 31, 2002, and 2.35 to 1.0 thereafter. The credit facility restricts the Company in paying dividends, engaging in acquisition transactions, incurring additional indebtedness, and encumbering its assets. The Company was in compliance with all requirements of the credit facility at March 31, 2002.

The revolving credit facility allows the Company to repurchase up to \$5 million of its stock from time to time through open market purchases at prevailing market prices. As of March 31, 2002, the Company had repurchased 75,400 shares of its common stock, valued at approximately \$1.1 million. The Company has not repurchased shares since the first quarter of 2001 and does not anticipate repurchasing any additional shares at this time.

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3. EARNINGS PER SHARE

The following table sets forth the Company's computation of basic and diluted earnings per share before the cumulative effect of change in accounting policy:

	Three Months Ended March 31,	
	2002	2001
	----	----
	(restated)	
	(In thousands, except per share data)	
	(unaudited)	
Basic		
-----		
Numerator:		
Income before cumulative effect of change in accounting policy	\$ 748	\$ 1,267
Less effect of dividends of preferred stock	--	(51)
	-----	-----
Income available for common shareholders before cumulative effect of change in accounting policy	\$ 748	\$ 1,216
	=====	=====
Denominator:		
Weighted average shares outstanding	6,417	5,628
	=====	=====
Income per common share before cumulative effect of change in accounting policy - basic	\$ 0.12	\$ 0.22
	=====	=====
Diluted		
-----		
Numerator:		
Income before cumulative effect of change in accounting policy	\$ 748	\$ 1,267
	=====	=====
Denominator:		
Weighted average shares outstanding	6,417	5,628
Effect of dilutive securities:		
Employee stock options	201	314
Convertible preferred stock	--	567
	-----	-----
	6,618	6,509
	=====	=====
Net income per common share - diluted	\$ 0.11	\$ 0.20
	=====	=====

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Options to purchase 265,000 and 239,500 shares of common stock for the three month periods ended March 31, 2002 and March 31, 2001, respectively, were not included for all or a portion of the computation of diluted net income per common share, as the options' exercise prices were greater than the average market price of the common shares and therefore the effect would be anti-dilutive.

#### 4. IMPLEMENTATION OF SFAS NO. 142, "GOODWILL AND OTHER INTANGIBLE ASSETS" AND SFAS NO. 144, "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS".

Issued in October 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". The accounting model for long-lived assets to be disposed of by sales applies to all long-lived assets, including discontinued operations, and replaces the provisions of APB Opinion No. 30, "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business", for the disposal of segments of a business. SFAS No. 144 requires that those long-lived assets be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 also broadens the reporting for discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The Company adopted the provisions of SFAS No. 144 on January 1, 2002. The adoption did not have a material effect on the results of operations, financial position or cash flows of the Company.

Effective January 1, 2002 the Company adopted SFAS No. 142 "Goodwill and Other Intangible Assets". SFAS No. 142 requires the Company to test goodwill and indefinite-lived intangible assets for impairment rather than amortize them. The Company will complete the impairment analysis of goodwill by the end of the second quarter 2002, and any impairment charge, if necessary, resulting from these transitional impairment tests will be recorded at that time. The following table provides information relating to the Company's goodwill as of March 31, 2002 (in thousands):

	Cost	Accumulated Amortization
	-----	-----
Goodwill	6,019	774

Pro forma results for the three months ended March 31, 2001, assuming the discontinuation of amortization of goodwill, are as follows (in thousands except per share amounts):

Reported net income	\$ 1,154
Goodwill amortization, net of taxes	34
	-----
Adjusted net income	\$ 1,188
	=====

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



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### Overview

From 18 service centers, the Company provides hospitals and surgery centers with a comprehensive surgical procedure-based delivery and retrieval service for reusable gowns, towels, drapes, basins, and instruments, and provides other disposable products necessary for surgery. At 11 reprocessing facilities and one disposable products division, the Company collects, sorts, cleans, inspects, packages, sterilizes and delivers its reusable products on a just-in-time basis. The Company offers an integrated "closed-loop" reprocessing service that uses two of the most technologically advanced reusable textiles: (i) a GORE(R) Surgical Barrier Fabric for gowns and drapes that is breathable yet liquidproof and provides a viral/bacterial barrier and (ii) an advanced microfiber polyester surgical fabric for gowns and drapes that is liquid and bacterial resistant. The Company also offers state of the art reusable laparoscopic instruments from Aesculap, Inc., one of the oldest and largest worldwide suppliers of surgical instruments. The surgical instruments have been designed either to be taken apart or with flush ports to allow complete cleaning and decontamination.

The Company offers its Surgical Express(R) program, which uses daily delivery and retrieval to provide customers an expanded program of products and services. Surgical Express is an outsourced Surgical Case Cart Management Program that the Company expects will reduce hospital and surgery centers' processing costs and their investment in surgical products. With its Surgical Express program, the Company supplements its core reusable products offering with disposable accessory packs containing smaller surgical items that are not reusable, such as needles, syringes, and tubing. Since the fourth quarter of 2000, the Company has offered customers its first complete procedure-based service, Surgical Express for Laparoscopy, which combines the Company's core reusable products offering with disposable products and laparoscopic instruments required for laparoscopic surgical procedures. Aesculap, Inc. furnishes laparoscopic instruments for this program under a joint marketing arrangement with the Company. In 2001, the Company introduced additional instrument procedures and expects to continue developing new instrument programs on a regular basis. As of March 31, 2002, the Company was servicing 36 instrument projects from eight of its facilities. The Company believes that its unique product and service offerings improve its competitive position in the marketplace.

In May 2001, the Company announced its contract with HealthTrust Purchasing Group (HPG), a group purchasing organization representing over 600 hospitals and surgery centers. The contract with HPG designates the Company as its primary outsource vendor for reusable surgical products including instruments. The Company was servicing 40 HPG hospitals and 18 surgery centers when the HPG contract was signed, and 22 new hospitals have been added through the end of the first quarter of 2002. In addition, through its relationship with Standard Textile Co., Inc., the Company has the opportunity to provide Surgical Express to Novation member hospitals. With its acceptance by HPG and Novation, Surgical Express is an available contracted alternative for over 2,000 hospitals and surgery centers across the country. The Company continues to pursue additional group purchasing organization contracts that will allow it to further penetrate the surgical supply market.

\*GORE(R) Surgical Barrier Fabric is a registered trademark of W.L. Gore & Associates, Inc.

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### Results of Operations

The following table sets forth for the periods shown the percentage of revenues represented by certain items reflected in the statement of income of the Company.

	Three Months Ended March 31,	
	2002	2001
	-----	-----
Revenues	100.0%	100.0
Cost of revenues	71.2	68.3
	-----	-----
Gross profit	28.8	31.7
Distribution expenses	6.6	6.3
Selling and administrative expenses	15.9	12.8
	-----	-----
Income from operations	6.3	12.6
Unrealized gain (loss) on derivative instruments	.3	(1.1)
Interest expense, net	1.1	1.8
	-----	-----
Income before income taxes	5.5	9.7
Income tax expense	2.1	3.8
	-----	-----
Income before cumulative effect of change in accounting policy	3.4	5.9
Cumulative effect of change in accounting policy, net of tax	--	.5
	-----	-----
Net income	3.4%	5.4
	=====	=====

Three Months Ended March 31, 2002 Compared to Three Months Ended March 31, 2001

Revenues. Revenues increased \$457,000, or 2.1%, to \$21.8 million in the first quarter of 2002, from \$21.3 million in the first quarter of 2001. The increased revenues were primarily attributable to the growth in instrument and Surgical Express accounts.

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Gross Profit. Gross profit decreased \$492,000, or 7.3%, to \$6.2 million in the first quarter of 2002, from \$6.7 million in the first quarter of 2001. As a percentage of revenues, gross profit decreased by 2.9% to 28.8% in the first quarter of 2002, from 31.7% in the first quarter of 2001. The decrease in gross profit reflects planned increases in salaries and lease expenses plus unanticipated increases in health insurance expense.

Distribution Expenses. Distribution expenses increased \$83,000, or 6.2%, to

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\$1.4 million in the first quarter of 2002, from \$1.3 million in the first quarter of 2001. As a percentage of revenues, distribution expenses increased to 6.6% in the first quarter of 2002 from 6.3% in the first quarter of 2001. The increase in distribution expenses resulted primarily from increased vehicle lease expenses and salaries.

**Selling and Administrative Expenses.** Selling and administrative expenses increased \$729,000, or 26.7%, to \$3.4 million in first quarter of 2002, from \$2.7 million in the first quarter of 2001. As a percentage of revenues, selling and administrative expenses increased 3.1% to 15.9% in the first quarter of 2002, from 12.8% in the first quarter of 2001. The Company's selling and administrative expenses increased due to additional legal fees, expenses related to the corporate office, marketing and administrative fees for GPO contracts, and an increased number of sales and marketing personnel.

**Income from Operations.** Income from operations decreased \$1.3 million, or 48.8%, to \$1.4 million in the first quarter of 2002, from \$2.7 million in the first quarter of 2001. As a percentage of revenues, income from operations decreased 6.3% to 6.3% for the first quarter of 2002, from 12.6% for the first quarter of 2001.

**Unrealized Loss on Derivative Instruments.** Pursuant to Statement of Financial Accounting Standards No. 133, the Company in the first quarter of 2002 recognized a current unrealized gain of \$65,000 on two interest rate swaps, compared to an unrealized loss of \$222,000 recognized in the first quarter of 2001. See - "Liquidity and Capital Resources."

**Interest Expense, Net.** Interest expense decreased \$150,000 to \$238,000 in the first quarter of 2002, from \$388,000 in the first quarter of 2001, primarily due to lower interest rates associated with the Company's credit facility.

**Income Tax Expense.** Income tax expense decreased \$348,000 to \$449,000 in the first quarter of 2002, compared to \$797,000 in the first quarter of 2001. The Company's effective tax rate is 37.5%.

**Cumulative Effect of Change in Accounting Policy.** The Company accrued a cumulative effect of change in accounting principle of \$113,000, which is net of tax of \$69,000, from the initial adoption of Statement 133.

### Liquidity and Capital Resources

The Company's principal sources of capital have been cash flows from operations and borrowings under its working capital loan facility.

The Company's positive cash flow provided by operating activities was \$1.6 million during the first quarter of 2002, compared to \$3.3 million during the first quarter of 2001. The decrease in cash from operating activities resulted primarily from a decrease in net income before amortization and decreased accounts payable, and was partially offset by a decrease in accounts receivable, prepaid expenses, and other accrued expenses.

The Company's net cash used in investing activities declined from \$2.9 million in the first quarter of 2001 to \$2.0 million in the first quarter of 2002. These expenditures were funded from cash provided by operating activities and borrowings under the Company's revolving credit facility. The decrease is primarily due to a reduction in the amount of reusable surgical products purchased.

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As of February 1, 1999, the Company entered into three-year leases for two new processing facilities in Stockton, California and Chattanooga, Tennessee. These three-year leases are a form of off-balance sheet financing in which a third-party purchased property and leased the asset to the Company as lessee. Lease payments are based on the approximately \$10.6 million aggregate cost of the facilities and are adjusted as the LIBOR rate fluctuates. The lessor has entered into interest rate swaps, which the Company guaranteed, on May 28, 1999 and July 1, 1999, to reduce the impact of interest rates on the floating rate operating leases for its facilities. In April 2002 the interest rate swaps were sold resulting in a gain of \$36,400. The Company's obligations under the leases are secured by a letter of credit issued by First Union National Bank. The Company accounts for these leases as operating leases.

In January 2002 the aforementioned lease agreements were extended for one year to February 2003. When the lease terms end, the Company may extend the lease terms, replace them with other leasing structures, or purchase the facilities for their cost (approximately \$10.6 million). The Company has not determined which option it will pursue. The Company currently reflects rent payments as an expense on its statements of income. If the Company purchases the land and buildings, the Company would reflect the costs as assets on its balance sheet, its rent expense would terminate, and the Company would record depreciation expense for the buildings over their estimated useful lives.

The Company spent \$1.6 million in the first quarter of 2002 for facility equipment and expansion projects that it began in 2001, and expects to spend approximately an additional \$1.0 million in the remainder of 2002 to complete these projects. The Company estimates that its expenditures for new carts and reusable surgical products will be approximately \$600,000 per month for the rest of the year, although this amount will fluctuate depending on the growth of business.

As of March 31, 2002, the Company had cash of approximately \$575,000. The Company believes that its cash flows from operating activities and funds available under its credit facility will be sufficient to fund its growth and anticipated capital requirements for the next twelve months.

### Certain Considerations

This report, other documents that are publicly disseminated by the Company, and oral statements that are made on behalf of the Company contain or might contain both statements of historical fact and forward-looking statements. Examples of forward-looking statements include: (a) projections of revenue, earnings, capital structure, and other financial items, (b) statements of the plans and objectives of the Company and its management, (c) statements of future economic performance, and (d) assumptions underlying statements regarding the Company or its business. The cautionary statements set forth below discuss important factors that could cause actual results to differ materially from any forward-looking statements. The Company assumes no obligation to update these forward-looking statements.

Sales Process and Market Acceptance of Products and Services. The Company's future performance depends on its ability to increase revenues to new and existing customers. The Company's sales process for new customers is typically between six and eighteen months in duration from initial contact to purchase commitment. The extended sales process is typically due to the complicated approval process within hospitals for purchases from new suppliers, the long duration of existing supply contracts, and implementation delays pending termination of a hospital's previous supply relationships. The long sales process inhibits the ability of the Company to quickly increase revenues from new and existing

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customers or enter new markets. The Company's future performance will also depend on market acceptance of its combination of reusable surgical products, disposable accessory packs, and direct delivery and retrieval service.

**Need for Capital.** The Company's business is capital intensive and will require substantial capital expenditures for additional surgical products and equipment during the next several years to achieve its operating and expansion plans. To adequately service a new customer, the Company typically makes an investment in new reusable surgical products and carts of approximately 40% of the projected new annual revenue from the customer. The Company's inability to obtain adequate capital could have a material adverse effect on the Company. See -- "Liquidity and Capital Resources."

**New Product Offering; Dependence on a Supplier.** The Company is regularly developing new instrument processing programs. While these programs are in their initial implementation stages, the Company is subject to a risk that the market will not broadly accept them. Further, the Company relies on Aesculap, Inc. as its major source of supply of laparoscopic instruments for its Surgical Express for Laparoscopy program. The Joint Marketing Agreement between the Company and Aesculap provides for Aesculap to furnish instruments to the Company for at least three years, subject to terms and conditions stated in the agreement. Any failure of Aesculap to furnish instruments for any reason would materially and adversely affect the Company's ability to service this program.

**Dependence on Significant Customers and Market Consolidation.** During the first quarter of 2002, Novation, Premier, Inc., and HPG hospitals accounted for approximately 35%, 15%, and 14% of the Company's sales, compared to 27%, 17%, and 13% in the first quarter of 2001, respectively. Although each Novation, Premier, and HPG hospital currently makes its purchasing decisions on an individual basis, and no single hospital accounted for more than 6% of the Company's sales, the loss of a substantial portion of the Novation, Premier, or HPG hospitals' business would have a material adverse effect on the Company.

**Competition.** The Company's business is highly competitive. Competitors include a number of distributors and manufacturers, as well as the in-house reprocessing operations of hospitals. Certain of the Company's existing and potential competitors possess substantially greater resources than the Company. Some of the Company's competitors, including Allegiance Corporation, serve as the sole supplier of a wide assortment of products to a significant number of hospitals. While the Company has a substantial array of surgical products, many of its competitors have a greater number of products for the entire hospital, which in some instances is a competitive disadvantage for the Company. There is no assurance that the Company will be able to compete effectively with existing or potential competitors.

**Government Regulation.** Significant aspects of the Company's businesses are subject to state and federal statutes and regulations governing, among other things, medical waste-disposal and workplace health and safety. In addition, most of the products furnished or sold by the Company are subject to regulation as medical devices by the U.S. Food and Drug Administration (FDA), as well as by other federal and state agencies. The Company's facilities are subject to quality systems inspections by FDA officials. The FDA has the power to enjoin future violations, seize adulterated or misbranded devices, require the manufacturer to remove products from the market, and publicize relevant facts. Federal or state governments might impose additional restrictions or adopt interpretations of existing laws that could materially adversely affect the Company.

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## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

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Class Action Litigation. Beginning on November 30, 2001, a series of substantially identical Class Action Complaints were filed in the United States District Court for the Middle District of Florida against the Company and certain of its officers and directors. The plaintiffs purport to assert claims on behalf of a class of purchasers of the Company's common stock during the period from July 23, 2001 through November 27, 2001. On April 19, 2002, these actions were consolidated into one case and the court appointed lead plaintiffs and lead counsel for the case. The actions claim violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated under that act. Among other things, the actions allege that during the class period, the Company and the individual defendants made materially false statements concerning the Company's financial condition and its future prospects. The actions seek compensatory and other damages, and costs and expenses associated with the litigation.

The Company believes that it has substantial defenses to this matter and intends to assert them vigorously. Management of the Company is unable to determine the impact, if any, that the resolution of this matter will have on the financial position or results of operations of the Company. No accruals for damages have been recorded for this matter as of March 31, 2002.

SEC Investigation. On February 21, 2002, the Securities and Exchange Commission issued a Formal Order of Private Investigation with respect to the Company. The investigation concerns the transactions underlying the Company's restatement of its financial results announced during its fourth quarter of 2001. The Company is cooperating with the investigation. Management of the Company is unable to determine the impact, if any, that the resolution of this matter will have on the financial position or results of operations of the Company.

### Item 2. Changes in Securities

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None.

### Item 3. Defaults Upon Senior Securities

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None

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

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None

### Item 5. Other Information

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None

### Item 6. Exhibits and Reports on Form 8-K

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None

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Reports on Form 8-K  
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The Company did not file a report on Form 8-K during the first quarter of 2002.

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SIGNATURE  
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Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

SRI/SURGICAL EXPRESS, INC.

Date: May 15, 2002

By: /s/ James T. Boosales  
-----

Executive Vice President  
Chief Financial Officer

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