

CATALINA LIGHTING INC
Form 10-Q
August 13, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 0-49881

Catalina Lighting, Inc.

(Exact Name of Registrant as Specified in Its Charter)

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Florida (State or Other Jurisdiction of Incorporation or Organization)	59-1548266 (I.R.S. Employer Identification No.)
18191 N.W. 68th Avenue Miami, Florida (Address of Principal Executive Offices)	33015 (Zip Code)

Registrant's Telephone Number, Including Area Code: (305) 558-4777

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by checkmark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act). Yes No .

The number of shares of the registrant's common stock, \$.01 par value, outstanding as of the close of business on July 29, 2004 was 4,316,059.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

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Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(In thousands)**

	June 30,	September 30,
	2004	2003
	<u>(Unaudited)</u>	<u></u>
Assets		
Current assets		
Cash and cash equivalents	\$ 2,874	\$ 2,899
Restricted cash	16	
Accounts receivable, net of allowance for doubtful accounts of \$936 and \$880, respectively	28,405	29,273
Inventories	39,405	34,392
Other current assets	4,915	5,032
	<u>75,615</u>	<u>71,596</u>
Total current assets	75,615	71,596
Property and equipment, net	15,680	16,665
Goodwill	28,282	28,282
Other assets, net	16,011	10,732
	<u>135,588</u>	<u>127,275</u>
Total assets	\$ 135,588	\$ 127,275

(Continues on Page 2)

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (continued)**

(In thousands, except share data)

	June 30, 2004	September 30, 2003
	(Unaudited)	
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	\$ 28,904	\$ 27,416
Revolving credit facilities	4,244	
Term loans	5,070	
Current maturities of other long-term debt	22	702
Other current liabilities	13,510	14,648
Total current liabilities	51,750	42,766
Revolving credit facilities	19,461	11,747
Term loans	449	12,284
Subordinated notes	2,776	3,038
Accrued pension and other liabilities	9,939	8,434
Total liabilities	84,375	78,269
Minority interest	1,061	1,211
Stockholders equity		
Preferred stock, \$.01 par value; authorized 1,000,000 shares; none issued		
Common stock, \$.01 par value; authorized 20,000,000 shares; issued 4,444,446 shares and 4,420,760 shares, respectively; outstanding 4,316,059 shares and 4,292,373 shares, respectively	44	44
Additional paid-in capital	39,159	38,604
Retained earnings	12,757	12,613
Deferred compensation	(69)	(262)
Accumulated other comprehensive income (loss)	722	(743)
Treasury stock, at cost, 128,387 shares	(2,461)	(2,461)
Total stockholders equity	50,152	47,795
Total liabilities and stockholders equity	\$ 135,588	\$ 127,275

See accompanying notes to condensed consolidated financial statements.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2004	2003	2004	2003
Net sales	\$ 50,467	\$ 48,398	\$ 158,190	\$ 154,510
Cost of sales	40,816	38,167	127,005	121,705
Gross profit	9,651	10,231	31,185	32,805
Selling, general and administrative expenses	10,113	7,816	27,062	23,024
Operating (loss) income	(462)	2,415	4,123	9,781
Other expenses:				
Interest expense	(1,175)	(874)	(3,132)	(2,946)
Net foreign currency gain (loss)	17	425	(641)	500
Other expenses	(40)	(28)	(129)	(32)
Total other expenses	(1,198)	(477)	(3,902)	(2,478)
(Loss) income before income taxes	(1,660)	1,938	221	7,303
Income tax (benefit) provision	(581)	679	77	2,557
Net (loss) income	\$ (1,079)	\$ 1,259	\$ 144	\$ 4,746
Weighted average number of shares outstanding				
Basic	5,581	5,559	5,577	5,557
Diluted	5,581	5,787	5,889	5,791
(Loss) earnings per share				
Basic	\$ (0.19)	\$ 0.23	\$ 0.03	\$ 0.85
Diluted	\$ (0.19)	\$ 0.22	\$ 0.02	\$ 0.82

See accompanying notes to condensed consolidated financial statements.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows****(Unaudited)****(In thousands)**

	Nine Months Ended June 30,	
	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 144	\$ 4,746
Adjustments for non-cash items:		
Gain on foreign currency exchange	(186)	(105)
Amortization to interest expense	1,256	986
Depreciation and other amortization	2,966	2,406
Deferred income taxes	(4,027)	(1,667)
Gain on disposition of property and equipment	(73)	(32)
Non-cash compensation	259	144
Change in assets and liabilities	(2,590)	2,375
Net cash (used in) provided by operating activities	<u>(2,251)</u>	<u>8,853</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(1,838)	(902)
Proceeds from sale of property and equipment, net	2,252	263
Net cash provided by (used in) investing activities	<u>414</u>	<u>(639)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on other long-term debt	(1,198)	(297)
Net borrowings (payments) on revolving credit facilities	11,320	(1,904)
Net payments on term loans	(7,085)	(6,925)
Payment of financing fees	(2,298)	
Changes in restricted cash	189	
Proceeds from exercise of stock options	111	8
Net cash provided by (used in) financing activities	<u>1,039</u>	<u>(9,118)</u>
Effect of exchange rate changes on cash	<u>773</u>	<u>76</u>
Net decrease in cash and cash equivalents	(25)	(828)
Cash and cash equivalents at beginning of period	2,899	2,657
Cash and cash equivalents at end of period	<u>\$ 2,874</u>	<u>\$ 1,829</u>

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Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Continued)****(Unaudited)****(In thousands)****Supplemental Disclosure of Cash Flow Information**

	Nine Months Ended June 30,	
	2004	2003
Cash paid for:		
Interest	\$ 2,030	\$ 2,034
Income taxes	\$ 4,120	\$ 2,536

In March 2004, warrants to purchase 5,486 shares at \$0.05 per share were exercised and warrants to purchase 23 shares were canceled in a cashless exercise.

Effective January 1, 2004, the Company amended the terms of stock options granted to the individual who formerly served as its Chief Financial Officer, and as a result recorded compensation expense of \$64,500 during the quarter ended March 31, 2004.

Effective December 1, 2002, the Company entered into a two-year consulting agreement with the individual who served as its Chief Executive Officer from July 2001 through November 2002. Concurrently with entering into this agreement, the Company amended the terms of the stock options granted to this individual and as a result was to incur compensation expense of approximately \$295,000 during the term of the consulting agreement on a straight-line basis. During the quarter ended December 31, 2003, the Company determined that the consultant had delivered all the anticipated benefit from the agreement. Consequently, the remaining deferred compensation was expensed in full in the first quarter of the fiscal year ended September 30, 2004. Compensation expense for the nine months ended June 30, 2004 and 2003 amounted to \$172,000 and \$86,000, respectively.

In November 2002, the Company issued 50,000 options to purchase shares of common stock to its new Chief Executive Officer at an exercise price of \$2.31 per share below the market price on the date of grant, resulting in compensation of \$116,000 that will be recognized over the four-year vesting period. Compensation expense for each of the three months ended June 30, 2004 and 2003 amounted to \$7,000. Compensation expense for the nine months ended June 30, 2004 and 2003 amounted to \$21,000 and \$18,000, respectively. The unamortized balance of approximately \$69,000 at June 30, 2004 is presented as deferred compensation in the accompanying balance sheet.

Effective November 1, 2002, the Company amended the terms of stock options granted to the individual who formerly served as its Chief Financial Officer, and as a result recorded compensation expense of \$40,000 during the first quarter of the fiscal year ended September 30, 2003.

See accompanying notes to condensed consolidated financial statements.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Catalina Lighting, Inc. and Subsidiaries (the Company) have been prepared in accordance with the accounting policies described in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2003 and should be read in conjunction with the consolidated financial statements and notes which appear in that report. These statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, the condensed consolidated financial statements include all adjustments (which consist of normal recurring accruals) considered necessary for a fair presentation. The results of operations for the three and nine months ended June 30, 2004 may not necessarily be indicative of operating results to be expected for any subsequent quarter or for the full fiscal year due to seasonal fluctuations in the Company's business, changes in economic conditions and other factors.

Restricted Cash

At June 30, 2004, the Company had \$16,000 of restricted cash, which collateralized trade letters of credit. At September 30, 2003, there was no restricted cash on hand.

Risks and Concentrations

The United Kingdom and China segments have one significant customer, which comprises the following percentages of consolidated net sales, as described below:

Three Months	Nine Months
Ended	Ended
June 30,	June 30,
<hr/>	<hr/>

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	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Customer of both UK and China segments	12.8%	18.2%	14.8%	17.2%

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (continued)****(Unaudited)**Stock-Based Compensation

The Company accounts for stock-based compensation issued to its employees using the intrinsic value method. Accordingly, compensation for stock options granted is measured as the excess, if any, of the fair value of the Company's common stock at the date of grant over the exercise price of the options. Had the compensation cost been determined based on the fair value of the stock options at the grant date, the Company's net (loss) income and basic and diluted (loss) earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share amounts):

	Three Months	
	Ended June 30,	
	2004	2003
Net (loss) income - as reported	\$ (1,079)	\$ 1,259
Add: stock-based employee compensation expense included in reported net income, net of income tax effect	5	29
Less: stock-based employee compensation determined under the fair value method, net of income tax effect	(79)	(128)
Net (loss) income - pro forma	\$ (1,153)	\$ 1,160
Basic (loss) earnings per share - as reported	\$ (0.19)	\$ 0.23
Basic (loss) earnings per share - pro forma	\$ (0.21)	\$ 0.21
Diluted (loss) earnings per share - as reported	\$ (0.19)	\$ 0.22
Diluted (loss) earnings per share - pro forma	\$ (0.21)	\$ 0.20

There were no options granted during the three months ended June 30, 2004 and 2003. The above table represents the effects of options vesting during the three month periods, but issued in prior periods.

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (continued)

(Unaudited)

	Nine Months	
	Ended June 30,	
	2004	2003
Net income - as reported	\$ 144	\$ 4,746
Add: stock-based employee compensation expense included in reported net income, net of income tax effect	15	67
Less: stock-based employee compensation determined under the fair value method, net of income tax effect	(242)	(318)
Net (loss) income - pro forma	\$ (83)	\$ 4,495
Basic earnings per share - as reported	\$ 0.03	\$ 0.85
Basic (loss) earnings per share - pro forma	\$ (0.01)	\$ 0.81
Diluted earnings per share - as reported	\$ 0.02	\$ 0.82
Diluted (loss) earnings per share - pro forma	\$ (0.01)	\$ 0.78

For purposes of the above pro forma disclosures, the weighted-average fair value of options has been estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants for the nine months ended June 30, 2004 and 2003, respectively: no dividend yield; expected volatility between 87% and 88%; risk-free interest rate between 3.1% and 3.0%; and an expected five-year holding period for options granted. The weighted average fair value at date of grant of options granted during the nine months ended June 30, 2004 and 2003 was \$8.38 and \$6.24 per option, respectively.

Comprehensive (Loss) Income (in thousands)

Total comprehensive (loss) income consisted of the following:

	Three Months		Nine Months	
	Ended June 30,		Ended June 30,	
	2004	2003	2004	2003
Net (loss) income	\$ (1,079)	\$ 1,259	\$ 144	\$ 4,746
Foreign currency translation gain (loss)	(340)	546	1,465	558

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Total comprehensive (loss) income	\$ (1,419)	\$ 1,805	\$ 1,609	\$ 5,304
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Components of Accumulated Other Comprehensive Income (Loss) are:

	June 30, 2004	September 30, 2003
Foreign currency exchange gain	\$ 3,416	\$ 1,951
Pension liability adjustment	(2,694)	(2,694)
Total accumulated other comprehensive income (loss)	\$ 722	\$ (743)

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CATALINA LIGHTING, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

New Accounting Pronouncements

On March 31, 2004, the Financial Accounting Standards Board (FASB) issued a proposed statement, *Share-Based Payment*, that addresses the accounting for share-based payment transactions (for example, stock options and awards of restricted stock) in which an employer receives employee-services in exchange for equity securities of the company or liabilities that are based on the fair value of the company's equity securities. This proposal, if finalized as proposed, would eliminate use of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally would require such transactions be accounted for using a fair-value-based method and recording compensation expense rather than optional pro forma disclosure of what expense amounts might be. The proposal, if approved, would substantially amend FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Because of the timing of the proposal and the uncertainty of whether it will be adopted substantially as proposed, management has not completed its review of the proposal or assessed its potential impact on the Company.

In December 2003, the FASB issued Statements of Financial Accounting Standards (SFAS) No. 132 revised (SFAS No. 132R), *Employers Disclosures about Pensions and Other Postretirement Benefits*. The provisions of SFAS No. 132R do not change the measurement and recognition provisions of SFAS No. 87, *Employers Accounting for Pensions* or SFAS No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Plans and Termination Benefits*. During the three months ended March 31, 2004, the Company adopted the provisions of SFAS No. 132R (see Note 5), which did not have a material effect on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities (VIE)*, which establishes criteria to identify variable interest entities and the primary beneficiary of such entities. An entity that qualifies as a VIE must be consolidated by its primary beneficiary. All other holders of interests in a VIE must disclose the nature, purpose, size and activity of the VIE as well as their maximum exposure to losses as a result of involvement with the VIE. FIN 46 was revised in December 2003 and is effective for financial statements of public entities that have special-purpose entities, as defined, for periods ending after December 15, 2003. For public entities without special-purpose entities, it is effective for financial statements for periods ending after March 15, 2004. The Company does not have any special-purpose entities, as defined, and accordingly the adoption of FIN 46 did not have a material effect on the Company's consolidated financial statements.

A variety of proposed or otherwise potential accounting standards are currently under study by standard-setting organizations and various regulatory agencies. Because of the tentative and preliminary nature of these proposed standards, management has not determined whether implementation of such proposed standards would be material to the Company's consolidated financial statements.

Reclassifications

Certain amounts presented in the financial statements of prior periods have been reclassified to conform to the current period presentation.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****2. Inventories**

Inventories consisted of the following (in thousands):

	June 30, 2004	September 30, 2003
Raw materials	\$ 2,568	\$ 2,142
Work-in-progress	1,247	377
Finished goods	35,590	31,873
Total inventories	\$ 39,405	\$ 34,392

3. Asset-based Credit Facility

On December 23, 2003, the Company entered into a new asset-based credit facility with a syndicate of lenders to refinance its indebtedness under its former \$75 million credit facility. The new facility matures June 30, 2006. The facility consists of two term loans in the amount of GBP 305,000 (\$556,000) and \$5.0 million and two revolving facilities in the amount of GBP 22.0 million (\$40.1 million) and \$6.0 million for loans, acceptances, and trade and stand-by letters of credit for the Company's ongoing operations in the United States and United Kingdom. Amounts outstanding under each revolving facility are limited under separate U.S. and U.K. borrowing bases that are defined as percentages of eligible accounts receivable and inventory. At June 30, 2004, the Company had approximately \$8.8 million available under this facility. Obligations under the facility are secured by substantially all of the Company's U.S. and U.K. assets. The facility prohibits the payment of cash dividends or other distribution on any shares of the Company's common stock. The Company pays a monthly commitment fee of 0.375% per annum based on the unused portion of the revolving facilities as well as a monthly servicing fee of \$7,500. If the \$5.0 million term loan is not repaid by the first anniversary of the loan, a fee of \$500,000 is due. No related provision has been made in the accompanying consolidated financial statements as the Company expects to repay the term loan by December 2004. Borrowings under the revolving facilities and the GBP 305,000 term loan bear interest, payable monthly, at LIBOR plus 2.25%. Borrowings under the \$5.0 million term loan bear interest at 9.0% per annum, payable monthly. The Company is required to meet monthly minimum levels of adjusted earnings and adjusted net worth, as defined in the facility, as well as a maximum debt to adjusted earnings ratio. Capital expenditures are limited to \$3.8 million per year. The Company paid a \$450,000 investment-banking fee to an affiliate of its majority shareholder for services provided in connection with the refinancing. Total fees incurred in connection with the refinancing were approximately \$2.3 million, of which \$1.8 million is being amortized over the term of the facility and \$550,000 is being amortized over 12 months starting January 1, 2004.

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****4. Segment Information**

Information on operating segments and a reconciliation to income before income taxes for the three and nine months ended June 30, 2004 and 2003 are as follows (in thousands):

Net Sales by Business Segment:

	Three Months Ended June 30,					
	2004			2003		
	External customers	Intersegment	Total	External customers	Intersegment	Total
North America	\$ 14,271	\$	\$ 14,271	\$ 13,327	\$	\$ 13,327
United Kingdom	32,534		32,534	32,003		32,003
China Manufacturing and Distribution	3,662	3,814	7,476	3,068	2,522	5,590
Eliminations		(3,814)	(3,814)		(2,522)	(2,522)
Total	\$ 50,467	\$	\$ 50,467	\$ 48,398	\$	\$ 48,398

	Nine Months Ended June 30,					
	2004			2003		
	External customers	Intersegment	Total	External customers	Intersegment	Total
North America	\$ 39,150	\$	\$ 39,150	\$ 46,171	\$	\$ 46,171
United Kingdom	108,353		108,353	97,403		97,403
China Manufacturing and Distribution	10,687	10,097	20,784	10,936	7,701	18,637
Eliminations		(10,097)	(10,097)		(7,701)	(7,701)
Total	\$ 158,190	\$	\$ 158,190	\$ 154,510	\$	\$ 154,510

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Segment Contribution (Loss):**

	Three Months	
	Ended June 30,	
	2004	2003
North America	\$ (3,749)	\$ (647)
United Kingdom	2,549	3,168
China Manufacturing and Distribution	(86)	88
Subtotal for segments	(1,286)	2,609
Parent/administrative expenses and other	(374)	(671)
Income (loss) before income taxes	\$ (1,660)	\$ 1,938

	Nine Months	
	Ended June 30,	
	2004	2003
North America	\$ (7,043)	\$ (2,157)
United Kingdom	10,786	10,354
China Manufacturing and Distribution	(531)	1,369
Subtotal for segments	3,212	9,566
Parent/administrative expenses and other	(2,991)	(2,263)
Income before income taxes	\$ 221	\$ 7,303

Interest Expense (1):

	Three Months	
	Ended June 30,	
	2004	2003

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North America	\$ 107	\$ 55
United Kingdom	878	620
China Manufacturing and Distribution	15	1
	<u> </u>	<u> </u>
Subtotal for segments	1,000	676
Parent	175	198
	<u> </u>	<u> </u>
Total interest expense	\$ 1,175	\$ 874
	<u> </u>	<u> </u>

Nine Months

Ended June 30,

	<u>2004</u>	<u>2003</u>
North America	\$ 237	\$ 267
United Kingdom	2,213	2,139
China Manufacturing and Distribution	22	2
	<u> </u>	<u> </u>
Subtotal for segments	2,472	2,408
Parent	660	538
	<u> </u>	<u> </u>
Total interest expense	\$ 3,132	\$ 2,946
	<u> </u>	<u> </u>

Table of Contents**CATALINA LIGHTING, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Total Assets by asset location:**

	June 30, 2004	September 30, 2003
North America (2)	\$ 31,937	\$ 30,036
United Kingdom	99,937	74,585
China (3)	29,346	27,283
Eliminations	(25,632)	(4,629)
Total assets	\$ 135,588	\$ 127,275

Property and Equipment, net:

	June 30, 2004	September 30, 2003
North America (2)	\$ 627	\$ 1,729
United Kingdom	1,956	2,056
China (3)	13,097	12,880
Property and equipment, net	\$ 15,680	\$ 16,665

Expenditures for Additions to Property and Equipment:

	Nine Months	
	Ended June 30,	
	2004	2003
North America		