ALLIED HEALTHCARE PRODUCTS INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 September 30, 2006

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Action of 1934

For the transition period from __________________ to __________________

Commission File Number 0-19266

ALLIED HEALTHCARE PRODUCTS, INC.

1720 Sublette Avenue
St. Louis, Missouri 63110
314/771-2400
IRS Employment ID 25-1370721

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 twelve months (or for such shorter periods that the registrant was required to file such reports, and (2) has been subject to such filing requirements for the past ninety days.

Yes [X] No [ ]

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 [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

Yes [ ] No [X]

The number of shares of common stock outstanding at November 1, 2006 is 7,874,577 shares.

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SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Statements contained in this Report, which are not historical facts or information, are "forward-looking statements." Words such as "believe," "expect," "intend," "will," "should," and other expressions that indicate future events and trends identify such forward-looking statements. These forward-looking statements involve risks and uncertainties, which could cause the outcome and future results of operations, and financial condition to be materially different than stated or anticipated based on the forward-looking statements. Such risks and uncertainties include both general economic risks and uncertainties, risks and uncertainties affecting the demand for and economic factors affecting the delivery of health care services, and specific matters which relate directly to the Company's operations and properties as discussed in the Company's annual report on Form 10-K for the year ended June 30, 2006. The Company cautions that any forward-looking statements contained in this report reflects only the belief of the Company or its management at the time the statement was made. Although the Company believes such forward-looking statements are based upon reasonable assumptions, such assumptions may ultimately prove inaccurate or incomplete. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement was made.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALLIED HEALTHCARE PRODUCTS, INC.

CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three months ended September 30, 2006	Three months ended September 30, 2005
Net sales	$14,477,442	$14,986,280
Cost of sales	10,957,890	11,011,763
Gross profit	3,519,552	3,974,517
Selling, general and administrative expenses	3,190,997	3,169,959
Income from operations	328,555	804,558
Interest income	(28,169)	(7,957)
Other expense, net	9,302	11,069
	(18,867)	3,112
Income before provision for income taxes	347,422	801,446
Provision for income taxes	145,788	335,605
Net income	$ 201,634	$ 465,841
Basic and diluted earnings per share	$ 0.03	$ 0.06
Weighted average shares outstanding - basic	7,859,903	7,829,577
Weighted average shares outstanding - diluted	8,065,153	8,061,758

See accompanying Notes to Consolidated Financial Statements.

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ALLIED HEALTHCARE PRODUCTS, INC.
CONSOLIDATED BALANCE SHEET
ASSETS

	(Unaudited) September 30, 2006	June 30, 2006
Current assets:		
Cash and cash equivalents	$ 2,418,227	$ 2,696,324
Accounts receivable, net of allowances of $430,000	7,586,497	7,429,355
Inventories, net	11,944,922	11,491,305
Other current assets	660,555	224,853
Total current assets	22,610,201	21,841,837

Property, plant and equipment, net	11,063,163	11,252,934
Goodwill	15,979,830	15,979,830
Other assets, net	254,534	255,845
Total assets	$49,907,728	$49,330,446

See accompanying Notes to Consolidated Financial Statements.

(CONTINUED)

ALLIED HEALTHCARE PRODUCTS, INC.
CONSOLIDATED BALANCE SHEET
(CONTINUED)
LIABILITIES AND STOCKHOLDERS' EQUITY

	(Unaudited) September 30, 2006	June 30, 2006
Current liabilities:		
Accounts payable	$ 3,670,235	$ 3,208,699
Deferred income taxes	687,056	689,942
Deferred revenue	465,000	465,000
Other accrued liabilities	2,778,569	2,834,495
Total current liabilities	7,600,860	7,198,136
Deferred revenue	1,356,250	1,472,500
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; $0.01 par value; 1,500,000 shares authorized; no shares issued and outstanding	--	--
Series A preferred stock; $0.01 par value; 200,000 shares authorized; no shares issued and outstanding	--	--
Common stock; $0.01 par value; 30,000,000 shares authorized; 10,178,069 shares issued at September 30, 2006 and 10,155,569 shares issued at June 30, 2006: 7,874,577 shares outstanding at September 30, 2006 and 7,852,077 shares outstanding June 30, 2006, respectively	101,781	101,556
Additional paid-in capital	47,347,131	47,258,182
Retained earnings	14,233,134	14,031,500
Less treasury stock, at cost; 2,303,492 shares at September 30, 2006 and June 30, 2006, respectively	(20,731,428)	(20,731,428)
Total stockholders' equity	40,950,618	40,659,810
Total liabilities and stockholders' equity	$ 49,907,728	$ 49,330,446

See accompanying Notes to Consolidated Financial Statements.

ALLIED HEALTHCARE PRODUCTS, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Three months ended September 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 201,634	$ 465,841
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	300,420	288,462
Stock based compensation	14,364	18,552
Provision for doubtful accounts and sales returns and allowances	(8,462)	62,728
Deferred tax benefit	(2,886)	(7,607)
Changes in operating assets and liabilities:		
Short-term investments	--	(651,277)
Accounts receivable	(148,680)	(864,243)
Inventories	(453,617)	(119,820)
Other current assets	(435,702)	(392,422)
Accounts payable	461,536	1,249,250
Deferred revenue	(116,250)	(116,250)
Other accrued liabilities	(55,926)	309,555
Net cash provided by (used in) operating activities	(243,569)	242,769
Cash flows from investing activities:		
Capital expenditures	(109,338)	(198,968)
Net cash used in investing activities	(109,338)	(198,968)
Cash flows from financing activities:		
Stock options exercised	54,450	--
Excess tax benefit from exercise of stock options	20,360	--
Net cash provided by financing activities	74,810	--
Net increase (decrease) in cash and cash equivalents	(278,097)	43,801
Cash and cash equivalents at beginning of period	2,696,324	317,775
Cash and cash equivalents at end of period	$2,418,227	$ 361,576

See accompanying Notes to Consolidated Financial Statements.

ALLIED HEALTHCARE PRODUCTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Unaudited Consolidated Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for any quarter are not necessarily indicative of the results for any other quarter or for the full year. These statements should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements thereto included in the Company's Form 10-K for the year ended June 30, 2006.

2. Significant Accounting Policies

Stock Options

A summary of option activity under the plans for the three months ended September 30, 2006 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Balance, June 30, 2006	741,750	$2.66		
Options Granted	30,000	5.18		
Options Exercised	(22,500)	2.42		
Options Forfeited	(7,500)	2.42		
Options Expired	(7,000)	6.75		
Balance, September 30, 2006	734,750	$2.73	3.7	$1,919,605
Exercisable, September 30, 2006	663,500	$2.47	3.1	$1,913,980

On December 14, 2005, options for an aggregate of 5,500 shares were granted as formula options under the 2005 Directors' Plan at $5.63 per share, however such options are void unless the 2005 Directors' Plan is approved by shareholders at or before the 2006 Annual Meeting of Shareholders. Such options are not reflected in the foregoing table and for accounting purposes are not deemed granted prior to receipt of such shareholder approval.

The fair value of options granted is estimated on the date of grant using the Black-Scholes option-pricing model. For options granted during the three months ended September 30, 2006 and 2005, the weighted average assumptions utilized in the Black-Scholes option-pricing model are as follows:

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005
Weighted avarage fair value	$2.50	$3.20
Volatility	41%	51%
Expected life (in years)	6.25 years	10 years
Risk-free interest rate	4.8%	4.2%
Dividend yield	0%	0%

Share-based compensation expense included in the statement of operations for the three months ended September 30, 2006 and 2005 was approximately $14,000 and $19,000 respectively. As of September 30, 2006, the total unrecognized shared-based compensation cost related to unvested stock options amounts to approximately $183,000. The cost is expected to be recognized over the next four years.

For the three months ended September 30, 2006, 22,500 stock options were exercised with an intrinsic value of $58,050. Cash received from stock options exercised was $54,450 with a tax benefit of $20,360. No stock options were exercised for the three months ended September 30, 2005.

3. Inventories

Inventories are comprised as follows:

	September 30, 2006	June 30, 2006
Work-in progress	$ 1,081,959	$ 715,643
Raw materials and component parts	8,683,743	8,820,622
Finished goods	3,326,078	3,123,435
Reserve for obsolete and excess inventory	(1,146,858)	(1,168,395)
	$11,944,922	$11,491,305

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4. Earnings per share

Basic earnings per share are based on the weighted average number of shares of all common stock outstanding during the period. Diluted earnings per share are based on the sum of the weighted average number of shares of common stock and common stock equivalents outstanding during the year. The number of basic shares outstanding for the three months ended September 30, 2006 and 2005 was 7,859,903 and 7,829,577 respectively. The number of diluted shares outstanding for the three months ended September 30, 2006 and 2005 was 8,065,153 and 8,061,758 respectively.

5. Commitments and Contingencies

The Company is subject to various investigations, claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its business activities. The Company has recognized the costs and associated liabilities only for those investigations, claims and legal proceedings for which, in its view, it is probable that liabilities have been incurred and the related amounts are estimable. Based upon information currently available, management believes that existing accrued liabilities are sufficient and that it is not reasonably possible at this time to believe that any additional liabilities will result from the resolution of these matters that would have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

6. Financing

On September 1, 2005, the Bank and the Company agreed to an amendment of the credit facility. In conjunction with the amendment to the Company's credit facility, the Bank extended the maturity on the Company's revolving credit facility from April 24, 2007 to September 1, 2008. Based on the Company's current level of debt, and performance, debt would bear interest at the Bank's prime rate. The prime rate was 8.25% on September 30, 2006. The interest rate on prime rate loans may increase from prime to prime plus 0.75% if the ratio of the Company's funded debt to EBITDA exceeds 2.5. The amended credit facility also provides the Company with a rate of LIBOR plus 1.75%, at the Company's option. The optional LIBOR rate may increase from LIBOR plus 1.75% to LIBOR plus 2.75% based on the Company's fixed charge coverage ratio. The 90-day LIBOR rate was 5.37% at September 30, 2006.

At September 30, 2006 the Company had no aggregate indebtedness, including capital lease obligations, short-term debt and long term debt.

The Company was in compliance with all of the financial covenants associated with its credit facility at September 30, 2006.

7. Stock Repurchase Arrangement

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On August 25, 2005, the Board of Directors authorized repurchases of shares of the Company's common stock pursuant to open market transactions in accordance with Rule 10b-18 under the Securities Exchange Act or in privately negotiated block transactions. The authorization permits repurchases from time to time until June 30, 2007 at the discretion of the Chairman of the Board or the President and Chief Executive Officer. The authorization permits up to $1.0 million to be applied to such repurchases. No specific number of shares are sought in connection with the authorization. The Company received the consent of the Bank for this authorized repurchase. As of September 30, 2006 no shares have been repurchased under this arrangement.

8. Baralyme(R) Agreement

A reconciliation of deferred revenue resulting from the agreement with Abbott Laboratories ("Abbott"), with the amounts received under the agreement, and amounts recognized as net sales is as follows:

Three Months ended September 30,	
2006	2005

Beginning balance	$1,937,500	$1,472,500
Payment Received from Abbott Laboratories	--	--
Revenue recognized as net sales	(116,250)	(116,250)
	1,821,250	1,356,250
Less - Current portion of deferred revenue	(465,000)	(465,000)
	$1,356,250	$ 891,250

In addition to the provisions of the agreement relating to the withdrawal of the Baralyme(R) product, Abbott has agreed to pay Allied up to $2,150,000 in product development costs to pursue development of a new carbon dioxide absorption product for use in connection with inhalation anesthetics that does not contain potassium hydroxide and does not produce a significant exothermic reaction with currently available inhalation agents. As of September 30, 2006; $363,000 has been received, and $57,000 is receivable, as a result of product development activities. For the three months ended September 30, 2006; $149,512 has been included in Net Sales and $149,512 has been included in Cost of Sales.

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

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2005.

Allied had net sales of $14.5 million for the three months ended September 30, 2006, down $0.5 million, or 3.3%, from net sales of $15.0 million in the prior year same quarter. The overall sales decrease is primarily due to production delays as a result of component shortages for products with higher than normal demand and the timing of customer purchase order releases. These delays reduced shipments by approximately $0.4 million for the quarter. Customer purchase order releases were $0.7 million lower than in fiscal 2006 further contributing to the decrease in sales for the quarter. Purchase order release times depend on the scheduling practices of individual customers.

Sales for the three months ended September 30, 2006 include $116,250 for the recognition into income of payments resulting from the agreement with Abbott Laboratories to cease the production and distribution of Baralyme(R). Sales for the three months ended September 30, 2006 also include $149,512 as a result of product development activities to pursue development of a new carbon dioxide absorption product. The agreement with Abbott provides for Abbott to pay Allied up to $2,150,000 in product development cost to pursue development of a new carbon dioxide absorption product for use in connection with inhalation anesthetics that does not contain potassium hydroxide and does not produce a significant exothermic reaction with currently available inhalation agents.

The Company ceased the sale of Baralyme(R) on August 27th, 2004. Sales for the three months ended September 30, 2005 include $116,250 for the recognition into income of payments resulting from the agreement with Abbott Laboratories to cease the production and distribution of Baralyme(R). Sales for the three months ended September 30, 2005 also include $74,000 as a result of product development activities to pursue development of a new carbon dioxide absorption product. Income from the agreement will continue to be recognized over eight years, the term of the agreement, at $38,750 per month. Allied continues to sell Carbolime(R), a carbon dioxide absorbent with a different formulation than Baralyme(R).

Domestic sales were down 3.5% from the prior year, while international business, which represented 15.4% of first quarter sales, was down 2.7%. Orders for the Company's products for the three months ended September 30, 2006 of $13.8 million were $0.2 million or 1.4% lower than orders for the prior year same quarter of $14.0 million. Domestic orders are up 2.4% over the prior year period while international orders have declined by 17.4%. The Company believes that the slight decrease in

orders, primarily for international construction products, is a result of order timing, and is not reflective of a loss of market share. International orders and shipments are dependent on hospital construction projects and the expansion of medical care in those regions.

Gross profit for the three months ended September 30, 2006 was $3.5 million, or 24.1% of net sales, compared to $4.0 million, or 26.7% of net sales, for the three months ended September 30, 2005. The reduction in gross margins from the prior year period is primarily due to an increase in material cost which occurred during fiscal 2006 and continues to negatively impact gross margins. Material cost during the first quarter was 8.3% higher than in the first quarter of the prior year. The majority of this increase occurred during the fiscal year ended June 30, 2006. Cost of sales for the three months ended September 30, 2006 also included $149,512 as a result of product development of a new carbon dioxide absorption product.

Selling, general and administrative expenses for the three months ended September 30, 2006 and 2005 were $3.2 million. Salaries and benefits increased by $29,000 from the prior year as a result of scheduled increases. There have not been changes to staffing levels from the prior year. Also, relocation and recruiting expenses increased by approximately $0.1 million over the same quarter of the prior year due to the employment searches resulting from employee turnover. These increases were offset by decreases in other spending including $49,000 in legal fees, $40,000 in insurance cost, and $41,000 in bad debt expense.

Income from operations was $0.3 million for the three months ended September 30, 2006 compared to $0.8 million for the three months ended September 30, 2005. Interest income was $28,169 for the three months ended September 30, 2006 compared to interest income of $7,957 for the three months ended September 30, 2005. Allied had income before provision for income taxes in the first quarter of fiscal 2007 of $0.3 million, compared to income before provision for income taxes in the first quarter of fiscal 2006 of $0.8 million. The Company recorded a tax provision of $0.1 million for the three-month period ended September 30, 2006, versus a tax provision of $0.3 million for the three-month period ended September 30, 2005.

In fiscal 2007, the net income for the first quarter was $0.2 million or $0.03 per basic and diluted share compared to net income of $0.5 million or $0.06 per basic and diluted share for the first quarter of fiscal 2006. The weighted average number of common shares outstanding, used in the calculation of basic earnings per share for the first quarters of fiscal 2007 and 2006 were 7,859,903 and 7,829,577 shares respectively. The weighted average number of common shares outstanding used in the calculation of diluted earnings per share for the first quarters of fiscal 2007 and fiscal 2006 were 8,065,153 and 8,061,758 shares, respectively.

LIQUIDITY AND CAPITAL RESOURCES

The Company believes that available resources and anticipated cash flows from operations are sufficient to meet operating requirements in the coming year.

The Company's working capital was $15.0 million at September 30, 2006 compared to $14.6 million at June 30, 2006. Inventory increased by $0.5 million as a result of an effort by the Company to increase inventory levels of key items to improve customer service levels. Other current assets increased $0.4 million as a result of an increase in prepaid insurance. Accounts receivable increased to $7.6 million at September 30, 2006, up $0.2 million from $7.4 million at June 30, 2006. Accounts receivable as measured in days sales outstanding ("DSO") remained unchanged at 46 DSO. Accrued liabilities decreased $0.1 million. At September 30, 2006, these increases in working capital were offset by an increase in accounts payable of $0.5 million and a decrease in cash and cash equivalents of $0.3 million.

On August 25, 2005, the Board of Directors authorized repurchases of shares of the Company's common stock pursuant to open market transactions in accordance with Rule 10b-18 under the Securities Exchange Act or in privately negotiated block transactions. The authorization permits repurchases from time to time until June 30, 2007 at the discretion of the Chairman of the Board or the President and Chief Executive Officer. The authorization permits up to $1.0 million to be applied to such repurchases. No specific number of shares are sought in connection with the authorization. The Company received the consent of the Bank for this authorized repurchase. As of September 30, 2006 no shares have been repurchased under this arrangement.

On September 1, 2005, the Bank and the Company agreed to an amendment of the credit facility. In conjunction with the amendment to the Company's credit facility, the Bank extended the maturity on the Company's revolving credit facility from April 24, 2007 to September 1, 2008. Based on the Company's current level of debt, and performance, debt would bear interest at the Bank's prime rate. The prime rate was 8.25% on September 30, 2006. The interest rate on prime rate loans may increase from prime to prime plus 0.75% if the ratio of the Company's funded debt to EBITDA exceeds 2.5. The amended credit facility also provides the Company with a rate of LIBOR plus 1.75%, at the Company's option. The optional LIBOR rate may increase from LIBOR plus 1.75% to LIBOR plus 2.75% based on the Company's fixed charge coverage ratio. The 90-day LIBOR rate was 5.37% at September 30, 2006.

At September 30, 2006 the Company had no aggregate indebtedness, including capital lease obligations, short-term debt and long term debt.

The Company was in compliance with all of the financial covenants associated with its credit facility at September 30, 2006.

In the event that economic conditions were to severely worsen for a protracted period of time, we believe that our borrowing capacity under our credit facilities will provide sufficient financial flexibility. The Company would have options available to ensure liquidity in addition to increased borrowing. Capital expenditures, which are budgeted at $0.8 million for the fiscal year ended June 30, 2007, could be postponed. At September 30, 2006, the Company had no bank debt. Based on the Company's current

level of debt, and performance, debt would bear interest at the Bank's prime rate. The Company's agreement with the Bank does include provisions for higher interest rates at higher debt levels and different levels of Company performance.

LITIGATION AND CONTINGENCIES

The Company becomes, from time to time, a party to personal injury litigation arising out of incidents involving the use of its products. The Company believes that any potential judgments resulting from these claims over its self-insured retention will be covered by the Company's product liability insurance.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

At September 30, 2006, the Company did not have any debt outstanding. The revolving credit facility bears an interest rate using the commercial bank's "floating reference rate" or LIBOR as the basis, as defined in the loan agreement, and therefore is subject to additional expense should there be an increase in market interest rates.

The Company had no holdings of derivative financial or commodity instruments at September 30, 2006. Allied Healthcare Products has international sales; however these sales are denominated in U.S. dollars, mitigating foreign exchange rate fluctuation risk.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

(a) As of September 30, 2006, the Company, under the supervision, and with the participation, of its management, including its principal executive officer and principal financial officer, performed an evaluation of the Company's disclosure controls and procedures, as contemplated by Securities Exchange Act Rule 13a-15. Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that such disclosure controls and procedures were effective as of September 30, 2006.

(b) There has been no change in our internal controls over financial reporting during the quarter ended September 30, 2006, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

ITEM 6. EXHIBITS

(a) Exhibits:

31.1 Certification of Chief Executive Officer (filed herewith)

31.2 Certification of Chief Financial Officer (filed herewith)

32.1 Sarbanes-Oxley Certification of Chief Executive Officer (furnished herewith)*

32.2 Sarbanes-Oxley Certification of Chief Financial Officer (furnished herewith)*

99.1 Press Release dated November 9, 2006 announcing second quarter earnings*

* Notwithstanding any incorporation of this Quarterly Report on Form 10-Q in any other filing by the Registrant, Exhibits furnished herewith and designated with an asterisk (*) shall not be deemed incorporated by reference to any other filing under the Securities Act of 1933 or the Securities Exchange Act of 1934 unless specifically otherwise set forth therein.

SIGNATURE

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

ALLIED HEALTHCARE PRODUCTS, INC.

/s/ Daniel C. Dunn

Daniel C. Dunn
Chief Financial Officer

Date: November 7, 2006