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ALTERNATIVE TECHNOLOGY RESOURCES INC

Form 10-Q

November 13, 2001

United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2001

Commission file number 0-20468

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

68-0195770
(IRS Employer Identification No.)

33 Jewel Court, Portsmouth, N.H. 03801
(Address of principal executive offices)

(603) 501-3200
(Registrant's telephone number, including area code)

(Former address if changed since last report)

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

Number of shares of common stock outstanding as of September 30, 2001:
59,418,344

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
Condensed Balance Sheets
(Unaudited)

September 30,

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	2001	
	-----	-----
Assets		

Current assets:		
Cash and cash equivalents	\$ 2,749,984	\$
Short-term investments	-	
Trade accounts receivable	225	
Interest receivable	7,978	
Prepaid expenses and other current assets	241,984	
	-----	-----
Total current assets	3,000,171	
	-----	-----
Property and equipment:		
Equipment and software	592,659	
Accumulated depreciation and amortization	(142,395)	
	-----	-----
Property and equipment, net	450,264	
	-----	-----
Prepaid annual license and service fees	242,138	
Other non-current assets	40,996	
	-----	-----
	\$ 3,733,569	\$
	=====	=====
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Payable to Healthcare Exchange participants	\$ 86,348	\$
Trade accounts payable	232,889	
Accrued payroll and related expenses	363,858	
Accrued preferred stock dividends	283,195	
Accounts payable and accrued interest payable to stockholders	530,866	
Other current liabilities	240,533	
	-----	-----
Total current liabilities	1,737,689	
	-----	-----
Notes payable to stockholder	1,630,529	
Convertible notes payable to stockholder	2,423,823	
	-----	-----
Total notes payable to stockholders	4,054,352	
Commitments and contingencies		
Stockholders' equity (deficit):		
Common stock, \$0.01 par value - 100,000,000 shares authorized; 59,418,344 shares issued and outstanding at September 30, 2001 (59,394,844 at June 30, 2001)	594,184	
Additional paid-in capital	49,128,300	4
Accumulated other comprehensive (loss)	-	
Accumulated deficit	(51,780,956)	(4
	-----	-----
Total stockholders' equity (deficit)	(2,058,472)	
	-----	-----
	\$ 3,733,569	\$
	=====	=====

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See accompanying notes to condensed financial statements.

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PART I. FINANCIAL INFORMATION Item 1. Financial Statements

ALTERNATIVE TECHNOLOGY RESOURCES, INC. Condensed Statements of Operations (Unaudited)

	Three Months Ended September 30	
	2001	2000
	-----	-----
Healthcare Exchange		
Healthcare exchange revenue	\$ 108,218	\$ -
Healthcare exchange costs	(224,788)	-
	-----	-----
Healthcare exchange gross profit (loss)	(116,570)	-
Contract Programming		
Contract programming revenue	-	178,019
Programmer costs	-	(129,602)
Start-up and other costs	-	(6,200)
	-----	-----
Contract programming gross profit	-	42,217
Selling, Marketing and Product development costs	(1,505,195)	(1,057,426)
General and administrative expenses	(505,834)	(2,141,486)
	-----	-----
Loss from operations	(2,127,599)	(3,156,695)
Other income (expense)		
Interest income	33,133	80,736
Interest expense to stockholders and directors	(139,517)	(131,672)
	-----	-----
Total other income (expense)	(106,384)	(50,936)
	-----	-----
Net loss	(2,233,983)	(3,207,631)
Preferred stock dividends in arrears	-	(886,142)
	-----	-----
Net loss applicable to common stockholders	\$ (2,233,983)	\$ (4,093,773)
	=====	=====
Basic and diluted net loss per share	\$ (0.04)	\$ (0.07)
	=====	=====
Shares used in per share calculations	59,401,860	56,695,586
	=====	=====

See accompanying notes to condensed financial statements.

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ALTERNATIVE TECHNOLOGY RESOURCES, INC. Condensed Statements of Cash Flows (Unaudited)

	Three Months Ended September 30	
	2001	2000
	-----	-----
Net cash used in operating activities	\$ (2,005,312)	\$ (1,575,969)
	-----	-----
Cash flows used in investing activities:		
Purchases of property and equipment	(91,033)	(51,972)
Maturities of short-term investments	1,354,159	-
	-----	-----
Net cash provided (used) by investing activities	1,263,126	(51,972)
	-----	-----
Cash flows from financing activities:		
Proceeds from sale of common stock	-	9,564,644
Proceeds from exercise of options and warrants	19,251	26,666
Proceeds from notes payable to stockholders	313,902	233,027
Payments on notes payable to directors	-	(23,324)
	-----	-----
Net cash provided by financing activities	333,153	9,801,013
	-----	-----
Net increase (decrease) in cash and cash equivalents	(409,033)	8,173,072
Cash and cash equivalents at beginning of period	3,159,017	1,909,421
	-----	-----
Cash and cash equivalents at end of period	\$ 2,749,984	\$ 10,082,493
	=====	=====

See accompanying notes to condensed financial statements.

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PART I. FINANCIAL INFORMATION Item 1. Financial Statements

ALTERNATIVE TECHNOLOGY RESOURCES, INC. Notes to Condensed Financial Statements September 30, 2001 (Unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further

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information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the fiscal year ended June 30, 2001.

In the opinion of management, the unaudited condensed financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary to present fairly the Company's financial position at September 30, 2001 and June 30, 2001, results of operations for the three months ended September 30, 2001 and 2000, and cash flows for the three months ended September 30, 2001 and 2000. The results for the period ended September 30, 2001 are not necessarily indicative of the results to be expected for the entire fiscal year ending June 30, 2002.

The Company has incurred operating losses since inception, which have resulted in an accumulated deficit of \$51,780,956 at September 30, 2001. Based on the steps the Company has taken to refocus its operations and obtain additional financing, the Company believes that it has developed a viable plan to address the Company's ability to continue as a going concern, and that this plan will enable the Company to continue as a going concern, at least through the end of fiscal year 2002. However, the Company believes it will need to raise additional funds during fiscal 2002. There can be no assurance that this plan will be successfully implemented. If unsuccessful, the Company may be required to reduce the development efforts of its Healthcare Exchange or be forced into seeking protection under federal bankruptcy laws. As a result, the report of independent auditors on the Company's June 30, 2001 financial statements includes an explanatory paragraph indicating there is substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Note 2 - Financing Arrangements

See Part I, Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

Note 3 - Comprehensive Loss

Total comprehensive loss for the three months ended September 30, 2001 and 2000, was \$2,233,961, and \$3,207,631, respectively. Other comprehensive income (loss) represents the net change in unrealized gains (losses) on available-for-sale securities.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Note 4 - Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Boards issued Statements of Financial Accounting Standards No. 141, "Business Combinations," or SFAS 141 and No. 142, "Goodwill and Other Intangible Assets," or SFAS 142. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is no longer permitted. SFAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination that is completed after June 30, 2001. SFAS 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under certain conditions) for impairment in accordance with this statement. Intangible assets

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that do not have indefinite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with existing guidance. We are required to adopt SFAS 142 effective July 1, 2002. Because the Company has historically not been party to any business combinations and therefore has not recorded related goodwill and intangible assets, the adoption of SFAS 141 and 142 did not and will not, respectively, have an effect on the Company's results of operations, financial position or cash flows.

Note 5 - Net Loss Per Share

All loss per share amounts for all periods have been presented in accordance with Statement of Financial Accounting Standards Board No. 128, "Earnings per Share". As the Company has reported net losses in all periods presented, basic and diluted loss per share have been calculated on the basis of net loss applicable to common stockholders divided by the weighted average number of common stock shares outstanding without giving effect to outstanding options, warrants, and convertible securities whose effects are anti-dilutive. For the three-months ending September 30, 2001 and 2000, there were stock options, stock warrants, and a convertible note payable outstanding, which could potentially dilute earnings per share in the future but were not included in the computation of diluted loss per share as their effect was anti-dilutive in the periods presented.

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PART I. FINANCIAL INFORMATION

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

Management's Discussion and Analysis

The following discussion provides information to facilitate the understanding and assessment of significant changes in trends related to the financial condition of the Company and its results of operations. It should be read in conjunction with the Company's financial statements and the notes thereto and other financial information included elsewhere in the Form 10-K for the fiscal year ended June 30, 2001.

Overview

General

Alternative Technology Resources, Inc. has developed and is operating an exchange for healthcare services ("Healthcare Exchange"). The purpose of the Healthcare Exchange is to utilize the Internet and other technologies to facilitate Provider initiated discounts and administrative, billing and remittance services for all commercial lines of business. The Healthcare Exchange offers a direct and efficient conduit between Providers and Purchasers of healthcare services and/or their agents, such as Preferred Provider Organizations.

ATR's Healthcare Exchange began operations with a limited number of Providers and Purchasers in the quarter ending June 30, 2001. The Company continues to receive, process and analyze operating data, and the results of the Company's analysis will determine the amount and timing of remaining development related efforts.

The Company is currently recruiting in twenty states medical doctors, medical groups, hospitals and other health care practitioners (collectively, "Providers") to offer their services, through the Healthcare Exchange to those who purchase or facilitate the purchase of healthcare services ("Purchasers").

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The Company has outsourced to multiple vendors portions of the development and operations of the information systems for its Healthcare Exchange. The Company signed agreements effective in January 2001, with an application services provider to license, support and run software to process medical bills submitted to the Company's Healthcare Exchange. ATR has also signed agreements to receive claims from Providers through electronic clearinghouses and to convert paper claims into electronic formats. ATR is evaluating other potential technology vendors as well.

ATR will not provide healthcare services, but rather expects to act as a neutral conduit for efficiency between Providers, Purchasers and their intermediaries including Preferred Provider Organizations, that should benefit all. ATR believes that eliminating the costs associated with traditional "bricks and mortar" operations, creating economies of scale, facilitating access to Providers and Purchasers, streamlining overhead costs, exploiting possibilities for functional integration, reducing errors and speeding the payment of claims should allow Purchasers to pay less and Providers to recover more of what they bill.

History

Alternative Technology Resources, Inc. was founded as 3Net Systems, Inc. in 1989. In August 1999, James W. Cameron, Jr., the Company's largest stockholder, was named Chairman and Chief Executive Officer. Under his direction the Company identified what it believes to be a significant business opportunity and began

PART I. FINANCIAL INFORMATION

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

developing a business model involving the establishment of a Healthcare Exchange under the name "DoctorandPatient."

In February 2000, Jeffrey S. McCormick assumed the position of the Company's Chief Executive Officer. Mr. McCormick has significant experience in financing, managing and growing early stage development companies as a managing director of Boston-based Saturn Asset Management, Inc. Mr. McCormick has served as an advisor or director of several Internet and electronic commerce companies over the last six years. As the Company's CEO, Mr. McCormick is responsible for all phases of development, implementation and operation of the Company's Healthcare Exchange. Mr. Cameron still acts as Chairman and Chief Financial Officer and continues to play an active and substantial role in formulating the Company's business strategy and policy.

The Company is using its management's experience in health care and information technology to establish the Healthcare Exchange, which has become the Company's sole focus. At present, the Healthcare Exchange is operating with a limited number of Providers so the Company can refine its model and determine the amount and timing of remaining development efforts. ATR's previous business was recruiting, hiring, and training foreign computer programmers and placing them with U.S. companies. In line with the Company's strategy to focus on the establishment of a Healthcare Exchange for health care services, ATR suspended recruitment of foreign computer programmers in December 1999 and began pursuing the conversion of foreign computer programmers to become employees of ATR's former customers. This conversion process was complete as of June 30, 2001.

Financial Condition

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Cash and cash equivalents decreased approximately \$409,033 and short-term investments decreased \$1,354,137 since June 30, 2001. At September 30, 2001 substantially all of ATR's cash was invested in money market accounts.

Because the Company is emphasizing the development of the Healthcare Exchange, the results of operation for the three months ended September 30, 2001, may not be indicative of results of operations for the year ended June 30, 2002.

Results of Operation

Healthcare Exchange

Healthcare Exchange Revenue. The Company developed a proof of concept of its Healthcare Exchange, which began operations with a limited number of Providers in the three-month period ending June 30, 2001. Providers submit bills to ATR, who reprints the bills to the Provider's Healthcare Exchange rate, including adding a transaction-processing fee, and then routes them to Purchasers or their intermediaries. ATR receives payments from Purchasers on behalf of Providers, and then remits payments to Providers. The Company recognizes revenue for the transaction-processing fee when earned and no other contractual obligations or contingencies exist. During the three-month period ending September 30, 2001, the second quarter of operations of the Healthcare Exchange, \$108,218 of revenue was recognized. No revenue was generated during the three-month period ending September 30, 2000.

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PART I. FINANCIAL INFORMATION

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

Healthcare Exchange Costs. Healthcare Exchange costs are the direct costs related to the processing of the bills submitted by Providers and payments received from Purchasers. These costs include the salary and other wage and benefit costs of the Healthcare Exchange operations staff and the operating cost of the application services provider. The costs for three-month period ending September 30, 2001, were \$224,788. No operating costs were incurred for the three-month period ending September 30, 2000.

Contract Programming

Contract Programming Revenue. ATR's previous business was recruiting, hiring, training and placing foreign computer programmers with U.S. companies. In line with the Company's strategy to focus on the establishment of the Healthcare Exchange for health care services, ATR suspended recruitment of foreign computer programmers in December 1999 and began pursuing the conversion of computer programmers to employees of ATR's former customers. This conversion process was complete as of June 30, 2001. For the three-month period ending September 30, 2000, \$178,019 in revenue was generated primarily from sales of programmer services.

Programmer Costs. Programmer costs were salary, and other wage and benefit costs of ATR's programmer employees. Due to the final phase out of contract programming business through conversion of the computer programmers to employees of ATR's customers as of June 30, 2001, as discussed above in "Contract Programming Revenue," no contract programming costs were incurred for the three-month period ending September 30, 2001. There were \$129,602 in programmer costs for the three-month period ending September 30, 2000.

Start-up and Other Costs. Start-up and other costs represent the costs of recruiting fees, training, and travel for programmer employees coming to the

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United States from the former Soviet Union for the first time, relocation costs within the United States, and legal and other costs related to obtaining and maintaining compliance with required visas, postings and notifications. Start-up and other costs were expensed as incurred. There were no start-up and other costs for the three-month period ending September 30, 2001 as compared to \$6,200 the three-month period ending September 30, 2000.

Selling, Marketing and Product Development Costs

In October 1999 the Company began incurring costs to develop its Healthcare Exchange. Costs incurred are primarily salary, other wage and benefit costs of ATR's employees and other operational costs associated with recruiting the network of healthcare Providers. The cost increase of \$447,769 for the three-month period ending September 30, 2001, compared to the same period in the prior fiscal year is primarily the result of the increase of sales and marketing staff to 53 at quarter end September 30, 2001, from 23 at quarter end September 30, 2000.

General and Administrative Expenses

General and Administrative Expenses ("G&A"). G&A expenses decreased \$1,635,652 for the three-month period ended September 30, 2001 compared to the same period of the prior fiscal year. This decrease is due primarily to non-cash employee compensation related to the purchase of common stock in the Company's August 2000 private placement by the Company's Chief Executive Officer and related

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PART I. FINANCIAL INFORMATION

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

entities, and non-cash compensation due to conversion of Series D Preferred Stock into common stock by the Company's Chairman of the Board recorded during the three-month period ended September 30, 2000. No comparable costs were recorded in the three-month period ending September 30, 2001. The period ending September 30, 2001 reflects an increase of employees and related costs to support development efforts of the Healthcare Exchange.

Other Income (Expense)

Interest Income. Interest income is related to the short-term investment of cash balances. The decrease is the result of reduced cash balances in the three-month period ending September 30, 2001, in comparison to the same period in fiscal 2001.

Interest Expense. Interest expense increased \$7,845 in the three months ended September 30, 2001 primarily due to the increase in Notes Payable to Stockholder and Convertible Notes Payable to Stockholder.

Income Taxes

As of June 30, 2001, the Company had net operating loss carryforwards for federal and state income tax purposes of approximately \$37 million and \$21 million, respectively. The federal net operating loss carryforwards expire in 2004 through 2020 and the state net operating loss carryforwards expire in 2001 through 2010. The Company also has approximately \$98,000 and \$25,000 of research and development tax credit carryforwards for federal and state income tax purposes, respectively. The federal research and development tax credit carryforwards expire in 2005.

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Under certain provisions of the Internal Revenue Code of 1986, as amended, portions of the net operating loss carryforward and research and development tax credit carryforward are subject to annual limitations as a result of changes in the ownership of the company.

Liquidity and Capital Resources

Traditionally, the Company has used a combination of equity and debt financing and internal cash flow to fund operations and finance accounts receivable but has incurred operating losses since its inception, which has resulted in an accumulated deficit of \$51,780,956 at September 30, 2001.

The Company's Healthcare Exchange development efforts will require substantial funds prior to generating sufficient revenues to fund operations and repay debt. Therefore, the Company engaged a New York based financial and investment banking firm to assist the Company in raising capital. On August 28, 2000, the Company sold 3,333,334 shares of its common stock at \$3.00 per share. Proceeds, net of offering costs, were approximately \$9,560,345. Proceeds are being used to develop the Company's Healthcare Exchange. The Company's Chief Executive Officer and related entities purchased 2,333,335 shares of the Company's common stock in the private placement. Because the purchase price of such stock was less than the public trading price on the date of purchase, the Company recorded compensation expense of \$1,458,334 in the first fiscal quarter ended September 30, 2000.

On September, 11, 2000, the Company agreed with the Series D Preferred stockholders to exchange all their outstanding Series D shares and \$475,915 in accrued preferred stock dividends into 566,972 shares of common stock based on a

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PART I. FINANCIAL INFORMATION

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

purchase price of \$3.00 per common share. The benefit accruing to the Series D Preferred stockholders was recorded in the quarter ended September 30, 2000, approximately \$317,702 in compensation expense and \$862,033 in preferred stock dividends.

The Company has received short-term, unsecured financing to fund its operations in the form of notes payable of \$3,740,450 as of June 30, 2001, from Mr. Cameron and another stockholder. These notes bear interest at 10.25%. On September 11, 2000, the Company agreed with Mr. Cameron to extend the due date on notes payable to him until December 31, 2001, in exchange for an extension fee of 2%. These extended notes total \$1,511,635, including accrued interest and extension fees, and bear interest at 10.25% per annum. Also on September 11, 2000, the Company agreed with the other note holder to extend the due date of his notes until December 31, 2001, in consideration of such notes becoming convertible promissory notes. The convertible promissory notes total \$2,288,815, including accrued interest, bear interest at 10.25% per annum and are convertible into common stock at \$3.00 per share (approximate public trading price on that date) at the note holder's option. On September 1, 2001, the due dates of these notes were extended from December 31, 2001 to December 31, 2002. Mr. Cameron's extended notes total \$1,630,529, including accrued interest and extension fees of 2%, and bear interest at 10.25% per annum. The convertible promissory notes total \$2,423,826, including accrued interest at 10.25% per annum.

The Company signed agreements effective in January 2001 with an application services provider to license, support and run software to process medical bills submitted to the Company's Healthcare Exchange. The agreements are for 66

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months. They required payment of an initial base license fee of \$250,000, which is being amortized over 66 months, and start-up costs, including data center set up, training and implementation fees of approximately \$145,000, which were expensed. The agreements require monthly minimum payments currently of about \$35,000 and additional fees that are transaction based if volumes exceed levels included in the monthly minimums.

Based on the steps the Company has taken to refocus its operations and obtain additional financing, the Company believes that it has developed a viable plan to address the Company's ability to continue as a going concern, and that this plan will enable the Company to continue as a going concern through at least the end of fiscal 2002. However, the Company believes it will need to raise additional funds during fiscal 2002. There can be no assurance that this plan will be successfully implemented. If unsuccessful the Company may be required to reduce the development efforts or its Healthcare Exchange or be forced into seeking protection under federal bankruptcy laws. As a result, the report of independent auditors on the Company's June 30, 2001, financial statements includes an explanatory paragraph indicating there is substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Effects of Inflation

Management does not expect inflation to have a material effect on the Company's operating expense.

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PART I FINANCIAL INFORMATION

Item 3 Quantitative and Qualitative Disclosures About Market Risk

The Company has long-term debt in the aggregate amount of \$4,054,352 as of September 30, 2001, payable to two stockholders of the Company. The debt bears interest at 10.25% per annum and is due December 31, 2002. The Company does not believe that any change in interest rates will have a material impact on the Company during fiscal 2002. Further, the Company has no foreign operations and therefore is not subject to foreign currency fluctuations.

PART II OTHER INFORMATION

Items 1, 2, 3, 4, 5, 6

None

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SIGNATURES

In accordance with 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.

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
(Registrant)

Date: November 13, 2001

/s/ James W. Cameron, Jr.

James W. Cameron, Jr.
Chairman of the Board and Chief Financial
Officer
(Principal Executive and Financial Officer)