POWER ONE INC
Form 10-Q
November 13, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2002

or

o **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 0-29454

POWER-ONE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**77-0420182**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
740 CALLE PLANO, CAMARILLO, CA	**93012**
(Address of principal executive offices)	(zip code)

Registrant's telephone number, including area code (805) 987-8741

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 a 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 ý No o

As of November 11, 2002, 79,916,341 shares of the Registrant's $0.001 par value common stock were outstanding.

POWER-ONE, INC.

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PART I FINANCIAL INFORMATION

Item 1 Consolidated Financial Statements

POWER-ONE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
NET SALES	$ 60,044	$ 53,096	$ 164,630	$ 315,852
COST OF GOODS SOLD (Note 3)	116,952	66,811	193,265	325,857
GROSS LOSS	(56,908)	(13,715)	(28,635)	(10,005)
EXPENSES:				
Selling, general and administrative	16,603	16,419	45,829	58,135

	Three Months Ended September 30,		Nine Months Ended September 30,	
Engineering and quality assurance	9,033	9,543	26,637	30,558
Amortization of intangible assets	1,348	8,428	4,447	15,820
Restructuring costs	11,412	10,853	11,594	24,944
Asset impairment	42,253	3,276	42,253	14,349
Impairment of goodwill	67,587		67,587	
Total expenses	148,236	48,519	198,347	143,806
LOSS FROM OPERATIONS	(205,144)	(62,234)	(226,982)	(153,811)
INTEREST AND OTHER INCOME (EXPENSE):				
Interest income	746	652	1,970	3,388
Interest expense	(323)	(758)	(963)	(2,113)
Other expense, net	(699)	(3,381)	(497)	(3,457)
Total interest and other income (expense)	(276)	(3,487)	510	(2,182)
LOSS BEFORE INCOME TAX	(205,420)	(65,721)	(226,472)	(155,993)
BENEFIT FOR INCOME TAXES	(6,890)	(22,446)	(10,384)	(48,744)
NET LOSS	$ (198,530)	$ (43,275)	$ (216,088)	$ (107,249)
BASIC LOSS PER SHARE	$ (2.45)	$ (0.55)	$ (2.70)	$ (1.36)
DILUTED LOSS PER SHARE	$ (2.45)	$ (0.55)	$ (2.70)	$ (1.36)
BASIC WEIGHTED AVERAGE SHARES OUTSTANDING	80,878	78,825	80,136	78,692
DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	80,878	78,825	80,136	78,692

See notes to consolidated financial statements.

POWER-ONE, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2002	December 31, 2001
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 105,571	$ 79,671
Accounts receivable:		
	44,023	45,064

	September 30, 2002	December 31, 2001
Trade, less allowance for doubtful accounts: $5,219 at September 30, 2002; $4,698 at December 31, 2001		
Other	5,020	7,190
Notes Receivable	3,000	3,000
Inventories (Note 3)	40,907	125,682
Refundable income taxes	86	5,227
Prepaid expenses and other current assets	4,560	5,536
Total current assets	203,167	271,370
PROPERTY & EQUIPMENT, net of accumulated depreciation and amortization: $49,056 at September 30, 2002; $48,611 at December 31, 2001	64,324	97,416
PROPERTY & EQUIPMENT HELD FOR SALE (Note 8)	6,783	
GOODWILL, net (Note 5)	23,306	78,966
OTHER INTANGIBLE ASSETS, net (Note 5)	27,272	51,021
NOTES RECEIVABLE	9,841	14,136
OTHER ASSETS	8,759	7,326
TOTAL ASSETS	$ 343,452	$ 520,235
LIABILITIES & STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Bank overdraft	$ 226	$ 736
Bank credit facilities		1,395
Current portion of long-term debt	867	1,348
Current portion of long-term capital leases	55	245
Accounts payable	24,039	19,302
Restructuring reserve	13,383	7,363
Deferred income taxes	2,523	1,866
Other accrued expenses	24,859	22,594
Total current liabilities	65,952	54,849
LONG-TERM DEBT, less current portion	8,455	7,559
LONG-TERM CAPITAL LEASES, less current portion		39
DEFERRED INCOME TAXES	955	7,121
OTHER LIABILITIES	686	464
STOCKHOLDERS' EQUITY		
Common stock, par value $0.001; 300,000 shares authorized; 79,876 and 78,913 shares issued and outstanding at September 30, 2002 and December 31, 2001, respectively, net of 100 treasury shares	80	79
Additional paid-in-capital	583,975	570,427
Accumulated other comprehensive income (loss)	13,827	(5,913)
Accumulated deficit	(330,478)	(114,390)
Total stockholders' equity	267,404	450,203
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 343,452	$ 520,235

See notes to consolidated financial statements.

POWER-ONE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, unaudited)

	Nine Months Ended September 30,	
	2002	**2001**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (216,088)	$ (107,249)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization (a)	16,635	28,827
Goodwill impairment	67,587	
Asset Impairment (b)	44,770	19,822
Inventory write-off	73,029	110,313
Technology investment write-off (a)		2,750
Capitalized financing costs write-off		575
Stock compensation	8,494	20
Exchange gain	(838)	
Net loss on disposal of property and equipment	432	172
Deferred income taxes	(6,692)	(39,649)
Changes in operating assets and liabilities:		
Accounts receivable, net	6,217	51,134
Notes receivable	4,295	
Inventories	14,787	(13,479)
Refundable income taxes	5,141	(13,180)
Prepaid expenses and other current assets	1,162	(1,652)
Accounts payable	3,326	(52,697)
Accrued expenses	1,065	(4,020)
Restructuring reserve	5,729	8,482
Other liabilities	386	6
Net cash provided by (used in) operating activities	29,437	(9,825)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in Powec (Note 5)	(70)	(6,335)
Long-term investments	(2,000)	(3,505)
Acquisition of property and equipment	(5,021)	(30,415)
Proceeds from sale of property and equipment	97	89
Other assets	601	2,563
Net cash used in investing activities	(6,393)	(37,603)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings on bank credit facilities	1,236	15,383
Repayments of borrowings on bank credit facilities	(2,757)	(8,949)
Bank overdraft	(555)	(11,156)
Proceeds from borrowings on long-term debt		882

	Nine Months Ended September 30,	
Repayments of long-term debt	(1,163)	(2,213)
Principal payments under long-term capital lease obligations	(233)	(377)
Issuance of common stock-net	5,055	2,267
Net cash provided by (used in) financing activities	1,583	(4,163)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	1,273	(206)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	25,900	(51,797)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	79,671	137,113
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 105,571	$ 85,316
SUPPLEMENTAL CASH FLOW INFORMATION:		

Cash paid (received) for		
Interest	$ 1,200	$ 1,243
Income taxes	$ (11,558)	$ 8,895

(a) The total technology investment write-off for the 9 months ended September 30, 2001 was $7,538 of which $4,788 was recorded as amortization of intangibles and $2,750 was recorded as other expense.

(b) The asset impairment charge of $44,770 included in the Consolidated Statement of Cash Flows for the 9 months ended September 30, 2002 included $23,444 for the impairment of identifiable intangibles in accordance with SFAS No. 144, $18,809 for the impairment of property and equipment calculated in accordance with SFAS No. 144 and $2,517 for the fixed asset portion of the period's restructuring charge (See Note 8).

The asset impairment charge of $19,822 included in the Consolidated Statement of Cash Flows for the 9 months ended September 30, 2001 included $14,349 for the impairment of property and equipment calculated in accordance with SFAS No. 121 and $5,473 for the fixed asset portion of the period's restructuring charge (See Note 8).

See notes to consolidated financial statements.

POWER-ONE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands, Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
NET LOSS	$ (198,530)	$ (43,275)	$ (216,088)	$ (107,249)

	Three Months Ended September 30,		Nine Months Ended September 30,	
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation adjustment	(110)	7,162	19,740	(2,155)
COMPREHENSIVE LOSS	$ (198,640)	$ (36,113)	$ (196,348)	$ (109,404)

See notes to consolidated financial statements.

POWER-ONE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Operating results for the period ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the consolidated financial statements and notes thereto for the year ended December 31, 2001 on Form 10-K.

Power-One, Inc.'s ("the Company") reporting period coincides with the 52- to 53-week period ending on the Sunday closest to December 31 and its fiscal quarters are the 13- to 14-week periods ending on the Sunday nearest to March 31, June 30, September 30 and December 31. For simplicity of presentation, the Company has described the three- and nine- month periods ended September 29, 2002 as September 30, 2002. The Sunday nearest to September 30, 2001 coincided with September 30, 2001.

Unless otherwise noted, tabular quantities are in thousands, except per share amounts and period dates.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

Principles of Consolidation The accompanying consolidated financial statements include the consolidated accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company includes in its statement of operations its pro rata share of the financial results of investments accounted for under the equity method.

Use of Estimates in the Preparation of the Financial Statements The preparation of the financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory allowances, restructuring costs, impairment costs, depreciation and amortization, sales returns, warranty costs, taxes, and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may differ from those estimates.

Revenue Recognition The Company generally recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or readily determinable, and collectibility is probable. Sales are recorded net of sales returns and discounts. The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," (SAB 101).

Cash and Cash Equivalents The Company considers all highly liquid instruments with a maturity of three months or less at purchase date to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts The Allowance for Doubtful Accounts is generally established by analyzing each account that has a balance over 90 days past due. Each account is individually assigned a probability of collection. The total amount determined to be uncollectible in the 90-days-past-due category is then reserved fully. The percentage of this reserve to the total accounts

receivable balance is then established as a guideline and applied to the rest of the non-current accounts receivable balance. When other circumstances suggest that a receivable may not be collectible, it is immediately reserved for, even if the receivable is not yet in the 90-days-past-due category. This methodology may be modified or tailored to customary local practice, especially in the Company's overseas locations.

Inventories The Company's inventories are stated at the lower of cost (first-in, first-out method) or market. Slow moving and obsolete inventory are written off quarterly. To calculate the write-off amount, the Company generally compares the current on-hand quantities with the projected usages looking forward between 12 and 24 months. The methodology for forecasting usage may be modified depending on product lifecycles and local circumstances. On-hand quantities greater than projected usage are put on the initial list of slow-moving and obsolete items. The engineering and purchasing departments review the initial list of slow-moving and obsolete items to identify items that have alternative uses in new or existing products. These items are then excluded from the analysis. The remaining amount of slow-moving and obsolete inventory is then written off. Additionally, non-cancelable open purchase orders for parts the Company is obligated to purchase where demand has been reduced may be reserved. Reserves for open purchase orders where the market price is lower than the purchase order price are also established.

Investments The Company holds minority equity investments in non-publicly traded companies. These investments are included in other assets on the Company's balance sheet and are generally carried at cost or accounted for under the equity method. The Company monitors these investments for impairment and makes appropriate reductions in carrying value when necessary.

Property and Equipment Property and equipment are recorded at cost. Provisions for depreciation have been made based upon the estimated useful lives of the assets, which range from three to 30 years, using principally the double declining balance and straight-line methods. Provisions for amortization of leasehold improvements are made based upon the estimated lives of the assets or terms of the leases, whichever is shorter.

Intangible Assets Intangible assets include cost in excess of net assets acquired in connection with the acquisition of the Company in 1995, of Melcher in 1998, and of IPD in 1999 which have been allocated among certain intangible items determined by management to have value, such as the Company's name, distribution network and product technology. Provision for amortization has been made based upon the estimated useful lives of the intangible asset categories, which range from three to 20 years, using the straight-line method. In accordance with SFAS 142, "Goodwill and Other Intangible Assets," only intangible assets with definite lives are amortized. Goodwill and the Company's trade name are deemed to have indefinite lives and are not amortized. Non-amortized intangible assets are instead subject to periodic impairment testing.

Impairment of Long-Lived Assets The Company reviews the recoverability of the carrying value of long-lived assets using the methodology prescribed in Statement of Financial Accounting Standards (SFAS) 144, "Accounting for the Impairment and Disposal of Long-Lived Assets." SFAS 144 superceded SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The Company reviews long-lived assets for impairment whenever events or

changes in circumstances indicate that the carrying value of such assets may not be recoverable. Upon such an occurrence, recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows to which the assets relate, to the carrying amount. If the asset is determined to be unable to recover its carrying value, it is written down to fair value. Fair value is determined based on discounted cash flows, appraised values or management's estimates, depending on the nature of the assets.

Restructuring Costs The Company records restructuring charges in accordance with Emerging Issues Task Force (EITF) Issue 94-3. Restructuring costs relate to the downsizing of the Company's operations and primarily consist of specific charges that the Company has incurred and will incur with no future economic benefit. These charges include costs related to personnel severance, continuing lease obligations for vacant facilities and write-off of leasehold improvements and equipment therein, and certain contract termination penalties.

Income Taxes Provisions and/or benefits are recorded for taxes currently payable or refundable, and for deferred income taxes arising from future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The effects of income taxes are measured based on enacted tax laws and rates. The Company's international operations are subject to a variety of income and corporate taxes.

Certain Company subsidiaries have been granted tax exemptions from the payment of taxes on earnings. Specifically, these grants provide for exemption on income taxes, property taxes, distribution taxes and municipal license taxes. Additionally, certain subsidiaries operate in tax-free enterprise zones and, accordingly, pay no income taxes in connection with those operations.

The Company has not provided for the U.S. federal and state income tax that would be paid on unremitted earnings from its international subsidiaries as there is no intent to remit any future earnings.

Deferred Income Tax Asset Valuation Allowance The Company records a deferred tax asset in jurisdictions where it generates a loss for income tax purposes. Due to volatility in the industry within which the Company operates, the Company records a valuation allowance against these deferred tax assets in accordance with SFAS 109, "Accounting for Income Taxes," when, in management's judgment, the deferred tax assets may not be realized in the foreseeable future.

Stock Compensation The Company uses the intrinsic-value method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for stock options and other stock compensation granted to employees. Accordingly, the Company does not recognize compensation expense in the Consolidated Statement of Operations for stock option grants to employees which have been made at fair market value.

Earnings Per Share The Company presents both basic and diluted earnings (loss) per share ("EPS") amounts. Basic EPS is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted EPS amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares are excluded from the computation in periods in which they have an

anti-dilutive effect. The difference between basic and diluted EPS is solely attributable to stock compensation. The Company uses the treasury stock method to calculate the impact of outstanding stock options. Stock options for which the exercise price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the calculation.

Engineering Engineering costs include existing product engineering, custom product development and research and development costs. Research and development costs are expensed in the period incurred.

Warranties Power-One generally offers its customers a two-year warranty on products sold, although warranty periods may vary by product and geographical location. The Company further assumes that the goods will generally be received for repair under warranty at a steadily declining rate over the warranty period. The expected returns are weighted in order to reflect the fact that the majority of returns will be received within one month of sale and will decline each month thereafter. Based on historical sales and warranty repair expenses, an expected per-unit cost of repair is calculated and applied to actual units sold over the warranty period. This calculation is reviewed monthly and the reserve adjusted accordingly.

Derivative Instruments The Company has adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as subsequently amended by SFAS 137 and SFAS 138, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The Company did not hold any derivative financial instruments during 2002 and 2001. As a result, adoption of SFAS 133 and subsequent amendments did not have a significant effect on the Company's financial position, operations or cash flows.

Fair Value of Financial Instruments The recorded values of the Company's accounts receivable, notes receivable, accounts payable and accrued expenses approximate their fair values based on their short-term nature. The recorded values of the Company's notes receivable, notes payable to banks, long-term debt and other liabilities approximate fair value, as interest is tied to or approximates market rates.

Concentration of Risk Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents placed with high credit quality institutions and trade receivables. The Company sells products and extends credit to customers, primarily in the United States, Europe and Asia, periodically monitors its exposure to credit losses, and maintains allowances for anticipated losses. Certain European subsidiaries mitigate this risk through credit insurance and collection via bank drafts. Cisco Systems was the only customer to exceed 10% of net sales in the three- and nine-month periods ending September 30, 2002.

Conversion of Foreign Currencies The reporting currency for the consolidated financial statements of the Company is the U.S. dollar. The assets and liabilities of companies whose functional currency is other than the U.S. dollar are included in the consolidation by translating the assets and liabilities at the exchange rates applicable at the end of the reporting period. The statements of income and cash flows of such companies are translated at the average exchange rates during the applicable period. Translation gains or losses are accumulated as a separate component of stockholders' equity. The

Company has not tax-effected the cumulative translation adjustment as there is no intention to remit the earnings.

Reclassifications Certain prior year amounts have been reclassified to conform to the current year presentation.

Segment Reporting The Company operates as one segment in accordance with SFAS 131, "Disclosures About Segments of an Enterprise and Related Information." The Company's chief operating decision maker and management personnel view the Company's performance and make resource allocation decisions by looking at the Company as a whole. Although there are different divisions within the Company, they are economically similar and are also similar in terms of the five criteria set forth in SFAS 131 required for combination of segments. The Company's products are all power conversion products primarily geared toward the communications industry, and our sales force sells products from one company-wide product portfolio. The nature of the production process is similar across divisions, and manufacturing for the different divisions occurs in common facilities. Generally, the same engineers with the same qualifications design and manufacture products across divisions. The types and class of customers are similar across the divisions and product lines, and the Company's products are distributed through common channels and distributor networks.

Recent Pronouncements and Accounting Changes In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, "Business Combinations," and SFAS 142, "Goodwill and Other Intangible Assets." They also issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" in October 2001.

SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for under the purchase method. SFAS 141 supersedes APB Opinion No. 16, "Business Combinations", and SFAS 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises", and is effective for all business combinations initiated after June 30, 2001. The Company has not completed any business combinations that were initiated subsequent to June 30, 2001. Future business combinations, if any, will be accounted for under the purchase method in accordance with SFAS 141.

SFAS 142 addresses the financial accounting and reporting for acquired goodwill and other intangible assets. Under the new rules, the Company is no longer required to amortize goodwill and other intangible assets with indefinite lives; rather, these intangible assets are subject to periodic testing for impairment. SFAS 142 supersedes APB Opinion No. 17, "Intangible Assets". The Company adopted SFAS 142 effective January 1, 2002 and has ceased amortization of goodwill and other intangible assets deemed to have an indefinite life.

SFAS 144 establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. SFAS 144 superseded SFAS 121, "Accounting for the Impairment of Long-Lives Assets and for Long-Lived Assets to Be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The provisions of SFAS 144 are effective in fiscal years beginning after December 15, 2001 and in general are to be applied prospectively. The Company adopted SFAS 144 effective January 1, 2002.

In June of 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which nullifies EITF Issue 94-3. SFAS 146 is effective for exit and disposal activities that are initiated after December 31, 2002 and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, in contrast to the date of an entity's commitment to an exit plan, as required by EITF Issue 94-3. The Company will adopt the provisions of SFAS 146 effective January 1, 2003.

The Company believes that the adoption of SFAS 146 may be material to the financial statements should any restructuring initiatives be implemented subsequent to adoption. Currently, the Company does not anticipate any new restructuring initiatives that would be subject to SFAS 146. Had SFAS 146 been adopted and applied to the third quarter of 2002, the Company's restructuring charge would have been smaller, as SFAS 146 delays recognition of certain restructuring liabilities until they are incurred rather than committed to, such as severance obligations,

and requires fair value recognition of continuing lease obligations. The Company has not fully analyzed the impact that SFAS 146 would have had on its financial statements for the third quarter of 2002 if it had been adopted early.

NOTE 3 INVENTORIES

Inventories consist of the following:

	September 30, 2002	December 31, 2001
Raw materials	$ 24,459	$ 100,450
Subassemblies-in-process	7,751	9,013
Finished goods	8,697	16,219
	$ 40,907	$ 125,682

During the third quarter of 2002, the Company determined that a change in methodology for calculating excess and obsolete inventory was warranted due to shorter product lives. The Company will now only look at 12 or 24-month forward demand for components in determining excess and obsolete inventory. The methodology for forecasting demand may be modified depending on specific product lifecycles and local circumstances. Any inventory in excess of this demand will be written off. The Company believes the trend toward shorter product life cycles is permanent, and that this change in methodology will reduce the risk of inventory obsolescence in the future. In addition, the Company is discontinuing a number of product lines as part of its restructuring, and is writing off the inventory associated with these lines. The Company recorded an inventory charge of $73.0 million to cost of goods sold during the third quarter of 2002 in connection with the change in methodology and discontinuation of product lines.

NOTE 4 EARNINGS LOSS PER SHARE

Basic loss per share is computed by dividing net loss by the weighted average common shares outstanding for the period while diluted earnings per share would also include the dilutive effect of stock options.

The dilutive effect of stock options outstanding at September 30, 2002 and 2001 was not included in the calculation of diluted loss per share for the three-and nine-month periods ended September 30, 2002 and 2001 because to do so would have had an anti-dilutive effect as the Company had a net loss for each of these periods. The weighted average number of shares excluded from the diluted loss per share computation was approximately 1.1 million and 2.0 million for the three-month periods ended September 30, 2002 and 2001, respectively, and 2.0 million and 2.5 million for the nine-month periods ended September 30, 2002 and 2001, respectively. Dilutive shares relate to stock options whose exercise prices are below the current fair market value of shares of the Company.

Basic and diluted loss per share are calculated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Basic loss per share:				
Net loss	$ (198,530)	$ (43,275)	$ (216,088)	$ (107,249)
Basic weighted average shares outstanding	80,878	78,825	80,136	78,692
Basic loss per share	$ (2.45)	$ (.55)	$ (2.70)	$ (1.36)
Diluted loss per share:				