CREATIVE COMPUTER APPLICATIONS INC
Form 10QSB
April 14, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended February 29, 2004

o	**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from to

Commission file number 0-12551

CREATIVE COMPUTER APPLICATIONS, INC.

(Exact name of small business issuer as specified in its charter)

California	**95-3353465**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

26115-A Mureau Road, Calabasas, California 91302
(Address of principal executive offices)

(818) 880-6700
Issuer s telephone number:

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: 3,318,900 common shares as of March 31, 2004.

Transitional Small Business Disclosure Format (check one):

Yes o No ý

CREATIVE COMPUTER APPLICATIONS, INC.

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I N D E X

CREATIVE COMPUTER APPLICATIONS, INC.

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

		February 29, 2004 (Unaudited)		August 31, * 2003
ASSETS				
CURRENT ASSETS:				
Cash	$	1,228,121	$	1,075,323
Receivables, net		1,784,434		2,063,311
Inventories		154,843		164,581
Prepaid expenses and other assets		180,285		231,117
Deferred tax asset		362,850		362,850
TOTAL CURRENT ASSETS		3,710,533		3,897,182
PROPERTY AND EQUIPMENT, net		193,723		219,627
INVENTORY OF COMPONENT PARTS		237,275		267,275
CAPITALIZED SOFTWARE COSTS, net of accumulated amortization of $1,324,111 and $1,114,645		1,435,032		1,360,374
DEFERRED TAX ASSET		536,885		536,885
	$	6,113,448	$	6,281,343
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES:				
Notes payable to bank (Note 3)	$		$	
Accounts payable		219,923		207,624
Accrued liabilities:				
Vacation Pay		221,801		185,508
Accrued Payroll		111,500		105,768
Other		153,464		159,241
Deferred service contract income		1,216,972		1,115,366
Deferred revenue on system sales		365,438		501,507

Capital lease obligation, current portion				361
TOTAL CURRENT LIABILITIES		2,289,098		2,275,375
SHAREHOLDERS EQUITY:				
Common shares, no par value; 20,000,000 shares authorized; 3,318,900 and 3,318,900 shares outstanding		6,192,692		6,192,692
Accumulated deficit		(2,368,342)		(2,186,724)
TOTAL SHAREHOLDERS EQUITY		3,824,350		4,005,968
	$	6,113,448	$	6,281,343

See Notes to Condensed Consolidated Financial Statements.

*** As presented in the audited consolidated financial statements**

CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended February 29 & 28	
	2004	2003
	(unaudited)	
NET SYSTEM SALES AND SERVICE REVENUE		
System sales	$ 828,666	$ 817,856
Service revenue	1,022,521	1,036,929
	1,851,187	1,854,785
COST OF PRODUCTS AND SERVICES SOLD		
System sales	434,591	526,044
Service revenue	402,231	360,823
	836,822	886,867
Gross profit	1,014,365	967,918
OPERATING EXPENSES:		
Selling, general and administrative	696,022	715,457
Research and development	245,826	225,768
Total Operating Expenses	941,848	941,225
Operating income	72,517	26,693
INTEREST AND OTHER INCOME	1,010	4,785
INTEREST EXPENSE	(1,487)	(2,204)
Income before provision for income taxes	72,040	29,274
PROVISION FOR INCOME TAXES		12,411
NET INCOME	$ 72,040	$ 16,863
EARNINGS PER SHARE (Note 2):		
Basic	$ .02	$ .01
Diluted	.02	.01
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING		

Basic	3,318,900	3,272,233
Diluted	3,440,646	3,540,303

See Notes to Condensed Consolidated Financial Statements.

CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Six Months Ended February 29 & 28	
	2004	2003
	(unaudited)	
NET SYSTEM SALES AND SERVICE REVENUE		
System sales	$ 1,300,021	$ 1,620,325
Service revenue	2,146,727	2,116,621
	3,446,748	3,736,946
COST OF PRODUCTS AND SERVICES SOLD		
System sales	881,966	1,105,221
Service revenue	807,285	717,506
	1,689,251	1,822,727
Gross profit	1,757,497	1,914,219
OPERATING EXPENSES:		
Selling, general and administrative	1,436,506	1,366,897
Research and development	502,062	439,278
Total Operating Expenses	1,938,568	1,806,175
Operating income (loss)	(181,071)	108,044
INTEREST AND OTHER INCOME	2,367	8,510
INTEREST EXPENSE	(2,914)	(4,551)
Income (loss) before provision for income taxes	(181,618)	112,003
PROVISION FOR INCOME TAXES		47,157
NET INCOME (LOSS)	$ (181,618)	$ 64,846
EARNINGS (LOSS) PER SHARE (Note 2):		
Basic	$ (.05)	$ .02
Diluted	(.05)	.02
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING		

Basic	3,318,900	3,269,317
Diluted	3,318,900	3,461,395

See Notes to Condensed Consolidated Financial Statements.

CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash

	Six Months Ended February 29 & 28	
	2004	2003
	(unaudited)	
OPERATING ACTIVITIES:		
Net income (loss)	$ (181,618)	$ 64,846
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	61,416	83,313
Provision for doubtful accounts	10,000	
Amortization of capitalized software costs	209,466	210,391
Deferred tax provision		47,157
Increase (decrease) from changes in:		
Receivables	268,877	(278,103)
Inventories	39,738	8,026
Prepaid expenses and other assets	50,832	7,676
Accounts payable	12,299	99,973
Accrued liabilities	36,248	(224,684)
Deferred revenues	(34,463)	413,265
Net cash provided by operating activities	472,795	431,860
INVESTING ACTIVITIES		
Additions to property and equipment	(35,512)	(38,118)
Additions to capitalized software costs	(284,124)	(228,000)
Net cash used in investing activities	(319,636)	(266,118)
FINANCING ACTIVITIES:		
Payments on capital lease obligations	(361)	(11,375)
Proceeds from issuance of stock and exercises of stock options		48,650
Net cash provided by (used in) financing activities	(361)	37,275
NET INCREASE IN CASH	152,798	203,017
Cash, beginning of period	1,075,323	1,027,810

Cash, end of period	$	1,228,121	$	1,230,827

See Notes to Condensed Consolidated Financial Statements.

CREATIVE COMPUTER APPLICATIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (which include only normal recurring accruals) necessary to present fairly the Company s financial position as of February 29, 2004, the results of its operations for the three and six month periods ended February 29, 2004 and February 28, 2003, and cash flows for the six months ended February 29, 2004 and February 28, 2003. These results have been determined on the basis of accounting principles generally accepted in the United States of America and practices applied consistently with those used in preparation of the Company s Annual Report on Form 10-KSB for the fiscal year ended August 31, 2003.

The results of operations for the three and six months ended February 29, 2004 are not necessarily indicative of the results expected for any other period or for the entire year.

Note 2. The Company accounts for its earnings per share in accordance with SFAS No.128, which requires presentation of basic and diluted earnings per share. Basic earnings per share is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts, such as stock options, to issue common stock were exercised or converted into common stock.

Earnings per share has been computed as follows:

	Three Months Ended February 29, 2004	Six Months Ended February 29, 2004	Three Months Ended February 28, 2003	Six Months Ended February 28, 2003
NET INCOME (LOSS)	$ 72,040	$ (181,618)	$ 16,863	$ 64,846
Basic weighted average number of common shares outstanding	3,318,900	3,318,900	3,272,233	3,269,317
Dilutive effect of stock options	121,746		268,070	192,078
Diluted weighted average number of common shares outstanding	3,440,646	3,318,900	3,540,303	3,461,395
Basic earnings (loss) per share	$ .02	$ (.05)	$ .01	$ .02
Diluted earnings (loss) per share	$ .02	$ (.05)	$ .01	$ .02

For the three and six months ended February 29, 2004, options to purchase 20,000 and 405,000 shares, respectively, of common stock at a per share price ranging from $.72 to $1.76 were not included in the computation of diluted loss per share because inclusion would have been anti-dilutive.

Note 3. The Company s line of credit with its bank provides for $500,000 on a revolving basis through February 1, 2005. On February 29, 2004, there were no amounts outstanding under the line of credit.

Note 4. As allowed by SFAS 123, the Company has adopted the intrinsic value method of accounting for employee stock options under the principles of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and discloses the pro forma effect on net income (loss) and income (loss) per share as if the fair value based method had been applied. For equity instruments, including stock options, issued to non-employees, the fair value of the equity instruments or the fair value of the consideration received, whichever is more readily determinable, is used to determine the value of services or goods received and the corresponding charge to operations.

The following table illustrates the effect on net income (loss) and income (loss) per share as if the Company had applied the fair value recognition provision of SFAS No. 123 to stock-based employee compensation.

	Three Months Ended February 29, 2004	Six Months Ended February 29, 2004	Three Months Ended February 28, 2003	Six Months Ended February 28, 2003
Net Income (Loss), as reported	$ 72,040	$ (181,618)	$ 16,863	$ 64,846
Less: total stock based employee compensation expense determined under fair value method for all awards	(16,835)	(33,670)	(10,464)	(20,927)
Pro forma net income (loss)	$ 55,205	$ (215,288)	$ 6,399	$ 43,919
Basic net earnings (loss) per share, as reported	$ .02	$ (.05)	$ .01	$ .02
Basic net earnings (loss) per share, pro forma	$ .02	$ (.06)	$ .00	$ .01
Diluted net earnings (loss) per share, as reported	$ .02	$ (.05)	$ .01	$ .02
Diluted net earnings (loss) per share, pro forma	$ .02	$ (.06)	$ .00	$ .01

As required by SFAS 123, the Company provides the following disclosure of estimated values for these awards: The fair value of each option was estimated on the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions for 2004 and 2003: risk free interest rates ranging from 3.8% to 6.1%, expected lives of 5 years; volatility ranging from 67% to 126% and no assumed dividends. The weighted-average grant-date fair value of options granted during 2003 was estimated to be $1.25. There were 60,000 options granted in the three months ended February 29, 2004.

Note 5. In accordance with the bylaws of the Company, officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director s serving in such capacity. The term of the indemnification period is for the lifetime of the officer or director. The maximum potential amount of future payments the Company could be required to make under the indemnification provisions of its bylaws is unlimited. However, the Company has a director and officer liability insurance policy that reduces its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated exposure for the indemnification provisions of its bylaws is minimal and, therefore, the Company has not recorded any related liabilities.

The Company enters into indemnification provisions under agreements with various parties in the normal course of business, typically with customers and landlords. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions cannot be estimated. The Company maintains general liability, errors and omissions, and professional liability insurance in order to mitigate such risks. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated exposure under these agreements is minimal. Accordingly, the Company has not recorded any related liabilities.

Note 6. New Accounting Pronouncements - On December 17, 2003, the SEC s Office of the Chief Accountant and Division of Corporation Finance issued Staff Accounting Bulletin (SAB) 104, Revenue Recognition. The SAB updates portions of the interpretive guidance included in Topic 13 of the codification of staff accounting bulletins (SAB 103 codification) in order to make the guidance consistent with current authoritative accounting literature. The principal revisions relate to the incorporation of certain sections of the staff s FAQ document on revenue recognition into Topic 13. The Company does not expect the adoption of SAB 104 to have a material effect on the Company s financial statements.

In November 2002, the EITF reached a consensus on EITF 00-21, Revenue Arrangements with Multiple Deliverables, related to the separation and allocation of consideration for arrangements that include multiple deliverables. The EITF requires that when the deliverables included in this type of arrangement meet certain criteria they should be accounted for separately as separate units of accounting. This may result in a difference in the timing of revenue recognition but will not result in a change in the total amount of revenue recognized in a bundled sales arrangement. The allocation of revenues to the separate deliverables is based on the relative fair value of each item. If the fair value is not available for the delivered items then the residual method must be used. This method requires that the amount allocated to the undelivered items in the arrangement is their full fair value. This would result in the discount, if any, being allocated to the delivered items. This consensus is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-32 does not have a material impact on the Company s financial statements at this time.

Item 2. **<u>Management s Discussion and Analysis of Financial Condition and Results of Operations</u>**

This Quarterly Report on Form 10-QSB includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 that involve risk and uncertainty, such as forward-looking statements relating to sales and earnings per share expectations, expectations regarding the Company s liquidity and the impact of seasonality on the Company s operations and is subject to the Risk Factors set forth below. We disclaim any obligation to update our forward-looking statements

<u>Overview</u>

CCA generates revenues primarily from the sale of its Clinical Information Systems (CIS), which includes the licensing of proprietary application software, the licensing of third party software, and the sale of servers upon which the application software operates. In connection with its sales of CIS products, the Company provides implementation services for the installation, integration, and training of end users personnel. The Company generates sales of ancillary software and hardware, including its data acquisition products, to its CIS clients and to third parties. The Company also generates recurring revenues from the provision of comprehensive post implementation services to its CIS clients, pursuant to extended service agreements.

Because of the nature of its business, CCA makes significant investments in research and development for new products and enhancements to existing products. Historically, CCA has funded its research and development programs through cash flow primarily generated from operations. Management anticipates that future expenditures in research and development will either continue at current levels or may increase for the foreseeable future, and will be funded primarily out of the Company s cash flow.

CCA s results of operations for the six-month period ended February 29, 2004 were marked by a decrease in sales over the comparable period in 2003 and a decrease in earnings. For the second fiscal quarter ended February 29, 2004, revenues were only slightly below the comparable quarter of fiscal 2003. The Company s decrease in revenues for the six-month period was due to a number of factors. The primary factor was a transition to a new version of our core product, CyberLAB® 7.0 that impacted sales of the previous version of this product. Other factors contributing to the decline in sales were associated with the sluggish economy and the healthcare industry s preoccupation with the Health Insurance Portability and Accountability Act (HIPAA) compliance issues. In addition, the Company experienced delays in closing new transactions that further impacted the first and second fiscal quarters of 2004. Typically, sales cycles for CIS products are lengthy and on average exceed one year from inception to closure. Because of the complexity of the sales process, a number of factors can delay the closing of transactions that are beyond the control of the Company.

The Company experienced a delay in the release of its new CyberLAB 7.0 laboratory information system due to timing issues and the need to complete HIPAA related upgrades to its existing products and deliver them to its clients. During the fourth fiscal quarter of 2003, CCA had substantially completed CyberLAB 7.0 and began to install the new software in its initial beta site for testing and evaluation. The Company began releasing CyberLAB 7.0 to its client base beginning January 1, 2004. As of March 30, 2004, CyberLAB 7.0 was live in three sites and two additional new sites were being implemented. In addition, new sales and marketing activities were initiated resulting in CCA s pipeline of potential new CyberLAB 7.0 related transactions returning to historical levels. CyberLAB 7.0 has generated significant interest among new buyers as well as CCA s installed client base. Management believes the industry and the market for healthcare information technology products continues to improve despite economic conditions. The market is experiencing a renewed interest in clinical applications that is being fueled by the demand for new technology that addresses compliance issues as well as patient care and safety issues.

In order to address compliance issues brought about by the HIPAA regulations, the Company completed the development of enhancements to its products and upgraded hundreds of client sites with the HIPAA related enhancements during the 2003 fiscal year. This posed considerable challenges to CCA s organization. Provisions of HIPAA are intended to ensure patient confidentiality and security for all health care related information. The requirements of HIPAA apply to any entity storing and/or transmitting patient identifiable information on electronic media. This affects virtually all health care organizations, from physicians and insurance companies to health care support organizations. Certain safeguards are required to accurately ensure the security of patient data including more robust audit trails and tiered/structured password security when accessing patient data. Management believes that the HIPAA enhancements will require that many CCA clients will need to upgrade their systems in order to effectively manage greater amounts of data, which will afford the Company opportunities to sell upgrades and provide professional services. It is also anticipated that the migration to CyberLAB 7.0 will require clients to acquire additional hardware and professional services from the Company in order to deploy the new software.

Results of Operations

The following table sets forth certain line items in our condensed consolidated statement of operations as a percentage of total revenues for the periods indicated:

	Three Months Ended February 29, 2004	Six Months Ended February 29, 2004	Three Months Ended February 28, 2003	Six Months Ended February 28, 2003
Revenues:				
System sales	44.8%	37.7%	44.1%	43.4%
Service revenues	55.2	62.3	55.9	56.6

Total revenues	100.0	100.0	100.0	100.0
Cost of products and services sold:				
System sales	23.5	25.6	28.4	29.6
Service revenues	21.7	23.4	19.4	19.2
Total cost of products and services	45.2	49.0	47.8	48.8
Gross profit	54.8	51.0	52.2	51.2
Operating expenses:				
Selling, general and administrative	37.6	41.7	38.6	36.6
Research and development	13.3	14.6	12.2	11.7
Total operating expenses	50.9	56.3	50.8	48.3
Operating income (loss)	3.9	(5.3		