Derycz Scientific Inc
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 30, 2011

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to _____________

Commission File No. 000-53501
DERYCZ SCIENTIFIC, INC.
(Exact name of registrant as specified in its charter)

Nevada	11-3797644
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1524 Cloverfield Blvd., Suite E, Santa Monica, California	90404
(Address of principal executive offices)	(Zip Code)

(310) 477-0354
(Registrant’s telephone number, including area code)

(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 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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of the latest practicable date: As of November 11, 2011, there were 17,069,437 shares of common stock outstanding.

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PART 1 — FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

Derycz Scientific, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

	September 30, 2011 (unaudited)	June 30, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,045,275	$ 2,868,260
Accounts receivable:		
Trade receivables, net of allowance of $201,584 and $223,298, respectively	6,854,452	6,690,662
Due from factor	141,238	356,540
Inventory	557,562	759,507
Prepaid expenses	243,614	298,927
Prepaid royalties	721,581	1,245,872
Other current assets	16,309	18,320
TOTAL CURRENT ASSETS	11,580,031	12,238,088
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $987,699 and $724,004, respectively	1,344,531	1,666,462
INTANGIBLE ASSETS, net of accumulated amortization of $858,554 and $641,698, respectively	1,694,640	1,883,660
GOODWILL	1,567,604	1,567,604
DEPOSITS AND OTHER ASSETS	283,577	308,721
TOTAL ASSETS	$ 16,470,383	$ 17,664,535
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 7,682,944	$ 6,296,566
Capital lease obligation, current	476,001	663,973
Accrued expenses and other current liabilities	654,296	748,969
Notes payable, current	57,787	53,252
Due to factor	319,444	312,440
Due to related parties	20,371	71,902
Line of credit	1,082,008	1,436,233
Deferred revenue	111,479	158,240
TOTAL CURRENT LIABILITIES	10,404,330	9,741,575
Notes payable, long term	92,460	110,080

Capital lease obligation, long term	1,211,376	1,281,600
Liability for estimated earnout	359,338	359,338
Deferred tax liability	350,000	350,000
TOTAL LIABILITIES	12,417,504	11,842,593
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock; $0.001 par value; 20,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock; $0.001 par value; 100,000,000 shares authorized; 17,069,437 and 16,822,509 shares issued and outstanding	17,069	16,823
Accumulated other comprehensive income (loss)	8,013	(11,590)
Additional paid-in capital	13,371,233	13,468,580
Accumulated deficit	(9,343,436)	(7,651,871)
TOTAL STOCKHOLDERS' EQUITY	4,052,879	5,821,942
TOTAL LIABILITIES AND EQUITY	$ 16,470,383	$ 17,664,535

See notes to condensed consolidated financial statements

Derycz Scientific, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Other Comprehensive Income (Loss)
(Unaudited)

	Three Months ended September 30, 2011	Three Months ended September 30, 2010
NET SALES	$ 9,861,219	$ 6,016,656
COST OF SALES	8,388,742	5,199,811
GROSS PROFIT	1,472,477	816,845
OPERATING EXPENSES:		
General and administrative	2,439,030	1,033,497
Marketing and advertising	188,414	114,526
Depreciation and amortization	486,001	59,550
TOTAL OPERATING EXPENSES	3,113,445	1,207,573
LOSS FROM OPERATIONS	(1,640,968)	(390,728)
Currency gain (loss)	(1,465)	-
Other Income	2,255	-
Interest expense	(51,694)	(15,150)
Interest income	307	609
NET LOSS	(1,691,565)	(405,269)
OTHER COMPREHENSIVE INCOME (LOSS):		
Foreign currency translation	19,603	-
COMPREHENSIVE LOSS	$ (1,671,962)	$ (405,269)
NET LOSS PER SHARE:		
BASIC AND DILUTED	$ (0.10)	$ (0.03)
WEIGHTED AVERAGE SHARES OUTSTANDING:		
BASIC AND DILUTED	16,977,178	13,011,527

See notes to condensed consolidated financial statements

Derycz Scientific, Inc. and Subsidiaries
Condensed Consolidated Statement of Stockholders' Equity
For the three months ended September 30, 2011
(Unaudited)

	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated Deficit	Other Comprehensive Income	Total stockholders' Equity
Balance, July 1, 2011	16,822,509	$16,823	$13,468,580	$(7,651,871)	$(11,590)	$5,821,942
Fair value of options issued to employees	-	-	37,084	-		37,084
Common shares issued upon exercise of warrants	246,928	246	(246)	-		-
Fair value of warrants issued for services	-	-	48,939	-		48,939
Adjustment to fair value of warrants granted to consultants			(447,838)			(447,838)
Fair value of warrant extensions	-	-	264,714	-		264,714
Net loss for the period				(1,691,565)		(1,691,565)
Foreign currency translation					19,603	19,603
Balance, September 30, 2011	17,069,437	$17,069	$13,371,233	$(9,343,436)	$8,013	$4,052,879

See notes to condensed consolidated financial statements

Derycz Scientific, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months ended September 30, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,691,565)	$ (405,269)
Adjustment to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	505,108	76,467
Fair value of vested stock options	37,084	20,529
Fair value of warrants issued for services	(398,899)	-
Fair value of common shares issued for services	-	17,648
Fair value of warrant extensions	264,714	-
Changes in assets and liabilities:		
Accounts receivable	(163,790)	(381,887)
Inventory	201,945	(4,383)
Due from Factor	215,302	-
Prepaid expenses	55,313	22,235
Prepaid royalties	524,291	-
Other current assets	27,155	20,262
Accounts payable and accrued expenses	1,386,378	(394,762)
Other current liabilities	(141,434)	(57,330)
Net cash provided by (used in) operating activities	821,602	(1,086,490)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(30,680)	(15,448)
Purchase of intangible assets	(27,836)	-
Acquisition of remaining interest in Pools Press	-	(120,000)
Net cash used in investing activities	(58,516)	(135,448)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of notes payable	(13,085)	-
Due to factor	7,004	-
Payment of capital lease obligation	(258,196)	(8,226)
Payment of related parties	(51,531)	-
Advances (payments) under line of credit	(354,225)	1,375,000
Net cash provided by (used in) financing activities	(670,033)	1,366,774
Effect of exchange rate changes	83,962	-

NET INCREASE IN CASH AND CASH EQUIVALENTS		177,015		144,836
CASH AND CASH EQUIVALENTS, Beginning of period		2,868,260		1,852,231
CASH AND CASH EQUIVALENTS, End of period	$	3,045,275	$	1,997,067
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Taxes paid	$	-	$	-
Interest paid	$	51,694	$	15,150
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Adjustment to additional paid in capital to reflect acquisition of remaining noncontrolling interest	$	-		34,904

See notes to condensed consolidated financial statements

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DERYCZ SCIENTIFIC, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three Months Ended September 30, 2011 and 2010 (Unaudited)

Note 1 — Organization, Nature of Business and Basis of Presentation

The accompanying condensed consolidated financial statements of the Company have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in the financial statements have been omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to fairly present the Company's financial position and results of operations for the interim periods reflected. Except as noted, all adjustments contained herein are of a normal recurring nature. Results of operations for the fiscal periods presented herein are not necessarily indicative of fiscal year-end results.

(a) Organization

Derycz Scientific, Inc. was incorporated in the State of Nevada on November 2, 2006. Derycz Scientific is a publicly traded holding company with three wholly owned subsidiaries, Reprints Desk, Inc., a Delaware corporation ("Reprints" or "Reprints Desk"), Techniques Appliquées aux Arts Graphiques, S.p.A., an entity organized under the laws of France ("TAAG"), and Pools Press, Inc., an Illinois corporation ("Pools" or "Pools Press").

(b) Nature of business

Reprints is a content repurposing and rights management company, with a focus on content re-use services and products. TAAG, our French subsidiary, in addition to supplementing the operations of the Company, also provides additional printing and logistics services to its customers in Europe. The Company operates within the periodicals publishing industry which is a large and growing market. The Company has developed products in the following areas:

- Reprints, ePrints and Article Distribution Systems
- Commercial Printing Services
- Publisher Outsourced Reprint Management
- Print-on-Demand Services for copyright and regulatory sensitive documents

(c) Basis of Presentation

The accompanying financial statements are consolidated and include the accounts of the Company and its wholly owned subsidiaries. The consolidated accounts include 100% of the assets and liabilities of our majority owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

(d) Liquidity

For the three months ended September 30, 2011, the Company recorded a net loss of $1,691,565. Cash provided by operating activities was $821,602. As of September 30, 2011, the Company had working capital of $1,175,701 and shareholders' equity of $4,052,879. The Company believes that its current cash resources and cash flow from operations will be sufficient to sustain current operations for the next twelve months. The Company plans on instituting expense reduction measures and reviewing the financial terms of its relationships with significant vendors and customers to reduce its net losses and increase its cash flow from operations. In addition, the Company plans to raise additional funds for general working capital purposes in the next twelve months through equity or debt financings or by other means to support its operations and fund growth initiatives. The Company can provide no assurances, however, that such financing will be available in an amount or on terms acceptable to the Company, if at all. The sale of additional equity or debt securities would result in dilution to its shareholders. The issuance of additional debt would result in increased expenses and could subject the Company to covenants that may have the effect of restricting its operations.

Note 2 — Summary of Significant Accounting Policies

(a) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

Those estimates and assumptions include estimates for reserves of uncollectible accounts, inventory obsolescence, analysis of impairments of recorded goodwill and intangibles, accruals for potential liabilities and assumptions made in valuing equity instruments issued for services or acquisitions.

(b) Concentration of credit risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist of cash and cash equivalents and accounts receivables. The Company places its cash with high quality financial institutions and at times may exceed the FDIC $250,000 insurance limit. The Company does not anticipate incurring any losses related to these credit risks. The Company extends credit based on an evaluation of the customer's financial condition, generally without collateral. Exposure to losses on receivables is principally dependent on each customer's financial condition. The Company monitors its exposure for credit losses and intends to maintain allowances for anticipated losses, as required.

Cash denominated in Euro with a US dollar equivalent of $491,857 and $636,324 at September 30, 2011 and June 30, 2011, respectively, was held in accounts at financial institutions located in Europe.

As of June 30, 2011, no customer accounted for more than 10% of accounts receivable, and one customer accounted for 10% of accounts receivable at September 30, 2011. No customer accounted for more than 10% of the revenues for the three months ended September 30, 2011 or 2010.

During the three months ended September 30, 2011 two vendors accounted for 19% and 12% of the Company's content costs and during the three months ended September 30, 2010 the Company's purchases from one vendor represented 21% of its content costs.

(c) Goodwill and intangible assets

Management performs impairment tests of goodwill and indefinite-lived intangible assets whenever an event occurs or circumstances change that indicate impairment has more likely than not occurred. Also, management performs impairment testing of goodwill and indefinite-lived intangible assets at least annually.

The Company accounts for acquisition of a business in accordance with guidance issued by the Financial Accounting Standards Board (the "FASB"), which may result in the recognition of goodwill. Goodwill is related to the Company's acquisition of TAAG (see Note 3) in March 2011 and the acquisition of Pools Press in prior years. Goodwill is not amortized, rather, goodwill is assessed for impairment at least annually. Management tests goodwill for impairment at the reporting unit level. The Company has three reporting units. The Company tests goodwill by using a two-step process. In the first step, the fair value of the reporting unit is compared with the carrying amount of the reporting unit, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any.

The Company reviews intangible assets subject to amortization at least annually to determine if any adverse conditions exist or a change in circumstances has occurred that would indicate impairment or a change in the remaining useful life. If the carrying value of an asset exceeds its undiscounted cash flows, the Company writes down the carrying value of the intangible asset to its fair value in the period identified. If the carrying value of assets is determined not to be recoverable, the Company records an impairment loss equal to the excess of the carrying value over the fair value of the assets. The Company's estimate of fair value is based on the best information available, in the absence of quoted market prices. The Company generally calculates fair value as the present value of estimated future cash flows that the Company expects to generate from the asset using a discounted cash flow income approach as described above. If the estimate of an intangible asset's remaining useful life is changed, the Company amortizes the remaining carrying value of the intangible asset prospectively over the revised remaining useful life.

Based upon management's assessment at September 30, there were no indicators of impairment of the Company's goodwill or intangible assets as of September 30, 2011 or June 30, 2011.

(d) Revenue recognition

The Company's primary source of revenue is from the re-use of published articles and rights management services as well as printing services. The Company recognizes revenue from printing services when the sales process is deemed complete and associated revenue has been earned which occurs when services have been rendered and the printed materials have been delivered to the customer. The Company's policy is to recognize revenue when services have been performed, risk of loss and title to the product transfers to the customer, the selling price is fixed and determinable and collectability is reasonably assured.

The Company recognizes revenues from the re-use of published articles and rights management services upon shipment or electronic delivery to the customer.

(e) Allowance for doubtful accounts

The Company evaluates the collectability of its trade accounts receivable based on a number of factors. In circumstances where the Company becomes aware of a specific customer's inability to meet its financial obligations to the Company, a specific reserve for bad debts is estimated and recorded, which reduces the recognized receivable to the estimated amount the Company believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on the Company's historical losses and an overall assessment of past due trade accounts receivable outstanding. The Company established an allowance for doubtful accounts of $201,584 and $223,298 as of September 30, 2011 and June 30, 2011, respectively.

(f) Stock-based compensation

The Company periodically issues stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. The Company accounts for share-based payments under the guidance as set forth in the Share-Based Payment Topic of the FASB Accounting Standards Codification, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees, officers, directors, and consultants, including employee stock options, based on estimated fair values. The Company estimates the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model, and the value of the portion of the award that is ultimately expected to vest is recognized as expense over the required service period in the Company's Statements of Operations. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance whereby the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) the date at which the necessary performance to earn the equity instruments is complete. Stock-based compensation is based on awards ultimately expected to vest and is reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, as necessary, in subsequent periods if actual forfeitures differ from those estimates.

(g) Foreign currency translation

The accompanying consolidated financial statements are presented in United States dollars, the functional currency of the Company. Capital accounts of foreign subsidiaries are translated into United States dollars from foreign currency at their historical exchange rates when the capital transactions occurred. Assets and liabilities are translated at the exchange rate as of the balance sheet date. Income and expenditures are translated at the average exchange rate of the period.

Although the majority of our expenditures are in US dollars, the revenues and costs of TAAG are in Euro. As a result, currency exchange fluctuations may impact the costs of our operations. We currently do not engage in any currency hedging activities.

(h) Shipping and handling costs

The Company includes shipping and handling charges billed to its customers in its revenues, and classifies shipping and handling costs of the sale of its products as a component of cost of sales. Those costs were approximately $81,294 and $95,964, respectively, for the three months ended September 30, 2011 and 2010.

(i) Net Income (Loss) per share

The FASB requires presentation of basic earnings per share and diluted earnings per share. Basic net income (loss) per share is computed by dividing the net income (loss) by the weighted average number of common shares available.

Weighted average number of shares outstanding reflects the equivalent number of shares received as a result of the exchange transaction as if these shares had been outstanding as of the beginning of the earliest period presented. Diluted income (loss) per share is computed similar to basic income (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Warrants to purchase 2,437,182 and 2,855,009 shares of common stock have been excluded from the calculation of diluted net loss per share for the three months ended September 30, 2011 and 2010, respectively, and options to purchase 1,439,000 and 1,401,000 shares of common stock outstanding as of September 30, 2011 and 2010, respectively, have also been excluded from the calculation as the effect would have been anti-dilutive.

(j) Marketing and advertising expenses

Marketing and advertising expenses are expensed as incurred and consist primarily of various forms of media purchased from Internet-based marketers and search engines. Marketing and advertising expense amounted to $188,414 and $114,524 for the three months ended September 30, 2011 and 2010, respectively.

(k) Recently issued accounting pronouncements

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-4, which amends the Fair Value Measurements Topic of the Accounting Standards Codification (ASC) to help achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. ASU No. 2011-4 does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The ASU is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. The ASU will affect the Company's fair value disclosures, but will not affect the Company's results of operations, financial condition or liquidity.

In June 2011, the FASB issued ASU No. 2011-5, which amends the Comprehensive Income Topic of the ASC. The ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, and instead requires consecutive presentation of the statement of net income and other comprehensive income either in a continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-5 is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. It will have no effect on the Company's results of operations, financial condition or liquidity.

In September 2011, the FASB issued ASU