

CONSOLIDATED GRAPHICS INC /TX/  
Form 10-Q  
February 14, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended December 31, 2002

OR

**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 0-24068

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**CONSOLIDATED GRAPHICS, INC.**

(Exact name of Registrant as specified in its charter)

**Texas**

(State or other jurisdiction of  
incorporation or organization)

**76-0190827**

(I.R.S. Employer Identification No.)

**5858 Westheimer Road, Suite 200  
Houston, Texas**

(Address of principal executive offices)

**77057**

(Zip Code)

Registrant's telephone number, including area code: **(713) 787-0977**

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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  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes  No

The number of shares of Common Stock, par value \$.01 per share, of the Registrant outstanding at January 31, 2003 was 13,328,647.

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**CONSOLIDATED GRAPHICS, INC.**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2002**

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**PART I FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**CONSOLIDATED GRAPHICS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share data)

	December 31, 2002 (Unaudited)	March 31, 2002 (Audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 7,050	\$ 8,955
Accounts receivable, net	113,018	121,981
Inventories	31,991	32,771
Prepaid expenses	5,586	6,114
Deferred income tax assets	4,631	5,153
Total current assets	162,276	174,974
PROPERTY AND EQUIPMENT, net	281,661	293,831
GOODWILL, net	110,556	199,331
OTHER ASSETS	7,973	8,597
	\$ 562,466	\$ 676,733
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 21,198	\$ 19,877
Accounts payable	32,759	32,068
Accrued liabilities	43,435	37,382
Income taxes payable	50	611
Total current liabilities	97,442	89,938
LONG-TERM DEBT, net of current portion	155,136	213,860
DEFERRED INCOME TAX LIABILITIES	60,079	66,337
COMMITMENTS AND CONTINGENCIES		
<b>SHAREHOLDERS EQUITY</b>		
Common stock, \$.01 par value; 100,000,000 shares authorized; 13,313,956 and 13,205,863 issued and outstanding	134	132
Additional paid-in capital	158,980	157,581
Retained earnings	90,695	148,885
Total shareholders equity	249,809	306,598
	\$ 562,466	\$ 676,733

See accompanying notes to consolidated financial statements.

**CONSOLIDATED GRAPHICS, INC.**  
**CONSOLIDATED INCOME STATEMENTS**

(In thousands, except per share data)

(Unaudited)

	Three Months Ended December 31		Nine Months Ended December 31	
	2002	2001	2002	2001
SALES	\$ 186,296	\$ 153,750	\$ 544,174	\$ 478,342
COST OF SALES	141,444	114,375	411,860	353,257
Gross profit	44,852	39,375	132,314	125,085
SELLING EXPENSES	19,820	16,591	58,931	50,652
GENERAL AND ADMINISTRATIVE EXPENSES	13,333	12,134	39,257	36,706
AMORTIZATION OF GOODWILL		1,346		4,025
Operating income	11,699	9,304	34,126	33,702
INTEREST EXPENSE, net	2,430	3,347	8,020	12,111
Income before taxes and accounting change	9,269	5,957	26,106	21,591
INCOME TAXES	3,522	2,383	9,920	8,637
Income before accounting change	5,747	3,574	16,186	12,954
CUMULATIVE EFFECT OF ACCOUNTING CHANGE, net of tax			74,376	
Net income (loss)	\$ 5,747	\$ 3,574	\$ (58,190)	\$ 12,954
<b>BEFORE ACCOUNTING CHANGE</b>				
Basic earnings per share	\$ .43	\$ .27	\$ 1.22	\$ .99
Diluted earnings per share	\$ .42	\$ .27	\$ 1.20	\$ .97
<b>AFTER ACCOUNTING CHANGE</b>				
Basic earnings per share	\$ .43	\$ .27	\$ (4.39)	\$ .99

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Diluted earnings per share	\$	.42	\$	.27	\$	(4.31)	\$	.97
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SHARES USED TO COMPUTE EARNINGS  
PER SHARE

Basic	13,295	13,150	13,245	13,082
Diluted	13,570	13,449	13,505	13,360

See accompanying notes to consolidated financial statements.



**CONSOLIDATED GRAPHICS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

(Unaudited)

	Nine Months Ended December 31	
	2002	2001
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (58,190)	\$ 12,954
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Cumulative effect of accounting change, net of tax	74,376	
Depreciation and amortization	27,658	30,329
Deferred income tax provision	9,643	3,696
Changes in assets and liabilities, net of effects of acquisitions-		
Accounts receivable, net	12,893	13,123
Inventories	1,239	1,094
Prepaid expenses	540	(1,579)
Other assets	(2,037)	(1,782)
Accounts payable and accrued liabilities	7,005	(3,989)
Income taxes payable	(561)	2,061
Net cash provided by operating activities	72,566	55,907
<b>INVESTING ACTIVITIES</b>		
Acquisitions of businesses, net of cash acquired	(5,554)	(2,880)
Purchases of property and equipment	(9,507)	(10,939)
Proceeds from asset dispositions	626	1,818
Net cash used in investing activities	(14,435)	(12,001)
<b>FINANCING ACTIVITIES</b>		
Proceeds from bank credit facilities	9,449	13,277
Payments on bank credit facilities	(64,547)	(52,120)
Payments on long-term debt	(6,339)	(6,668)
Proceeds from exercise of stock options	1,401	1,628
Net cash used in financing activities	(60,036)	(43,883)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(1,905)</b>	<b>23</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>8,955</b>	<b>8,667</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 7,050</b>	<b>\$ 8,690</b>

See accompanying notes to consolidated financial statements.



**CONSOLIDATED GRAPHICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(In thousands)  
(Unaudited)

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The accompanying unaudited consolidated financial statements include the accounts of Consolidated Graphics, Inc. and subsidiaries (collectively, the Company). All intercompany accounts and transactions have been eliminated. Such statements have been prepared in accordance with generally accepted accounting principles and the Securities and Exchange Commission's rules and regulations for reporting interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the accompanying unaudited consolidated financial statements have been included. Operating results for the nine months ended December 31, 2002 are not necessarily indicative of future operating results. Balance sheet information as of March 31, 2002 has been derived from the 2002 annual audited consolidated financial statements of the Company. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the fiscal year ended March 31, 2002, filed with the Securities and Exchange Commission in May 2002.

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share reflect net income divided by the weighted average number of common shares and dilutive stock options outstanding.

The consolidated statements of cash flows provide information about the Company's sources and uses of cash and exclude the effects of non-cash transactions. The Company issued term notes payable totaling \$4,034 (see Note 4. Long-Term Debt) during the nine months ended December 31, 2002 to finance the purchase of certain new equipment. The following is a summary of total cash paid for interest and income taxes, net of refunds:

	Nine Months Ended December 31	
	2002	2001
<i>Cash Paid for:</i>		
Interest	\$ 8,200	\$ 12,966
Income taxes	870	2,790

**2. ACCOUNTING CHANGE**

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Effective April 1, 2002, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets*, which requires companies to discontinue amortizing goodwill and perform annual impairment tests to determine if the remaining balance should be reduced to reflect estimated fair values of its reporting units. Prior to its adoption of SFAS No. 142, the Company periodically evaluated whether the remaining balance of goodwill was recoverable by assessing current and future levels of income and cash flows on an undiscounted basis, as well as other factors, such as business trends and general market conditions. The Company determines fair value under SFAS No. 142 using capitalization of earnings estimates and market valuation multiples for each reporting unit.

As of April 1, 2002, net goodwill balances attributable to each of the Company's reporting units were tested for impairment by comparing the fair value of each reporting unit to its carrying value. Based on these impairment tests the Company recognized a transitional impairment charge of \$74,376, net of deferred tax benefit totaling \$15,379, which is reflected as a cumulative effect of accounting change in the accompanying consolidated income statement.

The following unaudited pro forma financial data for the nine months ended December 31, 2002 and 2001, are presented as if the provisions of SFAS No. 142 had been in effect for all periods presented:

	Nine Months Ended December 31	
	2002	2001
Net income (loss) as reported	\$ (58,190)	\$ 12,954
Add: cumulative effect of accounting change, net of tax	74,376	
Add: goodwill amortization		4,025
Less: tax benefit of deductible goodwill amortization		(509)
Adjusted pro forma net income	\$ 16,186	\$ 16,470
<b>Basic Earnings Per Share:</b>		
Net income (loss) as reported	\$ (4.39)	\$ .99
Add: cumulative effect of accounting change, net of tax	5.61	
Add: goodwill amortization		.31
Less: tax benefit of deductible goodwill amortization		(.04)
Adjusted pro forma net income	\$ 1.22	\$ 1.26
<b>Diluted Earnings Per Share:</b>		
Net income (loss) as reported	\$ (4.31)	\$ .97
Add: cumulative effect of accounting change, net of tax	5.51	
Add: goodwill amortization		.30
Less: tax benefit of deductible goodwill amortization		(.04)
Adjusted pro forma net income	\$ 1.20	\$ 1.23

In accordance with SFAS No. 142, the Company is required to annually test the remaining balance of goodwill for impairment and intends to test for impairment at the conclusion of each fiscal year. A number of factors could cause the Company to further impair its goodwill balance. These factors include a decline in the financial performance of an individual reporting unit due to adverse business developments and/or changes in general market conditions. A decline in market valuation multiples could also impact the test. Subject to the potential impact of these factors, the Company may be required to record additional impairment on certain reporting units when its annual impairment test is conducted as of March 31, 2003.

### 3. ACQUISITIONS

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During the nine months ended December 31, 2002, the Company acquired the business and assets of two companies located near Baltimore, Maryland, one of which was immediately merged into another existing operation of the Company. To complete these acquisitions, the Company paid cash totaling \$4,205.

The allocation of the purchase price of the businesses acquired included current assets of \$3,627, property and equipment of \$1,012 and other assets of \$655, less current liabilities of \$1,089. Additionally, to satisfy certain liabilities of acquired businesses or pursuant to earnout agreements, the Company paid cash of \$1,349 during the nine months ended December 31, 2002.

#### 4. LONG-TERM DEBT

The following is a summary of the Company's long-term debt as of:

	December 31, 2002	March 31, 2002
Bank credit facilities	\$ 94,183	\$ 149,281
Term equipment notes	71,829	73,708
Other	10,322	10,748
	176,334	233,737
Less current portion	(21,198)	(19,877)
	\$ 155,136	\$ 213,860

The Company entered into a five-year \$225,000 senior secured credit facility (the Bank Credit Facility) with eleven banks in December 2000. The Bank Credit Facility is composed of a \$50,000 five-year term loan (the Term Loan), of which \$27,500 was outstanding at December 31, 2002, and a \$175,000 five-year revolving credit line (the Revolving Line), of which \$63,000 was outstanding at December 31, 2002. The Term Loan requires quarterly payments of \$2,500 each through September 30, 2005.

The proceeds of the Bank Credit Facility can be used to repay certain indebtedness, finance certain acquisitions, provide for working capital and general corporate purposes, and subject to certain restrictions, repurchase the Company's common stock. Borrowings outstanding under the Bank Credit Facility are secured by substantially all of the Company's assets other than real estate and certain equipment subject to term equipment notes and other financing. Borrowings under the Bank Credit Facility accrue interest, at the Company's option, at either (1) the London Interbank Offered Rate (LIBOR) plus a margin of 1.25% to 2.25%, or (2) an alternate base rate (based upon the greater of the agent bank's prime lending rate or the Federal Funds effective rate plus .50%) plus a margin of up to 1.00%. The Company is also required to pay a commitment fee on available but unused amounts ranging from .275% to .375% annually. The interest rate margin and the commitment fee are based upon the Company's ratio of Funded Debt to Pro Forma Consolidated EBITDA, as defined, redetermined quarterly. On December 31, 2002, borrowings outstanding under the Term Loan and the Revolving Line accrued interest at a weighted average rate of 3.29%.

The Company is subject to certain covenants and restrictions and must meet certain financial tests as defined in the Bank Credit Facility. The Company was in compliance with these covenants and financial tests at December 31, 2002. The Company obtained an amendment to its Bank Credit Facility which specifically provided that the transitional goodwill impairment charge (see Note 2. Accounting Change) would not impact compliance with these covenants.

In addition, the Company maintains an auxiliary revolving credit facility (the Auxiliary Bank Facility) with a commercial bank expiring in February 2003. The Auxiliary Bank Facility is unsecured and has a maximum borrowing capacity of \$5,000. At December 31, 2002, borrowings outstanding under the Auxiliary Bank Facility totaled \$3,683 and accrued interest at 3.13%. In February 2003, the Auxiliary Bank Facility was extended for a one year period.





The Company's term equipment notes consist primarily of notes payable pursuant to financing agreements between the Company and various lenders (the Lender Notes) and between the Company and two printing equipment manufacturers (the Equipment Notes). During the three months ended December 31, 2002, the Company issued Lender Notes in an aggregate principal amount of \$38,472 and utilized the proceeds thereof to retire certain of the outstanding Equipment Notes. The Lender Notes are secured by the equipment subject to this refinancing. At December 31, 2002 outstanding borrowings under the Lender Notes totaled \$37,647 and accrued interest at a weighted average rate of 5.91%. The Lender Notes provide for fixed monthly principal payments plus interest over a five-year term, ending with a balloon payment at maturity. At December 31, 2002 outstanding borrowings under the Equipment Notes totaled \$32,009 and accrued interest at a weighted average rate of 6.14%. The Equipment Notes provide for fixed payments of principal and interest for defined periods of up to ten years from the date of issuance and are secured by the purchased equipment. The remaining balance of term equipment notes totaling \$2,173 primarily consists of various secured debt obligations assumed by the Company in connection with certain prior year acquisitions. The Company is not subject to any significant financial covenants in connection with any of the term equipment notes; however, the Bank Credit Facility places certain limitations on the amount of additional term note obligations the Company may incur in the future.

The Company's remaining debt obligations consist of a promissory note totaling \$5,223, industrial revenue bonds totaling \$4,505 and various other debt obligations totaling \$594. The Company does not have any significant financial covenants or restrictions associated with these debt obligations.

## 5. RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 145, *Rescission of FASB Statement Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*, was issued in April 2002. SFAS No. 145 amends existing authoritative pronouncements to make various technical corrections, clarify meanings, and describe their applicability under changed conditions. This statement requires that gains and losses from the extinguishment of debt be classified as extraordinary items only if they meet the criteria in Accounting Principles Board (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*. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Management does not believe that the adoption of SFAS No. 145 will have a material impact on its financial position or results of operations.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in July 2002 and is effective for exit or disposal activities that are initiated after December 31, 2002. SFAS No. 146 requires that exit or disposal costs be recorded at their fair value when they are incurred. The Company adopted SFAS No. 146 as of October 1, 2002. The adoption did not have a material impact on its financial position or results of operations.

SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, was issued in December 2002 and is effective for interim periods beginning after December 15, 2002 and annual periods ending after December 15, 2002. This statement amends the disclosure requirements and provides additional guidance with respect to certain other provisions of SFAS No. 123, *Accounting for Stock-based Compensation*. Management does not believe that the adoption of the additional disclosure requirements of SFAS No. 148 will have a material impact on its financial position or results of operations.

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

*The following discussion contains forward-looking information. Readers are cautioned that such information involves known and unknown risks and uncertainties, including those created by general market conditions, competition and the possibility that events may occur which limit the ability of our Company to maintain or improve its operating results and acquire additional printing businesses. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate, and there can be no assurance that the forward-looking statements included herein will prove to be accurate. The inclusion of such information should not be regarded as a representation by us or any other persons that our objectives and plans will be achieved. We expressly disclaim any duty to provide updates to these forward-looking statements, assumptions or other factors after the date of this Report on Form 10-Q to reflect the occurrence of events or circumstances or changes in expectations.*

*The following discussion of the financial condition and performance of our Company should be read in conjunction with the consolidated financial statements included herein and the consolidated financial statements and related notes and other detailed information regarding our Company included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2002 and other reports filed by us with the Securities and Exchange Commission. Operating results for the nine months ended December 31, 2002 are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2003 or any periods thereafter.*

**Overview**

Our Company is a leading national provider of commercial printing services with 65 printing facilities in 25 states and is recognized as the largest sheet-fed and half-web commercial printing company in the United States. We are focused on adding value to our operating companies by providing the financial and operational strengths, management support and technological advantages associated with a national organization. Our strategy currently includes the following initiatives to generate sales and profit growth:

*Internal Sales Growth* In the midst of prevailing difficult industry conditions, we are seeking to use our competitive advantages to expand market share. We continue to pursue additional experienced sales professionals, invest in new equipment and technology, expand our national accounts program and develop complementary, value-added services.

*Disciplined Acquisition Program* We selectively pursue opportunities to acquire well-managed printing businesses at reasonable prices.

*Cost Savings* Because of our size and national presence, we leverage our economies of scale to purchase supplies and equipment at preferential prices, and centralize various administrative services to generate cost savings.

*Best Practices/Benchmarking* We provide a forum for our printing businesses to share their knowledge of technical processes and their best practices with one another, as well as benchmark financial and operational data to help our printing businesses identify and respond to changes in operating trends.

*Leadership Development* Through our unique Leadership Development Program, we develop talent for future sales and management positions at our printing businesses.

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Our printing operations maintain their own sales, estimating, customer service, prepress, production, postpress and accounting departments. Our corporate headquarters staff provides support to our printing operations in such areas as human resources, purchasing and management information systems. We also maintain centralized treasury, risk management, tax and consolidated financial reporting activities.

The majority of our sales are derived from commercial printing services, which include electronic prepress, printing, finishing, storage and delivery of high quality, custom-designed products. Examples of such products include multicolor product and capability brochures, shareholder communications, catalogs, training manuals, point-of-purchase marketing materials and direct mail pieces. We also serve our customers by providing a variety of complementary services, including fulfillment and mailing services and print-related e-commerce software solutions and electronic media services through CGXmedia.

Most of our sales are generated by individual orders through commissioned sales personnel and, in some cases, pursuant to long-term contracts. We recognize revenue from these orders when we deliver the ordered products. To a large extent, continued engagement of our Company by our customers for successive jobs depends upon the customer's on-going satisfaction with the quality of services we provide. As such it is difficult for us to predict the number, size and profitability of printing jobs that we expect to produce for more than a few weeks in advance.

Our cost of sales mainly consists of raw materials consumed in the printing process, as well as labor and outside services. Paper cost is the largest component of our materials cost; however, fluctuations in paper prices generally do not significantly impact our operating margins because any changes in paper pricing are generally passed on by our printing businesses. Additionally, our cost of sales includes maintenance, repair, rental and insurance costs associated with operating our facilities and equipment, along with depreciation charges.

Our selling expenses generally include the salary and commissions paid to our sales professionals or third-party sales agents, along with promotional, travel and entertainment costs. Our general and administrative expenses generally include the salary and benefits paid to support personnel at our printing businesses and our corporate staff. These expenses also include office rent and utilities, communications expenses and professional fees.

## Results of Operations

The following tables set forth the Company's historical consolidated income statements for the periods indicated:

	Three Months Ended December 31		Nine Months Ended December 31	
	2002	2001	2002	2001
	(in millions)		(in millions)	
Sales	\$ 186.3	\$ 153.8	\$ 544.2	\$ 478.3
Cost of sales	141.5	114.4	411.9	353.2
Gross profit	44.8	39.4	132.3	125.1
Selling expenses	19.8	16.6	58.9	50.7
General and administrative expenses	13.3	12.2	39.3	36.7
Amortization of goodwill		1.3		4.0
Operating income	11.7	9.3	34.1	33.7
Interest expense, net	2.4	3.3	8.0	12.1
Income before taxes and accounting change	9.3	6.0	26.1	21.6
Income taxes	3.5	2.4	9.9	8.6
Income before accounting change	\$ 5.8	\$ 3.6	\$ 16.2	\$ 13.0

The following tables set forth the components of income expressed as a percentage of sales for the periods indicated:

	Three Months Ended December 31		Nine Months Ended December 31	
	2002	2001	2002	2001
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	75.9	74.4	75.7	73.9
Gross profit	24.1	25.6	24.3	26.1
Selling expenses	10.6	10.8	10.8	10.6
General and administrative expenses	7.2	8.0	7.2	7.7
Amortization of goodwill		.8		.8
Operating income	6.3	6.0	6.3	7.0
Interest expense, net	1.3	2.2	1.5	2.5
Income before taxes and accounting change	5.0	3.8	4.8	4.5
Income taxes	1.9	1.5	1.8	1.8
Income before accounting change	3.1%	2.3%	3.0%	2.7%

*Comparative Analysis of Consolidated Income Statements for the Three and Nine Months Ended December 31, 2002 and 2001*

Sales for the three months ended December 31, 2002 increased 21% to \$186.3 million, and sales for the nine months ended December 31, 2002 increased 14% to \$544.2 million. The increase in sales for both the three and nine month periods of this fiscal year is primarily due to the incremental impact of three businesses acquired during the quarter ended March 31, 2002 and two businesses acquired during the nine months ended December 31, 2002. Further, our sales increase demonstrates the initial return on our efforts to expand market share through our recruiting program for experienced sales professionals and our pursuit of national accounts.

Gross profit margin for the three months ended December 31, 2002 declined to 24.1% from 25.6% in the corresponding quarter a year ago, and gross profit margin for the nine months ended December 31, 2002 declined to 24.3% from 26.1% in the same period last year. The gross profit margin decline for both the three and nine month periods of this fiscal year reflects continued pricing pressures caused by the current economic weakness and prevailing negative industry conditions. Further, gross profit margins of acquired businesses generally are lower than our Company's historical average and typically improve over time as we work with the management of the acquired businesses to implement cost savings strategies and other operating best practices.

Selling expenses for the three months ended December 31, 2002 increased 19% to \$19.8 million, and selling expenses for the nine months ended December 31, 2002 increased 16% to \$58.9 million. The increase in selling expenses for both the three and nine month periods of this fiscal year corresponds to the higher sales levels noted above. As a percentage of sales, selling expenses for the three months ended December 31, 2002 decreased to 10.6% from 10.8% in the corresponding quarter a year ago primarily due to a greater mix of non-commissioned sales in the current quarter. For the nine months ended December 31, 2002, selling expenses as a percentage of sales increased to 10.8% from 10.6% in the same period last year. This increase reflects our investments in recruiting and hiring new sales professionals and marketing efforts to promote our extensive printing capabilities and complementary services.

General and administrative expenses for the three months ended December 31, 2002 increased 10% to \$13.3 million, and general and administrative expenses for the nine months ended December 31, 2002 increased 7% to \$39.3 million. The increase in general and administrative expenses for both the three and nine month periods of this fiscal year is primarily due to the incremental impact of our recently acquired businesses. As a percentage of sales, general and administrative expenses for the three months ended December 31, 2002 declined to 7.2% from 8.0% in the corresponding quarter a year ago and for the nine months ended December 31, 2002 declined to 7.2% from 7.7% in the same period last year (excluding amortization of goodwill recorded in the prior comparable periods). The decline in general and administrative expenses as a percentage of sales for both the three and nine month periods of this fiscal year reflects our efforts to control our administrative costs and thereby leverage the higher sales levels described above.

Interest expense for the three months ended December 31, 2002 decreased 27% to \$2.4 million, and interest expense for the nine months ended December 31, 2002 decreased 34% to \$8.0 million. The decrease in interest expense for both the three and nine month periods of this fiscal year is due to lower borrowings outstanding under our variable-rate bank credit facility, coupled with a more favorable interest rate environment as compared to the same periods last year.

Effective April 1, 2002, we adopted Statement of Financial Accounting Standards ( SFAS ) No. 142 which required us to perform a series of transitional impairment tests pertaining to the valuation of our outstanding goodwill balance, which totaled \$199.3 million as of March 31, 2002. Pursuant to the adoption of SFAS No. 142, we determined that an after-tax impairment charge of \$74.4 million was required, and such charge has been classified as the cumulative effect of an accounting change as provided for by the new accounting standard. Further, under SFAS No. 142, we are no longer required to amortize the remaining outstanding goodwill balance, but are required to perform annual impairment tests to determine if the remaining balance of goodwill should be reduced to estimated fair values. As a result of discontinuing goodwill amortization, we reduced our overall effective tax rate for the three and nine months ended



December 31, 2002 to 38%, as compared to 40% in the same periods last year. The higher tax rate of 40% in fiscal 2002 was necessary to provide for the effect of the portion of goodwill amortization that was not deductible for tax purposes.

## Liquidity and Capital Resources

### *Sources and Uses of Cash*

Our Company's historical sources of cash have primarily been cash provided by operations or borrowings under our bank credit facilities. Our Company's historical uses of cash have been for capital expenditures, acquisitions of printing businesses and payment of principal and interest on outstanding debt obligations. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our consolidated statements of cash flows and notes thereto included in *Item 1. Financial Statements*:

	Nine Months Ended December 31	
	2002	2001
	(In millions)	
Net cash provided by operating activities	\$ 72.6	\$ 56.0
Acquisitions of businesses	(5.6)	(2.9)
Capital expenditures	(9.5)	(11.0)
Net repayments under bank credit facilities	(55.1)	(38.8)
Payments on term equipment notes and other debt	(6.3)	(6.7)

Additionally, our cash position, working capital and debt obligations are shown below for the periods indicated and should be read in conjunction with our consolidated balance sheets and notes thereto included in *Item 1. Financial Statements*:

December 31, 2002	March 31, 2002
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	(In millions)	
Cash and cash equivalents	\$ 7.1	\$ 9.0
Working capital	64.8	85.0
Total debt obligations	176.3	233.7

We believe that our cash flow from operations will be adequate to cover our working capital needs, debt service requirements and capital expenditures for the remainder of fiscal 2003 and for fiscal 2004 to the extent such items are known or are reasonably determinable based on current business and market conditions. However, we may elect to finance certain of our capital expenditure requirements through borrowings under our bank credit facilities or the issuance of additional term notes.

We intend to continue pursuing acquisition opportunities at prices we believe are reasonable based upon market conditions. However, we cannot accurately predict the timing, size and success of our acquisition efforts or our associated potential capital commitments. There can be no assurance that we will be able to acquire additional businesses on terms acceptable to us.

We expect to fund future acquisitions through cash flow from operations, additional borrowings or the issuance of our common stock. The extent to which we will be willing or able to use our common stock to make acquisitions will depend on its market value from time to time and the willingness of potential sellers to accept it as full or partial payment.

*Debt Obligations*

We entered into a five-year \$225.0 million senior secured credit facility (the *Bank Credit Facility*) with eleven banks in December 2000. The Bank Credit Facility is composed of a \$50.0 million five-year term loan (the *Term Loan*), of which \$27.5 million was outstanding at December 31, 2002, and a \$175.0 million five-year revolving credit line (the *Revolving Line*), of which \$63.0 million was outstanding at December 31, 2002. The Term Loan requires quarterly payments of \$2.5 million each through September 30, 2005.

The proceeds of the Bank Credit Facility can be used to repay certain indebtedness, finance certain acquisitions, provide for working capital and general corporate purposes and, subject to certain restrictions, repurchase our common stock. Borrowings outstanding under the Bank Credit Facility are secured by substantially all of our assets other than real estate and certain equipment subject to term equipment notes and other financings. Borrowings under the Bank Credit Facility accrue interest, at our option, at either (1) the London Interbank Offered Rate (LIBOR) plus a margin of 1.25% to 2.25%, or (2) an alternate base rate (based upon the greater of the agent bank's prime lending rate or the Federal Funds effective rate plus .50%) plus a margin of up to 1.00%. We are also required to pay a commitment fee on available but unused amounts ranging from .275% to .375% annually. The interest rate margin and the commitment fee are based upon our ratio of Funded Debt to Pro Forma Consolidated EBITDA, as defined, redetermined quarterly. On December 31, 2002, borrowings outstanding under the Term Loan and the Revolving Line accrued interest at a weighted average rate of 3.29%.

We are subject to certain covenants and restrictions and we must meet certain financial tests as defined in the Bank Credit Facility. We were in compliance with these covenants and financial tests at December 31, 2002. The Company obtained an amendment to its Bank Credit Facility which specifically provided that the transitional goodwill impairment charge (see Note 2. Accounting Change) would not impact compliance with these covenants.

In addition, we maintain an auxiliary revolving credit facility (the *Auxiliary Bank Facility*) with a commercial bank expiring in February 2003. This Auxiliary Bank Facility is unsecured and has a maximum borrowing capacity of \$5.0 million. At December 31, 2002, borrowings outstanding under the Auxiliary Facility totaled \$3.7 million and accrued interest at a rate of 3.13%. In February 2003, the Auxiliary Bank Facility was extended for a one year period.

Our term equipment notes consist primarily of notes payable pursuant to financing agreements between us and various lenders (the *Lender Notes*) and between us and two printing equipment manufacturers (the *Equipment Notes*). During the three months ended December 31, 2002, we issued Lender Notes in an aggregate principal amount of \$38.5 million and utilized the proceeds thereof to retire certain of the outstanding Equipment Notes. The Lender Notes are secured by the equipment subject to this refinancing. At December 31, 2002 outstanding borrowings under the Lender Notes totaled \$37.6 million and accrued interest at a weighted average rate of 5.91%. The Lender Notes provide for fixed monthly principal payments plus interest over a five-year term, ending with a balloon payment upon maturity. At December 31, 2002 outstanding borrowings under the Equipment Notes totaled \$32.0 million and accrued interest at a weighted average rate of 6.14%. The Equipment Notes provide for fixed payments of principal and interest for defined periods of up to ten years from the date of issuance and are secured by the purchased equipment. The remaining balance of term equipment notes totaling \$2.2 million primarily consists of various secured debt obligations assumed by us in connection with certain prior year acquisitions. We are not subject to any significant financial covenants in connection with any of the term equipment notes; however, the Bank Credit Facility places certain limitations on the amount of additional term note obligations we may incur in the future.

Our remaining debt obligations consist of a promissory note totaling \$5.2 million, industrial revenue bonds totaling \$4.5 million and various other debt obligations totaling \$.6 million. We do not have any significant financial covenants or restrictions associated with these debt obligations.



### **Other Commitments**

We have entered into various noncancelable operating leases primarily related to facilities and equipment used in the ordinary course of our business. Our future contractual obligations under such operating leases total approximately \$39.1 million as of December 31, 2002.

In connection with our assumption of obligations under outstanding industrial revenue bonds related to the acquisition of two printing businesses, which are reflected as outstanding debt obligations in our consolidated financial statements, we had two letters of credit outstanding for a combined total of \$4.6 million as of December 31, 2002. These letters of credit were issued pursuant to the terms of our Bank Credit Facility, which expires in December 2005, and we may be required to obtain replacement letters of credit at that time.

We have entered into earnout agreements in connection with certain prior year acquisitions. If the acquired printing businesses generate operating profits in excess of pre-determined targets, we may be obligated to issue additional shares of our common stock or make additional cash payments. As of December 31, 2002, we were contingently obligated through fiscal 2005 to issue up to 35,955 shares of our common stock and make additional cash payments of up to \$5.3 million for all periods in the aggregate. Based on current operating levels, we expect that the issuance of shares and actual payments pursuant to these obligations will be substantially less than the maximum amounts indicated.

### **Factors Which May Affect Future Results**

Our future operating results may be impacted by a number of factors, including general economic conditions and competitive factors in our industry, seasonal and cyclical variations in commercial printing demand, reasonable growth in the demand for our products and retention of key management and operating personnel. The magnitude and timing of any future acquisitions, as well as our ability to absorb and manage such businesses, will also impact our future results. In accordance with SFAS No. 142, the Company is required to annually test the remaining balance of goodwill for impairment and intends to test for impairment as the conclusion of each fiscal year. The Company may be required to record additional impairment on certain reporting units when its annual impairment test is conducted on March 31, 2003. Because of these and other factors, there can be no assurance that we will not experience material fluctuations in our future operating results or cash flows on a quarterly or annual basis.

### **Critical Accounting Policies**

We have identified our critical accounting policies based on the following factors—significance to our overall financial statement presentation, complexity of the policy and its use of estimates and assumptions. We are required to make certain estimates and assumptions in determining the reported amounts of assets and liabilities, disclosure of contingent liabilities and the reported amounts of revenues and expenses. We evaluate our estimates and assumptions on an ongoing basis and rely on historical experience and various other factors that we believe to be reasonable under the circumstances to determine such estimates. Because uncertainties with respect to estimates and assumptions are inherent in the preparation of financial statements, actual results could differ from these estimates.

We maintain an allowance for doubtful accounts as deemed necessary based upon expected collectibility of accounts receivable. We exercise judgment in determining the valuation and useful lives of our long-lived assets, primarily property/equipment and goodwill. We determine the

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realization of long-lived assets, other than goodwill, by assessing the future cash flows and income from such assets on an undiscounted basis, as well as other factors such as business trends and general economic conditions. Annually, as of the end of the Company's fiscal year, we determine the realization of goodwill by comparing the fair value of each reporting unit to its carrying value. The fair value is determined by using capitalization of earnings estimates and market valuation multiples for each reporting unit. We are self-insured up to specified limits for the majority of our workers' compensation costs and group health insurance costs, and we rely on claims experience and the advice of our administrators and consulting actuaries in determining an adequate liability.

for self-insurance claims. Finally, we utilize certain estimates and assumptions in our determination and allocation of the purchase price for acquisitions and in determining accruals for current and deferred income taxes.

### **Recent Accounting Pronouncements**

SFAS No. 145, *Rescission of FASB Statement Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*, was issued in April 2002. SFAS No. 145 amends existing authoritative pronouncements to make various technical corrections, clarify meanings, and describe their applicability under changed conditions. This statement requires that gains and losses from the extinguishment of debt be classified as extraordinary items only if they meet the criteria in Accounting Principles Board ( 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*. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Management does not believe that the adoption of SFAS No. 145 will have a material impact on its financial position or results of operations.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in July 2002 and is effective for exit or disposal activities that are initiated after December 31, 2002. SFAS No. 146 requires that exit or disposal costs be recorded at their fair value when they are incurred. We adopted SFAS No. 146 as of October 1, 2002. The adoption did not have a material impact on our financial position or results of operations.

SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, was issued in December 2002 and is effective for interim periods beginning after December 15, 2002 and annual periods ending after December 15, 2002. This statement amends the disclosure requirements and provides additional guidance with respect to certain other provisions of SFAS No. 123, *Accounting for Stock-based Compensation*. Management does not believe that the adoption of the additional disclosure requirements of SFAS No. 148 will have a material impact on its financial position or results of operations.

### **ITEM 3. Quantitative and Qualitative Disclosure About Market Risk**

Market risk generally means the risk that losses may occur in the estimated fair value of certain financial instruments as a result of adverse movements in interest rates, foreign currency exchange rates and commodity prices. We do not hold or utilize derivative financial instruments which could expose our Company to significant market risk. However, we are exposed to market risk for changes in interest rates related primarily to our debt obligations, which includes borrowings under our bank credit facilities, various term equipment notes and other debt obligations. As of December 31, 2002, there were no material changes in our market risk or the estimated fair value of our debt obligations relative to their recorded value, as reported in our Annual Report on Form 10-K for the fiscal year ended March 31, 2002.

### **ITEM 4. Controls and Procedures**

Our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-4(c) and 15d-14(c) of the Securities Exchange Act of 1934, as amended) as of a date ( Evaluation Date ) within 90 days prior to the filing date of this quarterly report. Based on such evaluation, our CEO and CFO have each concluded that as of the

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Evaluation Date, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the Evaluation Date.



**CONSOLIDATED GRAPHICS, INC.**

**PART II OTHER INFORMATION**

**ITEM 1. *Legal Proceedings***

From time to time, our Company is involved in litigation relating to claims arising out of its operations in the normal course of business. We maintain insurance coverages against certain potential claims in amounts which we believe to be adequate. Currently, we are not aware of any legal proceedings or claims pending against our Company that our management believes will have a material adverse effect on our financial position or results of operations.

**ITEM 2. *Changes in Securities and Use of Proceeds***

None.

**ITEM 3. *Defaults upon Senior Securities***

None.

**ITEM 4. *Submission of Matters to a Vote of Security Holders***

None.

**ITEM 5. *Other Information***

None.

**ITEM 6. *Exhibits and Reports on Form 8-K***

**(a) *Exhibits:***

- |       |   |
|-------|---|
| * 3.1 | Restated Articles of Incorporation of the Company filed with the Secretary of State of the State of Texas on July 27, 1994 (Consolidated Graphics, Inc. Form 10-Q (June 30, 1994) SEC File No. 0-24068, Exhibit 4(a)).  |
| * 3.2 | Articles of Amendment to the Restated Articles of Incorporation of the Company dated as of July 29, 1998 (Consolidated Graphics, Inc. Form 10-Q (June 30, 1998) SEC File No. 0-24068, Exhibit 3.1).   |
| * 3.3 | Restated By-Laws of the Company, dated as of November 2, 1998 (Consolidated Graphics, Inc. Form 10-Q (September 30, 1998) SEC File No. 0-24068, Exhibit 3.2).   |
| * 3.4 | Restated By-Laws of the Company, as amended on June 23, 1999 (Consolidated Graphics, Inc. Form 10-Q (June 30, 1999) SEC File No. 0-24068, Exhibit 3.4).   |
| * 3.5 | Amendments to the Restated By-Laws of the Company effective as of December 15, 1999 (Consolidated Graphics, Inc. Form 8-K (December 15, 1999) SEC File No. 0-24068, Exhibit 3.2).   |
| 3.6   | Amendment to the Restated By-Laws of the Company approved by the Board of Directors and effective as of December 2, 2002.   |
| * 4.1 | Specimen Common Stock Certificate (Consolidated Graphics, Inc. Form 10-K (March 31, 1998) SEC File No. 0-24068, Exhibit 4.1).   |
| * 4.2 | Rights Agreement dated as of December 15, 1999 between Consolidated Graphics, Inc and American Stock Transfer and Trust Company, as Rights Agent, which includes as Exhibit A the Certificate of Designations of Series A Preferred Stock, as Exhibit B the form of Rights Certificate and as Exhibit C the form of summary of Rights to Purchase Shares (Consolidated Graphics, Inc Form 8-K (December 15, 1999) SEC File No. 0-24068, Exhibit 4.1). |
| 10.1  | Form of Loan and Security Agreement and Schedule of Term Equipment Notes with Various Lenders as of October 2002 and December 2002.   |

\* Incorporated by reference

*Reports on Form 8-K:*

- 1) Form 8-K, filed October 23, 2002 in connection with the press release announcing the Company's fiscal 2003 second quarter results.
- 2) Form 8-K, filed November 15, 2002 in connection with the announcement of the Company's submission to the Securities and Exchange Commission of the certifications of its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 3) Form 8-K, filed January 22, 2003 in connection with the press release announcing the Company's fiscal 2003 third quarter results.
- 4) Form 8-K, filed February 4, 2003 in connection with the press release announcing the appointment of Jerry Brofft as the Company's Executive Vice President of Purchasing.

**SIGNATURES**

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

**CONSOLIDATED GRAPHICS, INC.**

Dated: February 14, 2003

By: /s/ G. Christopher Colville  
Executive Vice President,  
Chief Financial and Accounting  
Officer and Secretary

**CERTIFICATION**

I, Joe R. Davis, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of Consolidated Graphics, Inc.;**

2. **Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;**

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or



3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

**4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:**

a) **designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;**

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant



b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 d



c) **presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;**

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and p

**5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):**



a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the r

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 14, 2003

/s/ Joe R. Davis  
Chairman of the Board of Directors and  
Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION**

I, G. Christopher Colville, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of Consolidated Graphics, Inc.;**

2. **Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;**

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

**4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:**

a) **designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;**

a) designed such disclosure controls and procedures to ensure that material information relating to the regi 50



b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and p

**5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):**

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant

**6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.**

Date: February 14, 2003

/s/ G. Christopher Colville  
Executive Vice President,  
Chief Financial and Accounting  
Officer and Secretary  
(Principal Financial and Accounting Officer)