METATEC INC
Form 10-Q
August 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2003

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 No. 0-9220

METATEC, INC.
(Exact name of Registrant as specified in its charter)

OHIO	31-1647405
(State of Incorporation)	(IRS Employer Identification No.)

7001 Metatec Boulevard Dublin, Ohio	43017
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: (614) 761-2000

METATEC INTERNATIONAL, INC.

(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, and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Yes No X

Number of Common Shares outstanding as of July 16, 2003: 6,536,113

METATEC, INC.

FORM 10-Q

IMPORTANT INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

All statements, other than statements of historical facts, included in this Form 10-Q of Metatec, Inc. (the "Company") or incorporated herein by reference, including, without limitation, statements regarding the Company's future financial position, business strategy, budgets, projected costs, goals and plans and objectives of management for future operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "project," "believe" or "continue" or the negative thereof or variations thereon or similar terminology. Forward-looking statements speak only as the date the statements were made. Although the Company believes that the expectations reflected in forward-looking statements have a reasonable basis, it can give no assurance that these expectations will prove to be correct. Forward-looking statements are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. For a discussion of the most significant risks and uncertainties that could cause the Company's actual results to differ materially from those projected, see the Company's Form 10-K for its fiscal year ending December 31, 2002, Item 7--Forward-Looking Statements; Risk Factors Affecting Future Results. Except to the limited extent required by applicable law, the Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

INDEX

INDEX	PAGE
Part I: Financial Information	
Item 1 - Financial Statements	
Consolidated Balance Sheets as of June 30, 2003 (unaudited) and December 31, 2002	4
Consolidated Statements of Operations for the three months ended June 30, 2003 and 2002 (unaudited)	5
Consolidated Statements of Operations for the six months ended June 30, 2003 and 2002 (unaudited)	6
Consolidated Statements of Shareholders' Deficiency for the six months ended June 30, 2003 (unaudited)	7
Consolidated Statements of Cash Flows for the six months ended June 30, 2003 and 2002 (unaudited)	8
Notes to Consolidated Financial Statements (unaudited)	9-11
Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations	11-16
Item 3 - Quantitative and Qualitative Disclosures about Market Risk	17
Item 4 - Controls and Procedures	17
Part II: Other Information	
Items 1-6	18
Signatures	19

PART I - FINANCIAL INFORMATION

Item I. Financial Statements

METATEC, INC.

CONSOLIDATED BALANCE SHEETS		At June 30, 2003 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$	377,00
Restricted cash		120,00
Accounts receivable, net of allowance for doubtful accounts of $200,000		5,750,42
Inventory		1,213,70
Prepaid expenses		568,98
Total current assets		8,030,12
Property, plant and equipment - net		22,213,29
Other assets		136,06
TOTAL ASSETS	$	30,379,48
LIABILITIES & SHAREHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable	$	2,434,40
Accrued expenses:		
Royalties		346,08
Personal property taxes and real estate taxes		1,175,89
Payroll and benefits		1,056,28
Restructuring		354,57
Other		487,18
Unearned income		82,13
Current maturities of long-term real estate debt		173,94
Current maturities of other long-term debt and capital lease obligations		10,854,49
Total current liabilities		16,964,98
Long-term real estate debt		18,268,11
Other long-term debt and capital lease obligations, less current maturities		4,284,90
Other long-term liabilities		1,118,19
Total liabilities		40,636,19
Shareholders' deficiency:		
Common stock - no par value; authorized 10,000,000 shares; issued 7,217,855 shares		33,008,13
Accumulated deficit		(39,582,93
Treasury stock, at cost; 681,742 shares		(3,670,53

Unamortized restricted stock		(11,37
Total shareholders' deficiency		(10,256,70
TOTAL LIABILITIES & SHAREHOLDERS' DEFICIENCY	$	30,379,48

See notes to consolidated financial statements.

METATEC, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30	
	2003	200
NET SALES	$ 10,132,457	$ 11,9
Cost of sales	6,884,121	7,8
Gross margin	3,248,336	4,0
Selling, general and administrative expenses	(2,910,207)	(4,0
Gain on sale of assets	280,557	
OPERATING EARNINGS (LOSS) FROM CONTINUING OPERATIONS	618,686	
Other income and (expense):		
Investment income	3,013	
Interest expense	(655,281)	(7
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(33,582)	(7
Income tax benefit	0	
LOSS FROM CONTINUING OPERATIONS	(33,582)	(7
Income from discontinued operations	0	6

NET LOSS	$	(33,582)	$ (
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING			
Basic and diluted		6,536,113	6,5
LOSS FROM CONTINUING OPERATIONS PER COMMON SHARE			
Basic and diluted	$	(0.01)	$
NET LOSS COMMON SHARE			
Basic and diluted	$	(0.01)	$

See notes to consolidated financial statements.

METATEC, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

		Six Months Ended June 30	
		2003	200
NET SALES	$	20,581,512	$ 25,
Cost of sales		13,469,153	16,
Gross margin		7,112,359	8,
Selling, general and administrative expenses		(6,301,894)	(8,
Gain on sale of assets		737,066	
OPERATING EARNINGS (LOSS) FROM CONTINUING OPERATIONS		1,547,531	
Other income and (expense):			
Investment income		3,076	
Interest expense		(1,314,509)	(1,
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		236,098	(1,
Income tax benefit		0	
INCOME (LOSS) FROM CONTINUING OPERATIONS		236,098	(

Income from discontinued operations		0		
NET INCOME	$	236,098	$	
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING Basic and diluted		6,536,113		6,
INCOME (LOSS) FROM CONTINUING OPERATIONS PER COMMON SHARE Basic and diluted	$	0.04	$	
NET INCOME COMMON SHARE Basic and diluted	$	0.04	$	

See notes to consolidated financial statements.

METATEC, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIENCY (UNAUDITED)

		Common Stock		Accumulated Deficit		Treasury Stock
BALANCE AT DECEMBER 31, 2002	$	33,008,138	$	(39,819,030)	$	(3,670,537)
Net income				236,098		
Amortization of restricted stock						
BALANCE AT JUNE 30, 2003	$	33,008,138	$	(39,582,932)	$	(3,670,537)

See notes to consolidated financial statements.

METATEC, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the six months ended June 30,	2003	20
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 236,098	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,969,437	2,
Gain on sale of assets	(623,872)	
Changes in assets and liabilities:		
Accounts receivable	1,590,659	3,
Inventory	(116,596)	
Prepaid expenses and other assets	303,380	
Accounts payable and accrued expenses	(1,003,646)	(3,
Unearned income	23,364	
Net assets of discontinued operations	0	(
Net cash provided by operating activities	2,378,824	2,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(311,503)	(
Proceeds from the sales of property, plant and equipment	849,672	1,
Net cash provided by investing activities	538,169	1,
CASH FLOWS FROM FINANCING ACTIVITIES:		
Decrease in restricted cash	26,000	
Payment of long-term debt and capital lease obligations	(1,587,670)	(1,
Net payments on revolving line of credit	(1,314,914)	(3,
Net cash used in financing activities	(2,876,584)	(4,
Increase (decrease) in cash and cash equivalents	40,409	(1,
Cash and cash equivalents at beginning of period	336,597	1,
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 377,006	$
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Interest paid	$ 1,183,354	$ 1,
Income tax refunds received	$ 15,587	$

Assets purchased by the assumption of a liability	$ 29,119	$
Issuance of restricted stock	$ 0	$
Payment of accrued restrucuturing expense by the issuance of treasury stock	$ 0	$
Assets sold for the assumption of a receivable	$ 90,000	$

See notes to condensed consolidated financial statements.

METATEC, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION The consolidated balance sheet as of June 30, 2003, the consolidated statements of operations for the three and six months ended June 30, 2003 and 2002, the consolidated statement of shareholders' deficiency for the six months ended June 30, 2003, and the consolidated statements of cash flows for the six month periods then ended have been prepared by the Company, without audit. In the opinion of management, all adjustments, which consist solely of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position, results of operations and changes in cash flows for all periods presented have been made. At the May 15, 2003 Shareholders Meeting, shareholders voted to change the Company's name to Metatec, Inc.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's December 31, 2002 annual report on Form 10-K. The results of operations for the period ended June 30, 2003 are not necessarily indicative of the results for the full year.

In January 2003, the Company sold its Internet-based electronic software distribution ("ESD") business to Digital River, Inc. ("Digital River"), a global e-commerce outsource solutions provider based in Minneapolis, Minnesota. Under the terms of the agreement, Digital River acquired certain assets and assumed certain liabilities associated with the Company's ESD business, and the Company received approximately $1,100,000 in cash and notes, subject to adjustment based on an earn out computation. The Company recognized a gain on the sale of approximately $167,000 during the second quarter of 2003 and $635,000 for the six months ended June 30, 2003.

In February 2003, the Company entered into a licensing agreement with one of its DVD patent licensors which, among other things, provides for a deferred payment schedule for accrued royalties owed by the Company under prior licensing agreements, and, as a result, $137,000 of accrued royalties were reclassified to other long-term liabilities as of December 31, 2002.

In March 2002, the President signed the Job Creation and Worker Assistance Act of 2002 into law. This law extended the carry back period from two to five years for net operating losses arising in the 2001 and 2002 taxable years. The Company recorded an income tax benefit of $875,000 in the quarter ended March 31, 2002 related to this law.

SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," is effective for fiscal years beginning after May 15, 2002 (December 31, 2003 for the Company). This Statement rescinds FASB Statements No. 4 and 64 that dealt with issues relating to the extinguishment of debt. This Statement also rescinds FASB Statement No. 44 that dealt with intangible assets of motor carriers. This Statement modifies SFAS No. 13, "Accounting for Leases," so that certain capital lease modifications must be accounted for by lessees as sale-leaseback transactions. Additionally, this Statement identifies amendments that should have been made to previously existing pronouncements and formally amends the appropriate pronouncements. The adoption of SFAS No. 145 does not have a significant effect on the Company's results of operations or its financial position.

SFAS No. 146, "Accounting for Costs Associated With Exit or Disposal Activities" is effective for exit or disposal activities that are initiated after December 31, 2002. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force

(EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The principal difference between this Statement and Issue 94-3 is that this Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. The adoption of SFAS No. 146 did not have a material impact on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," ("SFAS 148"). SFAS 148 amends FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") to provide alternative methods for an entity that voluntarily changes to the fair value based method of accounting for stock-based compensation, amends the disclosure provisions of SFAS 123 and amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosure about those effects in interim financial information. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34. FIN 45 clarifies the requirements of SFAS No. 5, "Accounting for Contingencies," relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. The disclosure provisions of FIN 45 are effective for the current fiscal year and were not material in relation to the Company's 2002 consolidated financial statements. However, the provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The adoption of FIN 45 did not have a material impact on the Company's financial condition or results of operations.

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities. FIN 46 clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 requires a variable interest entity to be consolidated by a company, if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003 and to existing entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The initial adoption of this accounting pronouncement did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. FAS 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances), many of which were previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise shall be effective for the Company's 2004 financial statements. Management does not expect the initial adoption of this accounting pronouncement will have a material impact on the Company's financial statements.

2. DISCONTINUED OPERATIONS Pursuant to an agreement dated as of September 30, 2002, the Company sold its European CD-ROM manufacturing operations in Breda, The Netherlands, to Nimbus, a Netherlands-based private investment group. The transaction was structured as a sale of all of the shares of Metatec's European subsidiary to Nimbus. The shares were sold in exchange for the assumption of the European subsidiary's liabilities as of August 31, 2002.

European operations had revenues for the three months ended June 30, 2002 of $2,870,000 and $4,990,000 for the six months ended June 30, 2002.

Pre-tax income for the Company's European operations for the three months ended

June 30, 2002 was $681,000 and $784,000 for the six months ended June 30, 2002.

The Company accounted for these operations as discontinued operations in the 2002 consolidated financial statements.

3. STOCK OPTIONS The Company accounts for employee and director stock options using the intrinsic value method. Under this method, no compensation expense is recognized in all years presented because all stock options are granted at an exercise price equal to the fair market value of the Company's stock on the date of the grant. If compensation expense for the Company's stock option grants had been determined based on their estimated fair value at the grant dates, the Company's net income and earnings per share for the six months ending June 30, 2003 would have been as follows:

Net income, as reported	$236,098
Deduct: total stock-based compensation expense determined under the fair value method for all awards, net of related tax benefits	(41,585)
Pro forma net income	$194,513
Earnings per common share, basic and diluted:	
As reported	$.04
Pro forma	$.03

The fair value of options granted was estimated on the date of the grant using the Black-Scholes option-pricing model.

4. LONG-TERM DEBT Included in the Company's long-term debt balance at December 31, 2002 is a term loan facility and a revolving loan facility (collectively, the "Loans"). As of June 30, 2003, $7,680,000 and $2,295,000 were outstanding under the term loan facility and revolving loan facility, respectively, which are included in current maturities of long-term debt, as they are scheduled to mature on April 1, 2004. As further discussed in Part II- Other Information, Item. 5 Other Information, on August 8, 2003, the Company received notice that the Loans had been sold and assigned to ComVest Investment Partners II LLC, an affiliate of Commonwealth Associates Group Holdings, LLC ("Commonwealth"), and the Board of Directors of the Company has received a non-binding proposal from Commonwealth regarding a potential restructuring of the Loans.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2003 COMPARED TO THREE MONTHS ENDED JUNE 30, 2002 AND THE SIX MONTHS ENDED JUNE 30, 2003 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2002

RECENT EVENTS

The information set forth in Item 5 of Part II of this Form 10-Q is incorporated by reference into this Item 2 of Part I.

BUSINESS OF THE COMPANY

The Company provides technology driven supply chain solutions that enable its customers to streamline the process of delivering their products and information to market, increase efficiencies and reduce costs. The

Company assists its customers with a wide range of services, from preparing their products for market to delivering their finished products into the distribution channel or directly to the end-users. The Company's solutions are built on a solid technology foundation that includes both customized system integration and a web-based reporting and tracking tool that makes real-time information easily accessible. Technologies include CD-ROM and DVD manufacturing services. The Company's core CD-ROM manufacturing, packaging and distribution capabilities serve as the major component of its supply chain services. The Company's manufacturing and distribution facilities are located in Dublin, Ohio.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of accounting policies. Many of these accounting policies require the Company's management to make estimates and assumptions about future events and their impact on amounts reported in the Company's financial statements and related notes. Since future events and their impact cannot be determined with certainty, actual results will inevitably differ from management's estimates. Such differences could be material to the Company's financial statements.

Management believes that its application of accounting policies, and the estimates inherently required therein, are reasonable. Accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances indicate a change is necessary.

The Company's accounting policies are more fully described in Note 1 to the consolidated financial statements included in the Company's Form 10-K for the year ended December 31, 2002. Management believes there are certain critical accounting policies important to a reader of the financial statements which are described below. These critical accounting policies are not intended to be a comprehensive list of all the Company's accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting other available alternatives would not produce a materially different result.

Long-lived assets. In evaluating the fair value and future benefits of long-lived assets, management completes an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets and reduces their carrying value by the excess, if any, as a result of such calculation.

Allowance for doubtful accounts. Management provides a reserve for credit losses based on the Company's past experience with similar accounts receivable, and it believes that the Company's reserves are adequate. Since the accuracy of management's estimation process could be materially impacted by the composition of the accounts receivable over time, management periodically reviews and modifies the estimation process.

Litigation. The Company and its legal counsel evaluate litigation and review the likelihood of an outcome and the resulting materiality to the Company. The Company is involved in various legal claims arising from the normal course of its business. While the ultimate liability, if any, from these proceedings is presently indeterminable, in the opinion of management, these matters should not have a material adverse effect on the consolidated financial statements of the Company.

Income taxes. The Company has a history of unprofitable operations. These losses generated a significant federal tax net operating loss, or NOL, carryforward as

of June 30, 2003 and December 31, 2002. Accounting principles generally accepted in the United States of America require the Company to record a valuation allowance against the deferred tax asset associated with this NOL if it is "more likely than not" that the Company will not be able to utilize the NOL to offset future taxes. Because of the Company's history of unprofitable operations, management has recorded a valuation allowance to offset the deferred tax asset associated with the NOL because of the uncertainty surrounding the realizability of such asset.

In the future the Company could achieve levels of profitability which could cause management to conclude that it is more likely than not that the Company will realize all or a portion of the NOL carryforward. Upon reaching such a conclusion, the Company would reduce the valuation allowance which would increase the estimated net realizable value of the deferred tax asset at that time and would then provide for income taxes at a rate equal to the Company's combined federal and state effective rates.

RESULTS OF OPERATIONS

Net sales for the three months ended June 30, 2003, were $10,132,000, a decrease of $1,824,000, or 15% over the same period of the prior year. Net sales for the six months ended June 30, 2003, were $20,582,000, a decrease of $4,501,000, or 18% over the same period of the prior year. These decreases resulted from lower freight revenue, the sale of the Company's ESD business, which was sold on January 14, 2003 (see discussion below), and declining prices for the Company's CD-ROM products and services, a trend the Company anticipates will continue. In addition, demand for the Company's CD-ROM products and services declined due to several factors, including the continued poor general economic conditions, the continued increase in customers using on-line or electronic methods to distribute information, and the continued maturation of the CD-ROM market.

Gross margin was $3,200,000 or 32% of net sales for the three months ended June 30, 2003, as compared to $4,100,000 or 34% of net sales for the same period of the prior year. The decrease in the gross margin for the three month period-to-period comparisons was the result of the price declines noted above and an increased proportion of lower margin sales of customer procured materials. In addition, the gross margin in 2002 included higher margin ESD sales. Gross margin was 35% of net sales for the six months ended June 30, 2003, as compared to 33% of net sales for the same period of the prior year. The improvement in gross margin as a percentage of sales in the six month period to period comparisons reflects a lower volume of freight revenue, as the gross margin of freight sales is significantly lower than that obtained on the Company's other sales, coupled with higher first quarter gross margin related to certain supply chain customers.

Selling, general and administrative ("SG&A") expenses were $2,910,000, or 29% of net sales, for the three months ended June 30, 2003, as compared to $4,066,000, or 34% of net sales, for same period of the prior year. During the quarter ended June 30, 2003, the Company recorded a $200,000 credit related to an adjustment to personal property taxes and sales and use taxes. SG&A expenses were $6,302,000, or 31% of net sales for the six months ended June 30, 2003, as compared $8,185,000 or 33% of net sales for the same period of the prior year. The reduction in SG&A expenses for the period-to-period comparisons, as well as the improvement in the SG&A expense percentages for such period-to-period comparisons, was the result of the Company's cost-cutting initiatives, such as workforce reductions and facility closures.

On January 14, 2003, the Company sold its Internet-based electronic software distribution ("ESD") business to Digital River, Inc. ("Digital River"), a global e-commerce outsource solutions provider based in Minneapolis, Minnesota. Under the terms of the agreement, Digital River acquired certain assets and assumed certain liabilities associated with the Company's ESD business, and the Company received approximately $1,100,000 in cash and notes, subject to adjustment based on an earn out computation. The Company recognized a gain on the sale of approximately $635,000 during the six months ended June 30, 2003.

In addition to the gain noted above, the Company recognized a gain of $102,000 during the six months ended June 30, 2003, which was previously considered contingent and was related to the sale of the Company's Netherlands facility completed in September 2002.

No restructuring expenses were incurred during the three months or six months ended June 30, 2003 or the three months or six months of the prior year.

Interest expense for the three months ended June 30, 2003 was $655,000, as compared to $719,000 for the same period of the prior year. Interest expense for the six months ended June 30, 2003 was $1,315,000, as compared to $1,471,000 for the same period of the prior year. Interest expense decreased due to lower debt balances under the revolving loan and term loan facilities and lower interest rates.

The Company recognized an income tax benefit of $875,000 for the six months ended June 30, 2002. In March 2002, the Job Creation and Worker Assistance Act of 2002 was enacted into law. This law extended the carry back period from two years to five years for net operating losses arising in the 2001 and 2002 taxable years. For the six months ended June 30, 2003 the Company utilized approximately $250,000 of its net operating loss carryforward and, therefore, did not record any income tax expense.

The net income from continuing operations for the six months ended June 30, 2003 was $236,000, or $.04 per basic and diluted common share, as compared to a net loss from continuing operations in the same period of the prior year of $620,000, or $.09 per basic and diluted common share. Including discontinued operations, discussed below, the Company had a net income of $236,000 for the six months ended June 30, 2003, or $.04 per basic and diluted common share, as compared to net income in the same period of the prior year of $164,000, or $.03 per basic and diluted common share.

Discontinued Operations

Pursuant to an agreement dated as of September 30, 2002, the Company sold its European CD-ROM manufacturing operations in Breda, The Netherlands, to Nimbus, a Netherlands-based private investment group. The transaction was structured as a sale of all of the shares of Metatec's European subsidiary to Nimbus. The shares were sold in exchange for the assumption of the European subsidiary's liabilities as of August 31, 2002.

Revenues for the Company's European operations for the six months ended June 30, 2002, were $4,990,000.

Pre-tax income for the Company's European operations for the six months ended June 30, 2002, was $784,000.

FINANCIAL CONDITION - LIQUIDITY AND CAPITAL RESOURCES

Sources of Liquidity

The Company financed its business during the six months ended June 30, 2003, primarily through cash generated from operations and to a lesser extent, net proceeds from investing activities. Cash flow from operating activities was $2,379,000 for the three months ended June 30, 2003, as compared to $2,770,000 for the three months ended June 30, 2002. The Company had cash and cash equivalents of $377,000 as of June 30, 2003, as compared to $157,000 as of June 30, 2002.

Bank Financing Matters

The Company has a term loan facility and a revolving loan facility (collectively, the "Loans") with The Huntington National Bank and Bank One, N.A. (the "Banks"). As further described under Item 5 of Part II of this Form 10-Q, the Company has been notified that, on August 8, 2003, the Loans had been sold and assigned to ComVest Investment Partners II LLC ("ComVest"), an affiliate of Commonwealth Associates Group Holdings, LLC ("Commonwealth"). In addition, the Board of Directors of the Company has received a non-binding proposal (the "Proposal") from Commonwealth regarding a potential restructuring of the Loans. See Item 5 of Part II of this Form 10-Q for a further discussion of these matters.

The borrowing base of the revolving loan facility is limited to the lesser of (i) $10,000,000, or (ii) the sum of (A) 80% of eligible domestic accounts receivable, plus (B) 30% of eligible domestic inventory, plus (C) 90% of domestic machinery and equipment. The borrowing base is further reduced by the aggregate amount of

the Company's outstanding letters of credit. As of June 30, 2003, $7,680,000 and $2,295,000 were outstanding under the term loan and revolving loan, respectively, and the Company had approximately $3,985,000 available to draw on its revolving loan.

The Loans mature on April 1, 2004. Quarterly principal payments are required for the term loan if cash flows exceed certain specified targets over designated periods of time. In March 2003, the Company exceeded these targets and made a principle payment of $202,592 on May 1, 2003. The Company did not exceed these targets during the second quarter 2003. The Loans are secured by a first lien on all non-real estate business assets of the Company and a pledge of the stock of the Company's subsidiaries. The Company is required to comply with the financial and other covenants contained in the agreement for the Loans. As of June 30, 2003, the Company was in compliance with these covenants. The Loans accrue interest at a rate equal to 3.5% in excess of the prime rate of the Banks. Certain fees are required to be paid by the Company in connection with the Loans.

Gary W. Qualmann has submitted his resignation as chief financial officer and treasurer of the Company, effective as of August 19, 2003, to join another company. Under the terms of the Loans, the Company is prohibited from replacing or changing its chief financial officer without the prior written consent of the assignee of the Banks' interest, unless such replacement or change will not

have, or is not likely to have, a "material adverse effect" on the Company, as defined in the loan agreement. ComVest has waived any default under the Loans related to Mr. Qualmann's resignation, and the Company is attempting to retain a replacement chief financial officer. However there can be no assurance that the Company will be able to retain a replacement chief financial officer acceptable to ComVest, in which case ComVest may seek to declare the Company in default under the Loans. If it would be found that the Company was in default of the Loans for this reason, all principal and accrued interest under the Loans would be immediately due and payable to ComVest, and such event would have a material adverse impact on the Company's financial position and continuing operations and its ability to continue as a going concern.

Real Estate Financing Matters

The Company has a $19,000,000 term loan which was used to permanently finance the Company's Dublin, Ohio distribution center (completed in 1999) and to pay down other bank debt. The loan has an outstanding principal balance of $18,442,057 as of June 30, 2003. This term loan is payable in monthly principal and interest payments based upon a thirty year amortization schedule, bears interest at a fixed rate of 8.2%, and matures on September 1, 2009. This loan is secured by a first lien on all real property of the Company and letters of credit in favor of the lender, in an aggregate amount of $1,650,000, which are renewed annually. The current letters of credit were renewed April 2003. A contingency to the Proposal is the restructuring of this term loan.

Other Liquidity Matters

As of June 30, 2003, the Company had a working capital deficiency of approximately $8,900,000 primarily due to the $9,975,000 of term loan and revolving loan (under the Loans described above) maturing April 1, 2004.

The Company had a shareholders' deficiency of $10,257,000 as of June 30, 2003, as compared to a shareholders' deficiency of $10,503,000 as of December 31, 2002.

In February 2003, the Company entered into a licensing agreement with one of its DVD patent licensors which, among other things, provides for a deferred payment schedule for accrued royalties owed by the Company under prior licensing agreements, and, as a result, $137,000 of accrued royalties were reclassified to other long-term liabilities.

As previously discussed, the Company sold its EDS business to Digital River on January 14, 2003.

The Company did not carry any off-balance sheet derivative financial instruments or have any off-balance sheet financial arrangements at June 30, 2003.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Statements contained in this Form 10-Q or any other reports or documents prepared by the Company or made by management of the Company may be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause the Company's actual results to differ materially from those projected. Such risks and uncertainties that might cause such a

difference include, but are not limited to: changes in general business and economic conditions; changes in demand for CD-ROM products or supply chain services; excess capacity levels in the CD-ROM industry; the introduction of new products or services by competitors;

increased competition (including pricing pressures); changes in manufacturing efficiencies; changes in supply chain services techniques; changes in technology; the Company's ability to meet the cash flow thresholds and other financial covenants in its loan agreement with its banks, the failure of which could result in the banks' exercising their legal remedies against the Company or its assets; the Company's shareholders' deficiency, which means that shareholders may not realize any value upon a sale or liquidation of the Company or its assets; and other risks discussed in the Company's filings with the Securities and Exchange Commission, including those risks discussed under the caption "Forward Looking Statements; Risk Factors Affecting Future Results" and elsewhere in the Form 10-K for the Company's year ended December 31, 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

There is no change in the quantitative and qualitative disclosures about the Company's market risk from the disclosures contained in the Company's Form 10-K for its fiscal year ended December 31, 2002.

ITEM 4. CONTROLS AND PROCEDURES

(a) The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic filings with the Securities and Exchange Commission.

(b) There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Items 1-4. INAPPLICABLE.

Item 5. OTHER INFORMATION

The Company has received a term loan and a revolving loan (collectively, the "Loans") under the terms of a loan agreement dated as of February 8, 2002 (the "Loan Agreement"), with The Huntington National Bank and Bank One, N.A. (the "Banks"). Total principal of $9,975,000 is currently outstanding under the Loans which are scheduled to mature on April 1, 2004.

On August 8, 2003, the Company received notice that the Loans and all of the Banks' right, title and interest in and to the Loans, the Loan Agreement and any other Loan documents had been sold and assigned to ComVest Investment Partners II LLC ("ComVest"). ComVest is an affiliate of Commonwealth Associates Group Holdings, LLC ("Commonwealth").

In addition, the Board of Directors of the Company (the "Board") has received a non-binding proposal (the "Proposal") from Commonwealth regarding a potential restructuring of the Loans, as well as a potential equity investment, as a result of which ComVest would acquire control of the Company and its Board and the interests of the Company's shareholders would be substantially diluted. The transaction would be subject to various contingencies, including due diligence, restructuring of the existing obligations relating to the Company's Dublin, Ohio facility, receipt of shareholder approval, and the receipt by the Board of a favorable fairness opinion on the restructuring transaction.

The Board is considering the Proposal and intends to retain an investment banking firm or other financial advisor to assist it in its evaluation of the Proposal, as well as any other alternatives that may become available to the Company. The Company is cooperating with ComVest with respect to its due diligence reviews and expects that the parties will continue discussions regarding the Proposal. However, there can be no assurances that the parties will reach agreement on the Proposal or any alternative satisfactory to ComVest. Furthermore, ComVest may terminate the discussions regarding the Proposal at any time. If the parties do not reach agreement on the Proposal or a satisfactory alternative, or ComVest terminates discussions regarding the Proposal, and if an event of default occurs (including ComVest in good faith deeming itself insecure with respect to payment of the Loans), then ComVest could pursue any or all of its remedies under the Loan Agreement or related documents, or any other rights that may be available to it, including seeking to commence an involuntary Chapter 11 proceeding against the Company.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description of Exhibit
4.1	Form of Share Certificate for Metatec, Inc.
10.1	Second amendment to employment agreement for Christopher Munro
31.1	Certification of principal executive officer required by Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2	Certification of principal financial officer required by Rule 13a-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of principal executive officer required by Rule 13a-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.
32.2	Certification of principal financial officer required by Rule 13a-14(b) of the Securities 32.2 Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Cod.

(b) Reports on Form 8-K.

(i) The Company filed a Form 8-K dated May 8, 2003, under Items 7 and 9 furnishing a copy of the Company's earnings release for its first quarter 2003.

(ii) The Company filed a Form 8-K dated August 8, 2003, to announce the resignation of its Chief Financial Officer effective August 19, 2003.

SIGNATURES

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

Metatec, Inc.

/s/ Gary W. Qualmann

Date: August 14, 2003

BY: Gary W. Qualmann
Chief Financial Officer
(authorized signatory-
principal financial officer)

/s/ Julia A. Fratianne

BY: Julia A. Fratianne
Vice President - Finance
(authorized signatory-
principal accounting officer)

METATEC, INC.

Form 10-Q
For Quarterly Period Ended June 30, 2003

EXHIBIT INDEX

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