MONOLITHIC SYSTEM TECHNOLOGY INC
Form 8-K/A
November 14, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

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

Date of Report (Date of earliest event reported) **August 30, 2002**

Monolithic System Technology, Inc.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
of incorporation)

000-32929
Commission File Number

77-0291941
(I.R.S. Employer
Identification Number)

1020 Stewart Drive
Sunnyvale, California 94085

(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: **(408) 731-1800**

The registrant hereby amends its Current Report on Form 8-K filed with the Securities and Exchange Commission on September 13, 2002.

ITEM 7. FINANCIAL STATEMENTS AND EXHIBITS.

(a) Financial Statements of business acquired.

The following financial statements of ATMOS are included in this report.

(1) Audited balance sheets of ATMOS as of January 31, 2002 and 2001, and the related statements of operations and deficit and cash flows for the years then ended.

(2) Unaudited balance sheet of ATMOS as of July 31, 2002 and the unaudited statement of operations and deficit and cash flows for the six months then ended.

(3) Unaudited reconciliation of United States accounting principles as of July 31, 2002 and for the six months ended July 31, 2002

(b) Unaudited Pro forma financial information.

The following unaudited pro forma condensed financial information is being filed herewith:

(1) Unaudited Pro Forma Combined Condensed Balance Sheet as of June 30, 2002.

(2) Unaudited Pro Forma Combined Condensed Statements of Operations for the year ended December 31, 2001 and for the six months ended June 30, 2002.

(c) Exhibits

2.2 Share Purchase Agreement for the shares of ATMOS Corporation

23.3 Consent of Independent Accountants of ATMOS Corporation

(a) FINANCIAL STATEMENTS OF BUSINESS ACQUIRED

(1) Audited balance sheets of ATMOS as of January 31, 2002 and 2001, and the related statements of operations and deficit and cash flows for the years then ended.

Financial Statements of

ATMOS CORPORATION

Years ended January 31, 2002 and 2001

(In U.S. dollars)

AUDITORS' REPORT TO THE DIRECTORS

We have audited the balance sheets of Atmos Corporation as at January 31, 2002 and 2001 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

/s/ KPMG LLP

Chartered Accountants

Ottawa, Canada

March 8, 2002

COMMENTS BY AUDITORS FOR U.S. READERS ON CANADA U.S. REPORTING DIFFERENCE

In the United States of America, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when the financial statements are affected by conditions and events that cast substantial doubt on the Company's ability to continue as a going concern, such as those described in Note 1(a) to the financial statements. Our report to the directors dated March 8, 2002 is expressed in accordance with Canadian reporting standards which do not permit a reference to such events and conditions in the auditor's report when these are adequately disclosed in the financial statements.

/s/ KPMG LLP

Chartered Accountants

Ottawa, Canada
March 8, 2002

ATMOS CORPORATION

Balance Sheets

January 31, 2002 and 2001

(Expressed in U.S. dollars)

	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	$ 1,946,958	$ 1,116,471
Amounts receivable	60,390	147,998
Prepaid expenses	104,517	149,984
Investment tax credits receivable		476,706
Prepaid services		196,765

		2002		2001
		2,111,865		2,087,924
Property and equipment (note 2)		2,796,365		639,198
Term deposit (note 3)		253,116		266,667
	$	5,161,346	$	2,993,789

		2002		2001
Liabilities and Shareholders' Equity (Deficiency)				
Current liabilities:				
Accounts payable and accrued liabilities	$	645,996	$	387,109
Current portion of capital lease obligations (note 4)		626,676		56,045
Convertible debentures (note 5)				2,719,959
		1,272,672		3,163,113
Capital lease obligations (note 4)		58,452		112,886
Deferred lease inducement		161,124		
Shareholders' equity (deficiency):				
Share capital (note 6)		14,022,423		4,301,888
Additional paid-in capital (note 5)				13,374
Cumulative translation account		(207,112)		(12,477)
Deficit		(10,146,213)		(4,584,995)
		3,669,098		(282,210)
Basis of presentation (note 1(a))				
Commitments (note 9)				
	$	5,161,346	$	2,993,789

See accompanying notes to financial statements.

ATMOS CORPORATION

Statements of Operations and Deficit

Years ended January 31, 2002 and 2001

(Expressed in U.S. dollars)

		2002		2001
Revenues:				
Software licenses	$	71,667	$	36,315
Engineering and design services		245,946		127,779
		317,613		164,094

	2002	2001
Expenses:		
Research and development	3,016,258	594,835
General and administrative	1,234,775	689,815
Sales and marketing	955,933	361,709
Depreciation of property and equipment	515,184	64,383
Amortization of prepaid services	189,197	481,150
	5,911,347	2,191,892
Loss before other income (expenses)	(5,593,734)	(2,027,798)
Other income (expenses):		
Interest income, net	32,516	48,778
Royalty rate reduction		(2,274,066)
Gain on sale of subsidiary		67,249
Net loss	(5,561,218)	(4,185,837)
Deficit, beginning of year	(4,584,995)	(399,158)
Deficit, end of year	$ (10,146,213)	$ (4,584,995)
Loss per share basic and fully diluted (note 10)	$ (1.25)	$ (0.98)
Weighted average number of shares outstanding	4,453,143	4,255,859

See accompanying notes to financial statements.

ATMOS CORPORATION

Statements of Cash Flows

Years ended January 31, 2002 and 2001

(Expressed in U.S. dollars)

	2002	2001
Cash flows from operating activities:		
Net loss	$ (5,561,218)	$ (4,185,837)
Items not involving cash:		
Depreciation of property and equipment	515,184	64,383
Amortization of deferred lease inducement	(19,587)	
Amortization of prepaid services	189,197	481,150
Loss on disposal of property and equipment	14,632	
Royalty rate reduction		2,274,066
Gain on sale of subsidiary		(67,249)

	2002	2001
Changes in non-cash operating working capital	860,022	(247,430)
	(4,001,770)	(1,680,917)
Cash flows from financing activities:		
Repayment of capital lease obligations	(315,133)	(28,061)
Issuance of convertible debenture		1,296,760
Issuance of common shares	12,056	878
Issuance of preferred shares	7,233,155	1,860,561
Issuance of a warrant	16,291	
Share issue costs	(212,673)	(42,933)
	6,733,696	3,087,205
Cash flows from investing activities:		
Purchase of property and equipment	(1,718,406)	(280,554)
Increase in term deposit		(266,667)
Proceeds on sale of subsidiary		67,249
	(1,718,406)	(479,972)
Effects of exchange rates on cash and cash equivalents	(183,033)	20,429
Increase in cash and cash equivalents	830,487	946,745
Cash and cash equivalents, beginning of year	1,116,471	169,726
Cash and cash equivalents, end of year	$ 1,946,958	$ 1,116,471
Supplemental cash flow disclosure:		
Interest paid	$ 115,990	$ 37

The Company considers cash and cash equivalents to be highly liquid investments with original maturities of three months or less.

See accompanying notes to financial statements.

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ATMOS CORPORATION

Notes to Financial Statements

Years ended January 31, 2002 and 2001

(Expressed in U.S. dollars)

The Company was incorporated on February 22, 1994 to carry on the business of microelectronic consulting services. In fiscal 2000, the Company began developing and marketing embedded semi-conductor memory solutions to corporations which design and implement "Systems-on-chip" applications.

1. Significant accounting policies:

(a)

Basis of presentation:

The financial statements have been prepared assuming that the Company will continue as a going concern. As at January 31, 2002, the Company had positive working capital of $839,193, however for the year then ended it had incurred a loss of $5,561,218 and had negative cash flow from operations of $4,001,770. The Company expects to continue to incur operating losses for the foreseeable future. The Company currently has no operating line of credit.

All of the above factors raise substantial doubt about the Company's ability to continue as a going concern. Management has commenced implementation of a plan to address these issues including restructuring its organization and continuing to raise capital through the private placement of equity. The Company's ability to continue as a going concern is subject to management's ability to successfully implement the above plans. Failure to implement these plans could have a material adverse effect on the Company's financial condition and or results of operations. The financial statements do not include adjustments that may be required if the assets are not realized and the liabilities settled in the normal course of operations.

In the longer term, the Company cannot be certain that cash generated from its future operations will be sufficient to satisfy its liquidity requirements and it may need to continue to raise capital by selling additional equity or by obtaining credit facilities. The Company's future capital requirements will depend on many factors, including, but not limited to, the market acceptance of its products and services. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favourable to the Company.

(b)

Cash and cash equivalents:

Cash and cash equivalents include guaranteed investment certificates ("GICs") of $1,265,582 (2001 $Nil). All GIC's have maturities of less than 365 days but are redeemable at anytime.

(c)

Property and equipment:Property and equipment are stated at cost. Property and equipment under capital leases are stated at the present value of minimum lease payments. Depreciation is provided using the following methods and rates:

Asset	**Method**	**Rate**
Furniture and fixtures	Declining balance	20%
Electronic equipment	Declining balance	30%
Computer equipment	Declining balance	30%
Computer software	Declining balance	100%
Software	Straight-line	4 years or life of license

Leasehold improvements are depreciated on a straight-line basis over the related lease term.

One-half of one year's depreciation is taken in the year of acquisition.

(d)

Leases:

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risks of ownership to the lessee. Assets acquired under capital leases are depreciated at the same rates as those described in note 1(c) unless ownership of the asset does transfer in which case the asset is depreciated over the shorter of the lease term and its useful life. Obligations recorded under capital leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to expense.

(e)

Deferred lease inducement:

Lease inducements are deferred and amortized over the term of the lease.

(f)

Revenue recognition:

Revenue from software licenses is recognized when all of the following criteria have been met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectibility is probable.

Revenue from engineering and design services is recognized as the services are rendered based on contract milestones and collectibility is reasonably assured. Billings in advance of services rendered are recorded as deferred revenue and are recognized at the time services are rendered.

(g)

Research and development costs:

Research costs are expensed as incurred. Development costs are expensed in the year incurred unless management believes a development project meets the Canadian generally accepted accounting criteria for deferral and amortization. No development costs incurred to date meet the criteria for deferral and amortization.

(h)

Investment tax credits:

Investment tax credits are accounted for using the cost reduction approach whereby they are recorded as a reduction of the related expense or the cost of the assets acquired when there is reasonable assurance that they will be realized.

(i)

Income taxes:

Income taxes are accounted for under the asset and liability method. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. When necessary, a valuation allowance is recorded to reduce tax assets to an amount for which realization is more likely than not. The effect of changes in tax rates is recognized in the period in which the rate change occurs.

(j)

Foreign currency translation:

The Company's measurement currency is the Canadian dollar and its reporting currency is the U.S. dollar. Foreign currency transactions are translated into Canadian dollars at exchange rates in effect on the date of the transactions. Monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect as at the balance sheet date. Foreign currency gains and losses are included in income.

The Company's financial statements are translated into U.S. dollars for reporting purposes. Assets and liabilities are translated at rates of exchange at the balance sheet date and revenue and expenses are translated at average exchange rates. Gains and losses arising from the translation of financial statements are deferred and included as a separate component of shareholders' equity (deficiency).

(k)

Stock-based compensation:

No compensation expense is recognized for options granted to employees or non-employees when the option is granted. Proceeds received on the exercise of options granted to both employees and non-employees are recorded in shareholders' equity when the options are exercised.

(l)

Earnings per share:

Basic earnings per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. The treasury stock method is used for calculating diluted earnings per share. Under the treasury stock method, diluted earnings per share are computed similar to basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that the proceeds were used to acquire shares of common stock at the average market price during the reporting period.

(m)

Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts and disclosures in these financial statements. Actual results could differ from those estimates. Significant management estimates include assumptions used in estimating investment tax credits receivable. Receipt of these credits is dependent on Canada Customs and Revenue Agency's review and acceptance of the eligibility of expenditures.

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2. Property and equipment:

	Cost	Accumulated depreciation	2002 Net book value
Furniture and fixtures	$ 238,506	$ 40,025	$ 198,481
Electronic equipment	700,533	109,328	591,205
Computer equipment	415,181	110,096	305,085
Computer software	30,695	22,669	8,026
Software	408,624	75,267	333,357
Leasehold improvements	559,588	59,956	499,632
	2,353,127	417,341	1,935,786
Property under capital lease:			
Electronic equipment	50,623	20,502	30,121
Computer equipment	123,796	39,177	84,619
Software	833,127	87,288	745,839
	1,007,546	146,967	860,579
	$ 3,360,673	$ 564,308	$ 2,796,365

	Cost	Accumulated depreciation	2001 Net book value
Furniture and fixtures	$ 19,909	$ 6,354	$ 13,555
Electronic equipment	15,497	3,072	12,425
Computer equipment	266,680	14,825	251,855
Computer software	15,427	8,469	6,958
Software tools/licenses	173,250	7,219	166,031
Leasehold improvements	23,428	5,206	18,222
	514,191	45,145	469,046

	Cost	Accumulated depreciation	2001 Net book value
Property under capital lease:			
Furniture and fixtures	58,276	5,827	52,449
Electronic fixtures	53,334	8,000	45,334
Computer equipment	85,139	12,770	72,369
	196,749	26,597	170,152
	$ 710,940	$ 71,742	$ 639,198

During the year, property and equipment were acquired at an aggregate cost of $2,788,724 (2001 $680,771) of which $887,510 (2001 $198,469) were acquired by means of capital leases and $182,808 (2001 $Nil) were acquired by means of leasehold inducements. Cash payments of $1,718,406 (2001 $280,554) were made to purchase property and equipment.

In addition, during the year ended January 31, 2002, property and equipment under capital leases with a net book value of $45,389 was disposed of in exchange for forgiveness of the remaining capital lease obligation of $40,769. A loss of $4,620 was recognized on the transaction.

3. Term deposit:

The Company has a term deposit, held by a chartered bank, which supports a letter of credit with the Company's landlord as beneficiary. The letter of credit has been drawn pursuant to a security requirement of the Company's office lease and must stay in place for a minimum of five years.

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4. Capital lease obligations:

Future minimum capital lease payments as of January 31:

	2002	2001
2002	$	$ 67,282
2003	657,928	64,633
2004	38,450	40,842
2005	10,703	10,811
2006	11,153	8,626
Total minimum lease payments	718,234	192,194
Less amount representing interest (at approximately 8%)	33,106	23,263
Present value of minimum lease payments	685,128	168,931
Current portion of capital lease obligations	626,676	56,045
	$ 58,452	$ 112,886

5. Convertible debentures:

During the year ended January 31, 2001, the Company issued convertible debentures which were convertible at a 10% discount into the same series of securities of the Company as subscribed in the next round of financing. Interest accrued on the principal balance at a rate of 7% per annum. The debentures were issued on November 30, 2000 and January 31, 2001, at which time the fair value of the Company's obligation to make future payments of principal and interest was $2,719,959 and the fair value of the holder's conversion option was $13,374. During the year ended January 31, 2002, the debentures were converted into Class D series 2 preferred shares.

6. Share capital:

(a)

Authorized:

Unlimited	Class A preferred shares, voting, convertible to common without restriction on a 1 for 1 basis
Unlimited	Class B preferred shares, voting, convertible to common without restriction on a 1 for 1 basis
Unlimited	Class C preferred shares, non-voting, convertible to common without restriction on a 1 for 1 basis, automatically convertible to Class B preferred shares upon the issuance of a certain number of voting shares
4,000,000	Class D series 1 preferred shares, voting, convertible to common without restriction on a 1 for 1 basis
1,898,148	Class D series 2 preferred shares, voting, convertible to common without restriction on a 1 for 1 basis

(b)

Issued:

	2002		2001	
	Number of shares	Amount	Number of shares	Amount
Common shares:				
Balance, beginning of year	4,354,028	$ 233,005	4,223,000	$ 232,127
Issued for cash	139,938	12,056	131,028	878
Balance, end of year	4,493,966	245,061	4,354,028	233,005
Class A preferred shares:				
Balance, beginning of year	1,500,000	504,168	1,500,000	504,168
Issued for cash	1,700,000	553,890		
Balance, end of year	3,200,000	1,058,058	1,500,000	504,168
Class B preferred shares:				
Balance, beginning of year	3,773,314	3,058,900		
Conversion of Class C preferred shares	678,481	548,748		
Issued for cash	1,679,358	1,466,181	2,291,668	1,860,561
Issued for prepaid services and royalty rate reduction			1,481,646	1,198,339
Balance, end of year	6,131,153	5,073,829	3,773,314	3,058,900

	2002		2001	
Class C preferred shares:				
Balance, beginning of year	678,481	$ 548,748		$
Conversion to Class B preferred shares	(678,481)	(548,748)		
Issued for prepaid services and royalty rate reduction			678,481	548,748
Balance, end of year			678,481	548,748
Class D series 1 preferred shares:				
Issued for cash	3,333,333	5,213,084		
Balance, end of year	3,333,333	5,213,084		
Class D series 2 preferred shares:				
Conversion of debentures	1,898,148	2,671,706		
Balance, end of year	1,898,148	2,671,706		
Warrants:				
Balance, beginning of year				
Issued for cash	1	16,291		
Balance, end of year	1	16,291		
Less:				
Share issue costs		255,606		42,933
Balance, end of year		$ 14,022,423		$ 4,301,888

During the year ended January 31, 2001, the Company issued 1,898,313 Class B preferred shares and 678,481 Class C preferred shares in exchange for cash consideration of $336,995, services valued at $681,147 and the reduction of a royalty rate on licensing revenues valued at $1,065,940. The services, which were used by the Company over the twelve month period ending May 10, 2001, were recognized into income as utilized. The royalty rate reduction was included in other expenses.

During the year ended January 31, 2000, the Company granted 525,000 warrants in conjunction with the issuance of the 1,500,000 Class A preferred shares. The warrants can be exercised without restriction into common shares at an exercise price of Cdn. $0.50 per share.

During the year ended January 31, 2001, the Company granted 2,190,624 warrants in conjunction with the issuance of 3,773,314 Class B preferred shares. 1,175,000 of the warrants can be exercised into an equivalent number of Class A preferred shares at an exercise price of Cdn. $0.50 per share. 1,015,624 of the warrants can be exercised into an equivalent number of Class B preferred