

AVALON HOLDINGS CORP
Form 10-Q
August 11, 2010
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2010

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, 2010

“ **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 1-14105

AVALON HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

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Ohio (State or other jurisdiction of incorporation or organization)	34-1863889 (I.R.S. Employer Identification No.)
One American Way, Warren, Ohio (Address of principal executive offices)	44484-5555 (Zip Code)
Registrant's telephone number, including area code: (330) 856-8800	

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

The registrant had 3,191,038 shares of its Class A Common Stock and 612,293 shares of its Class B Common Stock outstanding as of August 10, 2010.

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AVALON HOLDINGS CORPORATION AND SUBSIDIARIES

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations (Unaudited)****(in thousands, except per share amounts)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net operating revenues	\$ 12,051	\$ 8,372	\$ 20,381	\$ 17,215
Costs and expenses:				
Costs of operations	9,842	6,804	16,827	14,076
Depreciation and amortization	422	423	842	848
Selling, general and administrative expenses	1,851	1,456	3,419	3,065
Operating loss	(64)	(311)	(707)	(774)
Other income (expense):				
Interest expense	(4)	(4)	(7)	(7)
Interest income	8	11	16	14
Other income, net	61	55	116	114
Income (loss) before income taxes	1	(249)	(582)	(653)
Provision for income taxes	13	14	14	14
Net loss	\$ (12)	\$ (263)	\$ (596)	\$ (667)
Net loss per share basic and diluted	\$ (.01)	\$ (.07)	\$ (.16)	\$ (.18)
Weighted average shares outstanding basic and diluted	3,803	3,803	3,803	3,803

See accompanying notes to condensed consolidated financial statements.

Table of Contents**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(in thousands, except per share amounts)**

	June 30, 2010 (Unaudited)	December 31, 2009
Assets:		
Current Assets:		
Cash and cash equivalents	\$ 5,663	\$ 5,862
Accounts receivable, net	8,452	7,094
Prepaid expenses	270	291
Refundable income taxes	25	25
Other current assets	737	568
Total current assets	15,147	13,840
Property and equipment, less accumulated depreciation and amortization of \$9,643 in 2010 and \$9,042 in 2009	27,695	28,277
Leased property under capital leases, less accumulated depreciation and amortization of \$1,971 in 2010 and \$1,774 in 2009	5,487	5,574
Noncurrent deferred tax asset	8	8
Other assets, net	58	58
Total assets	\$ 48,395	\$ 47,757
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of obligations under capital leases	\$ 1	\$ 1
Accounts payable	5,592	5,119
Accrued payroll and other compensation	792	545
Accrued income taxes	7	
Other accrued taxes	161	274
Deferred revenues	2,348	1,943
Other liabilities and accrued expenses	374	246
Total current liabilities	9,275	8,128
Obligations under capital leases	229	229
Shareholders' Equity:		
Class A Common Stock, \$.01 par value	32	32
Class B Common Stock, \$.01 par value	6	6
Paid-in capital	58,183	58,096
Accumulated deficit	(19,330)	(18,734)
Total shareholders' equity	38,891	39,400
Total liabilities and shareholders' equity	\$ 48,395	\$ 47,757

See accompanying notes to condensed consolidated financial statements.

Table of Contents**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited)**

(in thousands)

	Six Months Ended June 30,	
	2010	2009
Operating activities:		
Net loss	\$ (596)	\$ (667)
Reconciliation of loss to cash provided by (used in) operating activities:		
Depreciation and amortization	842	848
Compensation costs stock options	87	
Provision for losses on accounts receivable	1	55
Change in operating assets and liabilities:		
Accounts receivable	(1,359)	3,529
Prepaid expenses	21	30
Other current assets	(169)	(72)
Accounts payable	473	(680)
Accrued payroll and other compensation	247	(175)
Accrued income taxes	7	(8)
Other accrued taxes	(113)	(118)
Deferred revenues	405	187
Other liabilities and accrued expenses	128	7
Net cash (used in) provided by operating activities	(26)	2,936
Investing activities:		
Capital expenditures	(173)	(71)
Net cash used in investing activities	(173)	(71)
(Decrease) Increase in cash and cash equivalents	(199)	2,865
Cash and cash equivalents at beginning of year	5,862	3,061
Cash and cash equivalents at end of period	\$ 5,663	\$ 5,926

See accompanying notes to condensed consolidated financial statements.

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AVALON HOLDINGS CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

June 30, 2010

Note 1. Basis of Presentation

The unaudited condensed consolidated financial statements of Avalon Holdings Corporation and subsidiaries (collectively "Avalon") and related notes included herein have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted consistent with such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and related notes included in Avalon's 2009 Annual Report to Shareholders.

In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial position of Avalon as of June 30, 2010, and the results of its operations and cash flows for the interim periods presented.

The operating results for the interim periods are not necessarily indicative of the results to be expected for the full year.

Avalon evaluated subsequent events through the date the financial statements were issued.

Note 2. Basic Net Income (Loss) per Share

Basic net income (loss) per share has been computed using the weighted average number of common shares outstanding each period, which were 3,803,331. Although there are common equivalent shares outstanding, no diluted per share amounts are reported because Avalon was in a net loss position for the second quarter and six months ended June 30, 2010 and 2009 and therefore, such dilution would be considered anti-dilutive. As a result, diluted per share amounts are equal to basic per share amounts for the three and six months ended June 30, 2010 and 2009.

The weighted average number of common shares outstanding assuming dilution for the three and six months ended June 30, 2010 was 3,972,143 and 3,901,181, respectively.

Note 3. Credit Facility

On March 21, 2008, Avalon entered into a \$3.5 million unsecured line of credit agreement with The Huntington National Bank. Interest on borrowings accrues at LIBOR plus 1.75%. The agreement was amended in April 2009 to provide for a minimum interest rate of 3.25%. The line of credit contains certain financial and other covenants, customary representations, warranties and events of defaults. At June 30, 2010 and December 31, 2009, there were no borrowings under the line of credit.

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AVALON HOLDINGS CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

June 30, 2010

Note 4. Income Taxes

Avalon incurred a net loss of \$12,000 in the second quarter of 2010 compared with net loss of \$.3 million in the second quarter of 2009. Excluding the minor effect of the state income tax provisions, Avalon's overall effective tax rate was 0% in the second quarter of 2010 and 2009. The income tax provision for the second quarter of 2010 and the income tax benefit for the second quarter of 2009 were offset by a change in the valuation allowance. The overall effective tax rate is different than statutory rates primarily due to a change in the valuation allowance. A valuation allowance is provided when it is more likely than not that deferred tax assets relating to certain federal and state loss carryforwards will not be realized. Avalon continues to maintain a valuation allowance against the majority of its deferred tax amounts until it is evident that the deferred tax asset will be utilized in the future.

Avalon incurred a net loss of \$.6 million for the first six months of 2010 compared with net loss of \$.7 million for the first six months of 2009. Excluding the minor effect of the state income tax provisions, Avalon's overall effective tax rate was 0% in the first six months of 2010 and 2009. The income tax benefits for the first six months of 2010 and 2009 were offset by a change in the valuation allowance. The overall effective tax rate is different than statutory rates primarily due to a change in the valuation allowance. A valuation allowance is provided when it is more likely than not that deferred tax assets relating to certain federal and state loss carryforwards will not be realized. Avalon continues to maintain a valuation allowance against the majority of its deferred tax amounts until it is evident that the deferred tax asset will be utilized in the future.

Note 5. Long-term Incentive Plan

The purpose of the Avalon Holdings Corporation 2009 Long-term Incentive Plan (the "Plan") is (a) to improve individual employee performance by providing long-term incentives and rewards to employees of Avalon, (b) to assist Avalon in attracting, retaining and motivating employees and non-employee directors with experience and ability, and (c) to associate the interests of such employees and directors with those of the Avalon shareholders. Under the Plan, 1,300,000 shares have been reserved for the issuance of stock options. During the first quarter of 2010, Avalon granted 980,000 stock options, which were the first stock options granted under the Plan. These stock options, vest ratably over a five year period and have a contractual term of ten years from the date of grant. At the end of each contractual vesting period, the share price of the Avalon common stock, traded on a public stock exchange (NYSE Amex), must reach a predetermined price within three years following such contractual vesting period before the stock options are exercisable (See table below). If the Avalon common stock price does not reach the predetermined price, the stock options will either be cancelled or the period will be extended at the discretion of the Board of Directors.

The Monte Carlo Simulation was selected to determine the fair value because it incorporates six minimum considerations; 1) the exercise price of the option, 2) the expected term of the option, taking into account both the contractual term of the option, the effects of employees' expected exercise and post-vesting employment termination behavior, as well as the possibility of change in control events during the contractual term of the option agreements, 3) the current fair value of the underlying equity, 4) the expected volatility of the value of the underlying share for the expected term of the option, 5) the expected dividends on the underlying share for the expected term of the option and 6) the risk-free interest rate(s) for the expected term of the option.

Table of Contents**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited)****June 30, 2010**

The expected term, or time until the option is exercised is typically based on historical exercising behavior of previous option holders of a company's stock. Due to the fact there were no options previously granted and, therefore no historical exercising behavior available, an alternative method was used. Because of the nature of the vesting as described above, the options were separated into five blocks, with each block having its own vesting period and expected term. Assuming the vesting occurs ratably over the vesting period for each option block, the average vesting term (requisite service period) for each option block was calculated to be 2.54, 3.54, 4.54, 5.54 and 6.54 years for option blocks 1 through 5, respectively. Because there is no historical activity, the Simplified Method was used to determine the expected term. The expected term under the Simplified Method is equal to the average vesting term plus the original contractual term divided by two. As such, the expected terms were calculated to be 6.27, 6.77, 7.27, 7.77 and 8.27 years, for option blocks 1 through 5, respectively.

The current fair value of the underlying equity was determined to be equal to Avalon's publicly traded stock price as of the grant dates times the sum of the Class A and Class B common shares outstanding.

The expected volatility was based on the observed volatility of Avalon common stock for a five year period prior to the grant dates. The expected volatility that was used ranged from 60.9% to 61.5% with a weighted average expected volatility of 60.9%.

There were no expected dividends and the risk-free interest rate(s) which ranged from 2.28% to 2.44% were based on yield data for U. S. Treasury securities over a period consistent with the expected term.

The following table is a summary of the stock options granted during the first quarter of 2010:

Number of Options Granted	Weighted Average Exercise Price	Weighted Average Fair Value at Grant Date
980,000	\$ 2.52	\$ 3.56

The stock options vest and become exercisable based upon achieving two critical metrics as follows:

- 1) Contract Vesting Term: The stock options vest ratably over a five year period.
- 2) The Avalon common stock price traded on a public stock exchange (NYSE Amex) must reach the predetermined vesting price within three years after the options become vested under the Contract Vesting Term.

The table below represents the period and predetermined stock price needed for vesting.

	Begins Vesting	Ends Vesting	Predetermined Vesting Price
Block 1	12 mo. after Grant Dates	48 mo. after Grant Dates	\$ 3.43
Block 2	24 mo. after Grant Dates	60 mo. after Grant Dates	\$ 4.69
Block 3	36 mo. after Grant Dates	72 mo. after Grant Dates	\$ 6.43
Block 4			