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ADVO INC
Form 10-Q
May 12, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(Mark One)

(X) Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended MARCH 29, 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 number 1-11720

ADVO, INC.

(Exact name of registrant as specified in its charter)

Delaware

06-0885252

(State or other jurisdiction of incorporation or organization)

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

One Univac Lane, P.O. Box 755, Windsor, CT

06095-0755

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number including area code: (860) 285-6100

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 (X) No ()

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

As of April 26, 2003 there were 19,922,205 shares of common stock outstanding.

ADVO, INC.

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ON FORM 10-Q

QUARTER ENDED MARCH 29, 2003

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ADVO, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except share data)

	March 29, 2003	September 28, 2002
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,273	\$ 12,281
Accounts receivable, net	119,989	120,600
Inventories	2,583	2,415
Prepaid expenses and other current assets	7,262	7,140
Deferred income taxes	12,771	13,189
	-----	-----
Total current assets	153,878	155,625

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Property, plant and equipment	299,804	276,301
Less accumulated depreciation and amortization	(159,351)	(147,913)
	-----	-----
Net property, plant and equipment	140,453	128,388
Investment in deferred compensation plan	10,158	10,311
Goodwill	22,062	22,124
Other assets	14,325	13,661
	-----	-----
TOTAL ASSETS	\$ 340,876	\$ 330,109
	=====	=====
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	\$ 28,750	\$ 22,500
Notes payable - short term	74	1,715
Accounts payable	30,846	32,923
Accrued compensation and benefits	27,217	24,798
Other current liabilities	38,427	37,127
	-----	-----
Total current liabilities	125,314	119,063
Long-term debt	125,000	146,750
Deferred income taxes	15,431	12,770
Deferred compensation plan	10,158	10,311
Other liabilities	4,803	4,885
STOCKHOLDERS' EQUITY		
Series A Convertible preferred stock, \$.01 par value (Authorized 5,000,000 shares, none issued)	--	--
Common stock, \$.01 par value (Authorized 40,000,000 shares, issued 30,672,169 and 30,594,410 shares, respectively)	307	306
Additional paid-in capital	207,445	205,164
Unamortized deferred compensation	(1,913)	(873)
Accumulated earnings	83,182	61,329
	-----	-----
	289,021	265,926
Less common stock held in treasury, at cost	(228,909)	(228,473)
Accumulated other comprehensive income (loss)	58	(1,123)
	-----	-----
Total stockholders' equity	60,170	36,330
	-----	-----
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	\$ 340,876	\$ 330,109
	=====	=====

See Accompanying Notes.

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ADVO, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

Six months ended

Three months ended

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	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
	-----	-----	-----	-----
REVENUES	\$ 578,243	\$ 561,369	\$ 287,065	\$ 274,433
Costs and expenses:				
Cost of sales	426,622	409,321	212,268	201,855
Selling, general and administrative	110,202	107,731	55,101	53,376
Provision for bad debts	2,709	4,112	959	1,987
	-----	-----	-----	-----
OPERATING INCOME	38,710	40,205	18,737	17,215
Interest expense	4,571	6,864	1,673	3,349
Other (income) expense, net	(547)	787	(282)	493
	-----	-----	-----	-----
Income before income taxes	34,686	32,554	17,346	13,373
Provision for income taxes	12,834	12,045	6,418	4,948
	-----	-----	-----	-----
NET INCOME	\$ 21,852	\$ 20,509	\$ 10,928	\$ 8,425
	=====	=====	=====	=====
BASIC EARNINGS PER SHARE	\$ 1.10	\$ 1.03	\$.55	\$.42
	=====	=====	=====	=====
DILUTED EARNINGS PER SHARE	\$ 1.09	\$ 1.01	\$.55	\$.42
	=====	=====	=====	=====
Weighted average basic shares	19,802	19,939	19,816	19,950
Weighted average diluted shares	19,977	20,281	19,990	20,276

See Accompanying Notes.

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ADVO, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Six months ended	
	March 29, 2003	March 30, 2002
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 43,158	\$ 28,633
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(28,007)	(13,370)
Proceeds from disposals of property, plant and equipment	395	301
Distributions from equity affiliates	363	44
Acquisitions/joint ventures, net of cash acquired	146	(450)
	-----	-----
NET CASH USED BY INVESTING ACTIVITIES	(27,103)	(13,475)

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Cash flows from financing activities:		
Revolving line of credit - net	(5,500)	(9,000)
Payments on long-term debt	(10,000)	(3,750)
Decrease in note payable - net	(1,641)	(2,391)
Proceeds from exercise of stock options	467	1,522
Purchase of common stock for treasury	(435)	(8,674)
	-----	-----
NET CASH USED BY FINANCING ACTIVITIES	(17,109)	(22,293)
	-----	-----
Effect of exchange rate changes on cash and cash equivalents	46	--
Decrease in cash and cash equivalents	(1,008)	(7,135)
Cash and cash equivalents at beginning of period	12,281	17,728
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 11,273	\$ 10,593
	=====	=====
Noncash activities:		
Decrease in fair value of interest rate swap liabilities	1,090	2,028
Change in noncash portion of deferred compensation plan	101	1,967

See Accompanying Notes.

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ADVO, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. 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 considered necessary for a fair presentation have been included.

Operating results for the six-month period ended March 29, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending September 27, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in ADVO's annual report on Form 10-K for the fiscal year ended September 28, 2002.

Certain reclassifications have been made in the fiscal 2002 financial statements to conform with the fiscal 2003 presentation.

2. SUMMARY OF ACCOUNTING POLICIES

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("Statement") No. 143, "Accounting for Asset Retirement Obligations". Statement No. 143 establishes accounting standards for the recognition and measurement of legal obligations associated with the

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retirement of tangible long-lived assets and requires the recognition of a liability for an asset retirement obligation in the period in which it is incurred. The Company adopted Statement No. 143 at the beginning of fiscal 2003 and such adoption had no effect on the Company's financial position and results of operations.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and for the disposal of a segment of a business. The Company adopted Statement No. 144 at the beginning of fiscal 2003 and such adoption had no effect on the Company's financial position and results of operations.

In July 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which supercedes Emerging Issues Task Force Issue ("EITF") No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Associated with a Restructuring)". Statement No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred as opposed to when management is committed to an exit plan. Such liabilities should be recorded based on their fair value, as defined. This statement is effective for exit or disposal activities initiated after December 31, 2002. The Company recorded a severance charge in the first quarter of fiscal 2003 and recognized the liability in accordance with Statement No. 146.

In November 2002, the FASB issued Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Guarantees of Indebtedness of Others" which requires companies to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN No. 45 provides specific guidance for identifying the characteristics of contracts that are subject to its guidance in its entirety from those only subject to the initial recognition and measurement provisions. The recognition and measurement provisions of FIN No. 45 are effective on a prospective basis for guarantees issued or modified after December 31, 2002.

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ADVO, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The disclosure requirements of FIN No. 45 are effective for interim and annual period financial statements ending after December 15, 2002. The Company's contingent consideration related to the acquisition of ADVOCANADA in June 2002 is subject to the disclosure requirements of FIN No. 45. If certain earning targets are met by ADVOCANADA, the Company will be required to pay an additional payment of up to a maximum of \$0.7 million over the next three years.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Statement No. 148 also amends the disclosure requirements of Statement No. 123, "Accounting for Stock-Based Compensation", to require more prominent and additional disclosure in both annual and interim financial statements on the method of accounting for stock-based compensation. The interim disclosure provisions are effective for financial reports for interim periods beginning after December 15, 2002. The Company adopted the disclosure provisions of Statement No. 148 in the second quarter of fiscal 2003. See Note 5 of the "Notes to Consolidated Financial Statements".

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3. COMPREHENSIVE INCOME

Comprehensive income for a period encompasses net income and all other changes in a company's equity other than from transactions with the Company's owners. The Company's comprehensive income was as follows:

	Six months ended		Three months ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
(In thousands)				
Net income	\$21,852	\$20,509	\$10,928	\$ 8,425
Other comprehensive income:				
Unrealized gain on derivative instruments	1,090	2,028	--	1,362
Foreign currency translation adjustment	91	--	87	--
Total comprehensive income	\$23,033	\$22,537	\$11,015	\$ 9,787

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ADVO, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. EARNINGS PER SHARE

Basic earnings per share excludes the effect of common stock equivalents, such as stock options, and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if common stock equivalents, such as stock options, were exercised.

	Six months ended		Three months ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 30, 2002
(In thousands, except per share data)				
Net income	\$ 21,852	\$ 20,509	\$ 10,928	\$ 8,425
Weighted average basic shares	19,802	19,939	19,816	19,950
Effect of dilutive securities:				
Stock options	154	310	154	305
Restricted stock	21	32	20	21
Dilutive potential common shares	175	342	174	326
Weighted average diluted shares	19,977	20,281	19,990	20,276

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Basic earnings per share	\$ 1.10	\$ 1.03	\$.55	\$.42
	=====	=====	=====	=====
Diluted earnings per share	\$ 1.09	\$ 1.01	\$.55	\$.42
	=====	=====	=====	=====

5. STOCK - BASED COMPENSATION

The Company maintains several stock-based compensation plans relating to stock options. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25 ("APB Opinion No. 25") "Accounting for Stock Issued to Employees", and related Interpretations. Aside from the amortization of restricted stock awards, no stock-based employee compensation cost is reflected in net income, as all options granted under those plans have an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the Black-Scholes fair value method which is described in Statement No. 123, to stock-based employee compensation plans.

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ADVO, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Six months ended		Three months ended	
	March 29, 2003	March 30, 2002	March 29, 2003	March 29, 2002
(In thousands, except per share data)				
Net income, as reported	\$ 21,852	\$ 20,509	\$ 10,928	\$ 10,928
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,850)	(2,324)	(808)	(808)
Pro forma net income	\$ 20,002	\$ 18,185	\$ 10,120	\$ 10,120
	=====	=====	=====	=====
Earnings per share:				
Basic - as reported	\$ 1.10	\$ 1.03	\$.55	\$.42
Basic - pro forma	\$ 1.01	\$.91	\$.51	\$.42
Diluted - as reported	\$ 1.09	\$ 1.01	\$.55	\$.42
Diluted - pro forma	\$ 1.00	\$.91	\$.51	\$.42

For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the stock options' vesting period, ranging from one to four years. The pro forma effect on net income and related earnings per share may not be representative of the future years' impact since the terms

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and conditions of new grants may vary from the current terms.

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section should be read in conjunction with the consolidated financial statements of the Company and the notes thereto.

RESULTS OF OPERATIONS

REVENUES The Company reported revenues of \$287.1 million for the second quarter of fiscal 2003 representing a 4.6%, or \$12.6 million, increase from \$274.4 million in the second quarter of fiscal 2002. This growth was primarily related to increased volumes in the Company's core shared mail products demonstrated by a 5.4% increase in shared mail pieces distributed and a 4.8% increase in average pieces per package, when comparing the current quarter to the prior year quarter. Also contributing to the revenue growth for the second quarter of fiscal 2003 were revenues of \$1.8 million from ADVO Canada acquired in June 2002. Offsetting the second quarter revenue increases were shifts in product mix and weights, from heavier to lighter weight products, which contributed to the 1.5% decrease in shared mail revenue per piece to \$37.96 for the three months ended March 29, 2003 when compared to the three months ended March 30, 2002.

Driven by the volume growth that occurred in the second quarter of fiscal 2003 which is detailed above, revenues for the year-to-date period ended March 29, 2003 increased \$16.9 million, or 3.0%, to \$578.2 million. Also contributing to the year-to-date revenue growth were ADVO Canada revenues of \$3.9 million. Key statistics for the first six months of fiscal 2003 included a 2.2% increase over the first half of fiscal 2002 in shared mail pieces delivered. Shared mail packages delivered also increased 2.2% for the year-to-date period ended March 29, 2003, driven mainly by the 3.8% shared mail package growth in the first quarter of fiscal 2003. Average pieces per package increased 0.1% for the first half of fiscal 2003 due to the blending of the 4.8% increase in the second quarter and a 4.6% decrease in the first quarter of fiscal 2003.

OPERATING EXPENSES Cost of sales as a percentage of revenue remained comparatively flat at 73.9% for the second quarter of fiscal 2003 compared to 73.6% for the second quarter of fiscal 2002. Cost of sales for the six months ended March 29, 2003 increased 0.9 percentage points to 73.8% of revenues when compared to the same period of the prior year.

In absolute terms, cost of sales increased \$10.4 million and \$17.3 million, respectively, for the three and six months ended March 29, 2003 when compared to the same periods ended March 30, 2002. This increase was primarily caused by a 6.1% (quarter) and 5.2% (year-to-date) increase in distribution costs, which consist mostly of postage costs, resulting from the shared mail package and piece growth and the postal rate increase. Although the Company processed an increased number of pieces and packages in our facilities, the Company's variable operation costs remained flat for the quarter and increased slightly for the year-to-date period. The Company's cost per thousand pieces manufactured decreased 6.7% and 4.6%, respectively, for the current quarter and year-to-date periods, demonstrating continued efficiencies at the facilities. Also contributing to the increase for the quarter and year-to-date period were higher facilities overhead costs, such as utilities and increased rent associated with the modernization of certain facilities.

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the quarter and year-to-date periods ended March 29, 2003, selling, general and administrative ("SG&A") costs, including the provision for bad debts, increased \$0.7 million and \$1.1 million, respectively, when compared to the same periods in the prior year. As a percentage of revenues, SG&A costs decreased 0.7 and 0.4 percentage points for the three and six months ended March 29, 2003 versus the comparable periods in fiscal 2002. SG&A costs for the second quarter and year-to-date periods included higher incentive compensation costs offset to a degree by lower bad debt expense. Both the quarter and year-to-date periods included \$1.4 million and \$3.5 million, respectively, for a project focused on developing programs to accelerate the achievement of the Company's revenue growth potential. Also impacting the year-to-date SG&A costs was \$0.8 million of severance expense related to the departure of the Company's former Chief Financial Officer. These additional costs were partially offset by strict cost controls.

OPERATING INCOME For the second quarter ended March 29, 2003, the Company reported operating income of \$18.7 million compared to \$17.2 million for the quarter ended March 30, 2002, representing an 8.8% increase. For the first half of fiscal 2003, operating income was \$38.7 million versus \$40.2 million for the same period in the prior year, representing a 3.7% decrease.

INTEREST EXPENSE Interest expense decreased \$1.7 million and \$2.3 million for the three and six month periods ended March 29, 2003, respectively. The decreases were due to lower market rates of interest, a decrease in the average outstanding debt balance and the elimination of the Company's interest swap agreements at the beginning of December 2002.

OTHER INCOME/EXPENSE For the three and six months ended March 29, 2003, other income of \$0.3 million and \$0.5 million, respectively, was primarily the result of equity earnings from a newspaper partnership which the Company accounts for under the equity method. In the prior year's second quarter and year-to-date periods, other expense of \$0.5 million and \$0.8 million, respectively, included equity losses of \$0.3 million and \$0.4 million associated with the start up of the newspaper partnership.

INCOME TAXES The effective income tax rate for both the three and six months ended March 29, 2003 and March 30, 2002 was 37%.

EARNINGS PER SHARE As a result of the Company's improved earnings, diluted earnings per share increased 31.0% to \$0.55 for the second quarter of fiscal 2003 from \$0.42 for the same period of the prior year. On a year-to-date basis, diluted earnings per share were \$1.09 for the first six months of fiscal 2003 versus \$1.01 in the comparable prior year period, representing a 7.9% increase.

FINANCIAL CONDITION

Working capital at March 29, 2003 was \$28.6 million reflecting an \$8.0 million decrease from the September 28, 2002 working capital of \$36.6 million. The decrease was comprised of a \$1.7 million decrease in current assets and a \$6.3 million increase in current liabilities.

A lower cash balance at the end of March versus the end of September and a decrease in accounts receivable due to the continued focus on collection efforts account primarily for the change in current assets.

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The overall increase in current liabilities was the result of the following: a \$2.4 million increase in accrued compensation and benefits for higher incentive wages, increases in other current liabilities relating to the timing of customer advance payments of \$3.7 million and a \$6.3 million increase in the current portion of long-term debt due to scheduled debt repayments. Offsetting these increases was a \$2.1 million decrease in accounts payable due to the timing of vendor payments and a decrease in other current liabilities due to the expiration of the Company's interest rate swap agreements of \$1.1 million.

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Stockholders' equity increased \$23.8 million to \$60.2 million at March 29, 2003 from \$36.3 million at September 28, 2002. Year-to-date net income of \$21.9 million significantly contributed to the increase in stockholders' equity. Also contributing to the increase was \$1.2 million of restricted stock amortization and employee stock plan activity and related tax benefits and a positive change of \$1.1 million in the fair value of derivative instruments. These increases were offset by treasury stock purchases of \$0.4 million consisting of \$0.2 million made on the open market during the first fiscal quarter associated with the Company's buyback program and \$0.2 million pursuant to elections by employees to satisfy withholding requirements under the Company's restricted stock and stock option plans.

PROPERTY, PLANT AND EQUIPMENT

Investments in property, plant and equipment for the six-month period ended March 29, 2003 totaled \$28.0 million. The primary focus continues to be on software development for the Company's order fulfillment and service delivery redesign project. Additional capital investments were directed toward the deployment of computer hardware, Alphaliner computerized mail sorters and renovations to certain of the Company's facilities. The Company expects its capital expenditures for the entire year to be approximately \$45.0 million.

LIQUIDITY

The Company's main source of liquidity continues to be funds generated from operating activities. The Company also has available unused credit commitments of \$115.2 million which may be used to fund working capital requirements.

Cash and cash equivalents decreased \$1.0 million to \$11.3 million at March 29, 2003. Factoring into the decrease was cash used for investing and financing activities of \$27.1 million and \$17.1 million, respectively, offset by cash provided by operating activities of \$43.2 million.

Net cash provided by operating activities for the six months ended March 29, 2003 was \$43.2 million versus \$28.6 million for the six months ended March 30, 2002. The year over year increase, the first half of fiscal 2003 compared to the first half of fiscal 2002, was due to the following: a decrease in the cash outlay for accounts payable, the timing of customer advances which increased for the first half of fiscal 2003 and decreased for the comparable fiscal 2002 period, both offset by a decrease in cash collected from accounts receivable.

Capital investments in property, plant and equipment for the six-month period ended March 29, 2003, as detailed above, were the primary use of cash by investing activities. Investing activities of \$13.5 million for the first six months of the prior year were also mainly comprised of capital expenditures.

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Net cash used for financing activities for the year-to-date period ended March 29, 2003 and March 30, 2002 was \$17.1 million and \$22.3 million, respectively. In the current period, financing activities consisted of \$15.5 million of net payments on the revolver and scheduled principal payments on the term loan and the final payment of a \$1.6 million note resulting from the acquisition of Mail Marketing Systems Inc. ("MMSI"). Financing activities for the prior period included net revolver/term loan payments of \$12.8 million, \$2.4 million repaid to MMSI, and \$8.7 million of treasury stock purchases offset by \$1.5 million of proceeds from stock option exercises.

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Contractual and commercial commitments

The Company's contractual obligations are as follows:

(In millions)	Long term debt -----	Operating leases -----
Less than one year	\$ 28.8	\$ 16.1
One to three years	125.0	28.4
Four to five years	--	11.2
After five years	--	17.9
	-----	-----
Total	\$ 153.8 =====	\$ 73.6 =====

The Company's long-term debt obligations are discussed below in the "Financing Arrangements" section. The Company leases property in its normal business operations under noncancellable operating leases. Certain of these leases contain renewal options and certain leases also provide for cost escalation payments.

The Company has various agreements with International Business Machines Corporation ("IBM") Global Services to provide systems development, technical support, a customer support center and server farm management services to the Company. The noncancellable portion of these contracts has lapsed, and the Company has the right to cancel these contracts subject to termination charges ranging from \$12.7 million in fiscal 2003 to \$0.2 million in fiscal 2008 depending on the year in which the cancellation becomes effective.

The Company has agreements with various paper suppliers to assure the continuity of supply as well as supply of proper paper grades. Approximately 70% of the Company's expected paper requirements are covered by these agreements. The Company has negotiated prices that are tied to a published paper price index. These arrangements expire at various dates through October 31, 2005.

The Company has outstanding letters of credit of approximately \$9.8 million under separate agreements primarily relating to its worker's compensation program, expiring in April 2004.

The Company anticipates it will be able to meet its commitments detailed above through funds generated from operations or from unused credit under its

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revolving line of credit.

FINANCING ARRANGEMENTS

The Company maintains a credit agreement which provides for total credit facilities of \$300 million, consisting of a \$135 million term loan and a \$165 million revolving line of credit. At March 29, 2003, there was \$153.8 million of debt outstanding, with \$28.8 million classified as current due to scheduled principal payments. The Company anticipates it will be able to meet its debt obligations through funds generated from operations. During April 2003, the Company borrowed an additional \$20.0 million under the revolving line of credit.

Under the terms of the credit agreement, the Company is required to maintain certain financial ratios. In addition, the credit agreement also places restrictions on disposals of assets, mergers and acquisitions, dividend payments, investments and additional debt.

NEW ACCOUNTING PRONOUNCEMENTS

The FASB has issued several Statements of Financial Accounting Standards that the Company adopted at the beginning of the fiscal year. For further discussion of these Statements see Note 2 of the "Notes to Consolidated Financial Statements".

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICIES

Critical accounting polices are defined as those that are most important to the portrayal of a company's financial condition and results of operations and which require complex or subjective judgments or estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates under different assumptions and conditions. The Company has determined its critical accounting polices to include the allowance for doubtful accounts and the valuation of goodwill and intangible assets.

Allowance for doubtful accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. On a monthly basis, the Company conducts meetings to identify and review potential problems, such as a bankruptcy filing or deterioration in the customer's financial condition, to ensure the Company is adequately accrued for potential loss. The Company also calculates a trended write-off of bad debts over a rolling twelve-month period and takes into account aging categories and historical trends. If a customer's situation changes, such as bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts.

Valuation of goodwill and intangible assets

Goodwill represents the excess purchase price over the fair value of net assets

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acquired in connection with purchase business combinations. The Company is required to test goodwill annually for impairment. Impairment exists when the carrying amount of goodwill exceeds its fair market value. The Company's goodwill impairment test was performed by comparing the net present value of projected cash flows to the carrying value of goodwill. The Company utilized discount rates determined by management to be similar with the level of risk in the current business model. The Company performed the annual impairment testing during the first quarter of fiscal 2003 and determined that no impairment of goodwill exists. If the assumptions the Company made regarding estimated cash flows, such as future operating performance and other factors used to determine the fair value, are less favorable than expected, the Company may be required to record an impairment charge.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's interest expense is sensitive to changes in interest rates. In this regard, changes in interest rates affect the interest paid on its debt. To mitigate the impact of interest rate fluctuations, the Company had historically maintained interest rate swap agreements on notional amounts totaling \$100 million. However, the interest rate swap agreements expired on December 9, 2002.

If interest rates should change by 2 percentage points for the remainder of the 2003 fiscal year from those rates in effect at March 29, 2003, interest expense would increase or decrease by approximately \$1.6 million. These amounts are determined by considering the hypothetical interest rates on the Company's borrowing cost. The sensitivity analysis also assumes no changes in the Company's financial structure.

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ADVO, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

Except for the historical information stated herein, the matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Such forward looking statements are based on current information and expectations and are subject to risks and uncertainties which could cause the Company's actual results to differ materially from those in the forward looking statements. The Company's business is promotional in nature, and ADVO serves its clients on a "just in time" basis. As a result, fluctuations in the amount, timing, pages and weight, and kinds of advertising pieces can vary significantly from week to week, depending on its customers' promotional needs, inventories, and other factors. In any particular quarter these transactional fluctuations are difficult to predict, and can materially affect the Company's revenue and profit results. The Company's business contains additional risks and uncertainties which include but are not limited to: general changes in customer demand and pricing, the possibility of consolidation throughout the retail sector, the impact of economic and political conditions on retail advertising spending and our distribution system, postal and paper prices, possible governmental regulation or legislation affecting aspects of the Company's business, the efficiencies achieved with technology upgrades, the number of shares the Company will purchase in the future under its buyback program, fluctuations in interest rates related to the outstanding debt and other general economic factors.

ITEM 4. CONTROLS AND PROCEDURES

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Within 90 days prior to the filing of this Quarterly Report on Form 10-Q, the Company evaluated, under the supervision and with the participation of management, the principal executive officer and principal financial officer, the design and operation of its disclosure controls and procedures to determine whether they are effective in ensuring that the disclosure of required information is made timely in accordance with the Securities Exchange Act and the rules and forms of the Securities and Exchange Commission.

The principal executive officer and principal financial officer have concluded, based on their review, that the Company's disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-14(c) and 15d-14(c), are effective to ensure that information required to be disclosed by the Company in reports it files under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. No significant changes were made to the Company's internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

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PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibit Index

Exhibit No. -----	Exhibits -----
10	Trust Agreement between ADVO, Inc. and Fidelity Management Trust Company for the ADVO, Inc. Executive Deferred Compensation Plan Trust dated January 2, 2003 *
99(a)	Certification of Periodic Report Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Gary M. Mulloy.
99(b)	Certification of Periodic Report Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Donald E. McCombs.

* Management contract or compensatory plan required to be filed as an exhibit.

(b) Reports on Form 8-K

The Company furnished a current report on Form 8-K dated April 18, 2003 which reported the Company's earnings press release for the second quarter ended March 29, 2003.

Omitted from this Part II are items which are inapplicable or to which the answer is negative for the period covered.

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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.

ADVO, Inc.

Date: May 12, 2003

By: /s/ JOHN D. SPERIDAKOS

John D. Speridakos
Vice President and Controller
(Principal Accounting Officer)

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Gary M. Mulloy, Chairman and Chief Executive Officer of ADVO, Inc., certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of ADVO, Inc (the "registrant");
- 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 officers 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;
 - b) evaluated the effectiveness of this 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
 - 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;
- 5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the

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audit committee of registrant's board of directors:

- 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
 - 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 officers 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.

/s/ GARY M. MULLOY

Gary M. Mulloy
Chairman and Chief Executive Officer

Date: May 12, 2003

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CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Donald E. McCombs, Executive Vice President - President, Operations Group and Acting Chief Financial Officer, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of ADVO, Inc (the "registrant");
- 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 officers 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;
 - b) evaluated the effectiveness of this registrant's disclosure

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controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

- 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;
- 5) The registrant's other certifying officers 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:
- 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
 - 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 officers 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.

/s/ DONALD E. MCCOMBS

Donald E. McCombs
Executive Vice President - President, Operations
Group and Acting Chief Financial Officer

Date: May 12, 2003