

SCOPE INDUSTRIES

FORM 10-Q (Quarterly Report)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended December 31, 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 1-3552

SCOPE INDUSTRIES

(Exact name of Registrant as specified in its charter)

California

(State or other jurisdiction of
incorporation or organization)

95-1240976

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

233 Wilshire Boulevard, Suite 310
Santa Monica, California 90401-1206
(Address of principal executive office, zip code)

(Registrant's telephone number, including area code) (310) 458-1574

(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 (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

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

☐ Yes ☒ No

The number of shares of registrant's common stock outstanding at February 6, 2004 was 998,691.

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**PART I. FINANCIAL INFORMATION
SCOPE INDUSTRIES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)**

	December 31, 2003	June 30, 2003
ASSETS		
<i>Current Assets:</i>		
Cash and cash equivalents	\$ 7,494,022	\$ 7,132,957
Treasury bills	—	6,495,054
Accounts and notes receivable, less allowance for doubtful accounts of \$495,788 at December 31, 2003 and \$525,540 at June 30, 2003	5,504,595	5,049,924
Inventories	744,483	853,613
Deferred income taxes	566,600	737,000
Prepaid expenses and other current assets	1,078,144	1,570,669
Total current assets	15,387,844	21,839,217
<i>Notes Receivable</i>	560,090	553,794
<i>Land, buildings and improvements held-for-sale (net)</i>	1,352,980	805,480
<i>Property and Equipment:</i>		
Machinery and equipment	65,267,171	59,243,580
Land, buildings and improvements	19,557,051	20,604,736
	84,824,222	79,848,316
Less accumulated depreciation and amortization	42,015,209	39,636,554
	42,809,013	40,211,762
<i>Collection Routes and Contracts, less accumulated amortization of \$9,195,864 at December 31, 2003 and \$9,093,007 at June 30, 2003.</i>	451,429	554,286
<i>Other Assets:</i>		
Non-appropriated funds – IRB	4,906,358	—
Restricted cash and investments	11,081,193	—
Deferred charges and other assets	103,054	346,617
Deferred income taxes	502,400	648,000
Investments available for sale-at fair value	2,486,110	8,076,728
Other equity investments-at cost	6,378,800	6,177,300
	25,457,915	15,248,645
	\$86,019,271	\$79,213,184
LIABILITIES AND SHAREOWNERS' EQUITY		
<i>Current Liabilities:</i>		
Accounts payable	\$ 4,751,450	\$ 5,313,767
Current portion of Industrial Revenue Bond	250,000	—
Dividends payable	998,691	—
Other accrued liabilities	2,011,326	1,973,554
Accrued payroll and related employee benefits	976,802	1,171,646
Total current liabilities	8,988,269	8,458,967
<i>Long-term debt</i>	9,750,000	5,000,000
	18,738,269	13,458,967
<i>Shareowners' Equity:</i>		
Common stock, no par value, 5,000,000 shares authorized, shares issued and outstanding at December 31, 2003 and June 30, 2003 - 998,691	4,576,050	4,576,050
Retained earnings	61,508,352	60,241,067

Accumulated other comprehensive income	1,196,600	937,100
	<u>67,281,002</u>	<u>65,754,217</u>
	<u>\$86,019,271</u>	<u>\$79,213,184</u>

The accompanying notes are an integral part of these consolidated financial statements.

SCOPE INDUSTRIES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended December 31,	
	2003	2002
<i>Revenues:</i>		
Sales	\$18,198,003	\$19,379,194
Vocational school revenues	1,910,005	1,716,419
	<u>20,108,008</u>	<u>21,095,613</u>
<i>Operating Costs and Expenses:</i>		
Cost of sales	13,291,583	14,051,609
Vocational school expenses	1,224,365	1,187,155
Depreciation and amortization	1,852,521	2,395,129
General and administrative	2,336,223	2,593,473
	<u>18,704,692</u>	<u>20,227,366</u>
	<u>1,403,316</u>	<u>868,247</u>
<i>Other income and expense:</i>		
Investment and other income	105,398	1,402,634
Interest expense	(46,594)	(61,996)
	<u>58,804</u>	<u>1,340,638</u>
Income before income taxes	1,462,120	2,208,885
Provision for income taxes	(450,000)	(810,000)
<i>Net Income</i>	<u>\$ 1,012,120</u>	<u>\$ 1,398,885</u>
<i>Net Income Per Share – Basic and Diluted</i>	\$ 1.01	\$ 1.37
Average shares outstanding – Basic and Diluted	998,691	1,023,167

The accompanying notes are an integral part of these consolidated financial statements.

SCOPE INDUSTRIES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Six Months Ended December 31,	
	2003	2002
<i>Revenues:</i>		
Sales	\$36,834,790	\$38,647,832
Vocational school revenues	3,659,375	3,485,508
	<u>40,494,165</u>	<u>42,133,340</u>
<i>Operating Costs and Expenses:</i>		
Cost of sales	26,532,174	28,069,775
Vocational school expenses	2,461,294	2,391,884
Depreciation and amortization	3,863,154	4,588,121
General and administrative	4,562,491	4,900,389
	<u>37,419,113</u>	<u>39,950,169</u>
	<u>3,075,052</u>	<u>2,183,171</u>
<i>Other income and expense:</i>		
Investment and other income	260,587	1,465,937
Interest expense	(82,663)	(132,896)
	<u>177,924</u>	<u>1,333,041</u>
Income before income taxes	3,252,976	3,516,212
Provision for income taxes	(987,000)	(1,305,000)
<i>Net Income</i>	<u>\$ 2,265,976</u>	<u>\$ 2,211,212</u>
<i>Net Income Per Share – Basic and Diluted</i>	\$ 2.27	\$ 2.16
Average shares outstanding – Basic and Diluted	998,691	1,024,673

The accompanying notes are an integral part of these consolidated financial statements.

SCOPE INDUSTRIES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended December 31,	
	2003	2002
<i>Cash Flows from Operating Activities:</i>		
Net income	\$ 2,265,976	\$ 2,211,212
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	3,760,297	3,386,894
Amortization of contracts and routes	102,857	1,201,227
Gains on sales of property and equipment	(156,092)	(1,385,637)
Deferred income taxes	169,925	(79,710)
Unrealized loss in equity investment	300,000	311,000
Changes in operating assets and liabilities:		
Accounts and notes receivable	(460,967)	(1,428,268)
Inventories	109,130	104,305
Prepaid expenses and other current assets	492,525	(851,325)
Accounts payable and accrued liabilities	(719,389)	1,377,481
Income taxes payable	—	(772,000)
Tax benefit applied to collection routes and contracts	—	280,000
Other assets	243,563	128,811
Net cash flows from operating activities	<u>6,107,825</u>	<u>4,483,990</u>
<i>Cash Flows from Investing Activities:</i>		
Purchase of U.S. Treasury bills	—	(13,156,548)
Maturities of U.S. Treasury bills	4,497,272	19,173,828
Purchase of property and equipment	(6,982,206)	(4,654,998)
Proceeds from disposition of property and equipment	233,250	1,437,694
Purchase of waste recycling assets and routes and contracts	—	(3,500,000)
Purchase of investments available for sale	—	(6,054,766)
Purchase of other equity investments	(501,500)	(393,526)
Non-appropriated bond fund proceeds held by Trustee	(4,906,358)	—
Net cash flows used in investing activities	<u>(7,659,542)</u>	<u>(7,148,316)</u>
<i>Cash Flows from Financing Activities:</i>		
Proceeds from bank borrowings	—	7,400,000
Proceeds from New Jersey Industrial Revenue Bonds	5,000,000	—
Restricted cash	(3,087,218)	—
Redemption of Georgia Industrial Revenue Bonds	—	(6,000,000)
Repayment of bank borrowings	—	(2,000,000)
Repurchases of common stock	—	(614,172)
Net cash flows from (used in) financing activities	<u>1,912,782</u>	<u>(1,214,172)</u>
Net increase (decrease) in cash and cash equivalents	361,065	(3,878,498)
Cash and cash equivalents at beginning of period	<u>7,132,957</u>	<u>7,023,393</u>
Cash and cash equivalents at end of period	<u>\$ 7,494,022</u>	<u>\$ 3,144,895</u>
<i>Supplemental Disclosures :</i>		
Cash paid during the six months for:		
Interest	\$ 82,663	\$ 132,896
Income taxes	\$ 604,858	\$ 1,886,590

Cash dividends of \$998,961 and \$1,023,167 were declared and unpaid at December 31, 2003 and December 31, 2002.

The accompanying notes are an integral part of these consolidated financial statements.

SCOPE INDUSTRIES AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
December 31, 2003

Note 1. Basis of Financial Statement Preparation

The accompanying consolidated financial information of Scope Industries and its subsidiaries (“Scope” or the “Company”) should be read in conjunction with the Notes to the Consolidated Financial Statements contained in the Company’s Annual Report on Form 10-K to the Securities and Exchange Commission for the year ended June 30, 2003. The accompanying financial information includes all subsidiaries on a consolidated basis and all normal recurring adjustments that are considered necessary by the Company’s management for a fair presentation of the financial position, results of operations and cash flows for the periods presented. However, these results are not necessarily indicative of results for a full fiscal year. Certain prior year balances have been reclassified to conform to current period presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Collection routes represent the value assigned upon purchase for a group of suppliers of raw materials in a similar geographic area from which the Company will derive a dependable source of raw materials. Collection routes are amortized over 3 to 5 years using the straight-line method. Certain tax deductions for tax goodwill amortization require that the income tax benefit realized from the tax goodwill amortization first reduce the carrying value of collection routes, related to the tax goodwill, until fully amortized. Contracts include non-compete agreements that are recorded at cost and are amortized over 3 to 7 years using the straight-line method. Both collection routes and contracts represent businesses that were acquired from former competitors. Amortization expense for the quarter and six months ended December 31, 2003 and 2002 was \$ 51,429 and \$ 600,611 and \$102,857 and \$1,201,227, respectively. Amortization expense for the current year and next four years is estimated to be approximately \$205,700, \$205,700, \$35,700, \$35,700 and \$35,700.

The Company accounts for its stock option plan in accordance with the provisions of Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. As such, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. Statement of Financial Accounting Standards (“SFAS”) No. 123, *Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock Based Compensation-Transition and Disclosure*, permits entities to recognize as expense, over the vesting period, the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants as if the fair-value based method defined in SFAS No. 123 had been applied.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123.

	Six Months Ended December 31,	
	2003	2002
Net income as reported	\$2,265,976	\$2,211,212
Deduct: Total stock-based employee compensation expense determined under a fair value based method for all awards, net of related tax effects	(38,000)	(30,200)
Pro forma net income	\$2,227,976	\$2,181,012
Net income per share:		
Basic and diluted – as reported	\$ 2.27	\$ 2.16
Basic and diluted – pro forma	\$ 2.23	\$ 2.13